

FC9665

2004  
GULF INTERNATIONAL BANK  
ANNUAL REPORT



THE GULF'S OWN MERCHANT BANK



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## **GULF INTERNATIONAL BANK**

**G**ULF INTERNATIONAL BANK (GIB) IS A LEADING MERCHANT BANK in the Middle East with its principal focus on the Gulf Cooperation Council (GCC) states. With a proven track record spanning more than 28 years, GIB provides client-led, innovative financial products and services. Its client base includes major private-sector corporations, Gulf-based financial institutions, multinational companies active in the region and the governments of the GCC states.

GIB has gained an international reputation for project and trade finance and is a leading player in the regional syndicated loan market. The bank's financial strength is based on conservative asset and liability management policies, its high-quality asset profile and strong capital base. More recently, the bank increased its focus on merchant banking services, including corporate finance and asset management.

GIB was established in the Kingdom of Bahrain in 1975. The six GCC governments, Bahrain, Kuwait, Oman, Qatar, Saudi Arabia and the United Arab Emirates, own 72.5 per cent of the bank, while the Saudi Arabian Monetary Agency (SAMA) and JP Morgan Overseas Capital Corporation own 22.2 per cent and 5.3 per cent respectively. In addition to its main subsidiary Gulf International Bank (UK) Limited, the Bank has branches in London, New York, Riyadh and Jeddah, in addition to representative offices in Beirut and Abu Dhabi.



THE GULF'S OWN MERCHANT BANK

## FINANCIAL HIGHLIGHTS

	2004	2003	2002	2001	2000
<b>Earnings (US\$ millions)</b>					
Net Income after Tax	150.2	106.1	85.3	100.5	118.1
Net Interest Income	173.1	167.3	195.7	193.4	169.7
Other Income	123.5	120.3	88.4	70.3	127.3
Operating Expenses	124.4	126.1	115.6	118.1	132.3
<b>Financial Position (US\$ millions)</b>					
Total Assets	19,086.8	17,302.4	16,236.5	15,232.0	15,119.5
Available-for-Sale Securities	8,469.1	8,451.8	8,280.4	7,641.7	7,062.1
Loans	5,286.3	3,759.6	3,255.8	3,309.4	3,923.1
Term Financing	1,678.3	1,501.3	880.0	830.0	850.0
Shareholders' Equity	1,534.7	1,388.8	1,128.2	1,193.7	1,205.8
<b>Ratios (Per cent)</b>					
<b>Profitability</b>					
Return on Average Shareholders' Equity	10.3	8.4	7.3	8.4	10.1
Return on Average Assets	0.8	0.6	0.5	0.7	0.8
<b>Capital</b>					
BIS Risk Asset Ratio					
- Total	11.6	12.5	12.8	12.6	11.5
- Tier 1	9.4	10.0	10.3	10.2	10.2
Shareholders' Equity as % of Total Assets	8.0	8.0	6.9	7.8	8.0
<b>Asset Quality</b>					
Securities as % of Total Assets	52.8	58.0	58.4	56.8	49.8
Loans as % of Total Assets	27.7	21.7	20.1	21.7	25.9
<b>Liquidity</b>					
Liquid Assets Ratio	70.8	76.7	77.9	75.1	71.0
Deposits to Loans Cover (times)*	2.4	3.1	3.6	3.6	3.1

\* Deposits include Term Financing

<b>Credit Ratings</b>			
	Fitch	Moody's	Standard & Poors
Long-term	A-	Baa1	BBB+
Short term	F-2	P-2	A-2
Individual	C		
Financial Strength		C-	
Outlook	Stable	Stable	Stable

## BOARD OF DIRECTORS

**H E SHEIKH EBRAHIM BIN KHALIFA AL KHALIFA**

Chairman

Undersecretary, Ministry of Finance

Kingdom of Bahrain

**MR ABDULAZIZ M AL-ABDULKADER**

Vice Chairman

President, AMA Group

Kingdom of Saudi Arabia

**MR. BADER ABDULLAH AL-RUSHAID AL-BADER**

Ex-Chairman and Managing Director

Kuwait Investment Company

State of Kuwait

**DR HAMAD S AL-BAZAI**

Deputy Minister for Economic Affairs

Ministry of Finance

Kingdom of Saudi Arabia

**MR SAUD NASSIR AL-SHUKAILY**

Secretary General for Taxation

Ministry of Finance

Sultanate of Oman

**DR KHALID BIN ABDULLA AL-SWEILEM**

Director General, Investment Department

Saudi Arabian Monetary Agency

Kingdom of Saudi Arabia

**MR KHALID BIN ABDULLA AL-SUWAIDI**

Office Director at the Deputy Secretary General's Office

The Supreme Council for Economic Affairs and Investment

State of Qatar

**MR NASSER BIN KHAMIS AL-SUWAIDI**

Director of the Minister's Office

Ministry of Finance and Industry

United Arab Emirates

**MR MARK STEPHEN GARVIN**

Managing Director

JP Morgan Chase Bank

United Kingdom



GIB's intellectual capital and skill-sets were especially well demonstrated in 2004 through the bank's role as the exclusive financial advisor to the Saudi Electric Company. The mandate involved the structuring of a SR6 billion, 15 year loan facility. This represented Saudi Arabia's largest, and longest tenor, corporate loan.

## CHAIRMAN'S STATEMENT



Sheikh Ebrahim Bin Khalifa Al Khalifa  
Chairman

ON BEHALF OF THE BOARD OF DIRECTORS, I am pleased to present the Annual Report of Gulf International Bank B S C (GIB) for the year ended 31<sup>st</sup> December 2004

2004 proved to be an excellent year for GIB. I am delighted to report that as a result of our efforts to consolidate on significant improvements across the major operating activities in recent years, the Group recorded the highest profit level in its history, of US\$150.2 million. The strong performance reflects further improvements across all of the bank's principal business activities, demonstrating the success of our strategic initiatives combined with an effective and proactive management of risk. The significant year-on-year increase in net income was attributable to increases in both interest and non-interest earnings, the containment of expenses and a lower level of provisions. This provides testimony to

our embracing of strategic change in 2002 as a merchant bank focused primarily on the Gulf Cooperation Council (GCC), which has contributed to the diversification and enhancement of income. This has also further enabled us to fulfill the objective of achieving enhanced returns to our shareholders and, at the same time, maintaining favourable recognition from our clients, supervisory authorities and international credit rating agencies during the course of the year.

The Group's 2004 activities were undertaken in a global environment where synchronised growth was stronger than at any time in the past three decades. As the global recovery has become more established, it has been accompanied by upgrades on key sovereign and corporate risks by international credit rating agencies. During the course of the year, international financial market and credit conditions

## CHAIRMAN'S STATEMENT continued

greatly improved in response to strengthened economic fundamentals as well as the upturn in investor confidence

In the GCC region, robust hydrocarbon revenues and an increase in fiscal spending sustained a strong growth momentum that has been in place since 2000. This has further strengthened the financial positions of all six GCC states, whilst providing numerous opportunities in development and infrastructural investments. The strong balance sheets of regional banks and GCC-based companies reveal that they have also benefited from increased activity and liquidity, supported by strong investor and business confidence. Governments and entities in the region are choosing to increasingly tap domestic financial markets for their funding needs. In addition, there has been a growing trend towards the issuance of Islamically structured instruments.

As business opportunities have become more prolific and varied, particularly in the region's project finance market, GIB has further consolidated its position as the leading financier and arranger specialising in petrochemical and gas projects. The Group has also expanded its capabilities in areas such as shipping finance, secondary market loan asset trading and Islamic finance, while it remains the region's most active financial institution in the loan agency business. GIB also acted as the regional syndication bank for the world's largest oil and gas project financing deal in 2004, the Qatargas II liquefied natural gas facility.

While merchant banking activities provide significant support to the Group's earnings, fees from investment banking, advisory and management services are also growing in healthy proportion. Our

objective is to continue building the Group's flow of non-interest income through important investment banking mandates such as GIB's exclusive financial advisory role in the SR6 billion, 15-year corporate loan for the Saudi Electrical Company in mid-2004. The size and tenor of the loan was unprecedented in Saudi Arabia's corporate finance history.

The strong and stable revenues from Treasury's sizeable portfolio of investment-grade securities continued to underpin the Group's core earnings during 2004. The securities portfolio is the largest asset category in the Group's balance sheet and, besides its core earnings contribution, also provides effective risk diversification and ready liquidity. Outstanding results were also achieved from Treasury's investment and trading activities across several other asset classes.

Meanwhile, GIB's operations in Saudi Arabia have continued to strengthen and expand, following the launch of the Riyadh branch in September 2000. The branch is a consistently profitable and integral unit of the Group, reinforced by the October 2004 opening of our second branch in the Kingdom's second largest city and commercial hub of Jeddah. Going forward, we aim to further enhance our presence in the Kingdom and thereby provide a significant thrust to our merchant banking services within that market.

GIB's shareholders' equity at the end of 2004 stood at US\$1,534.7 million, the first time that it has exceeded US\$1.5 billion. The US\$145.9 million increase over the 2003 year end reflects 2004 net income as well as a further improvement in the fair value of the available-for-sale securities portfolio. At the 2004 year end, the fair value of the available-for-



sale securities portfolio exceeded the book value by US\$97.4 million

During 2004, GIB continued to progress with its plans for the implementation of the new Basel II capital adequacy guidelines. In June, the Basel Committee issued the final Basel II guidelines which are now due to be introduced by the end of 2006. GIB is fully committed to the Basel Committee's objective of strengthening the soundness and stability of the international banking system, promoting the adoption of stronger risk management practices, and increasing the risk-sensitivity of capital requirements. The bank has, for a number of years, been proactively preparing itself for the eventual introduction of the new regulations. It now has in place the necessary risk management framework, technology systems and human resources to meet the Basel II requirements well ahead of the final implementation deadlines, although certain work is still ongoing in relation to the supporting data requirements.

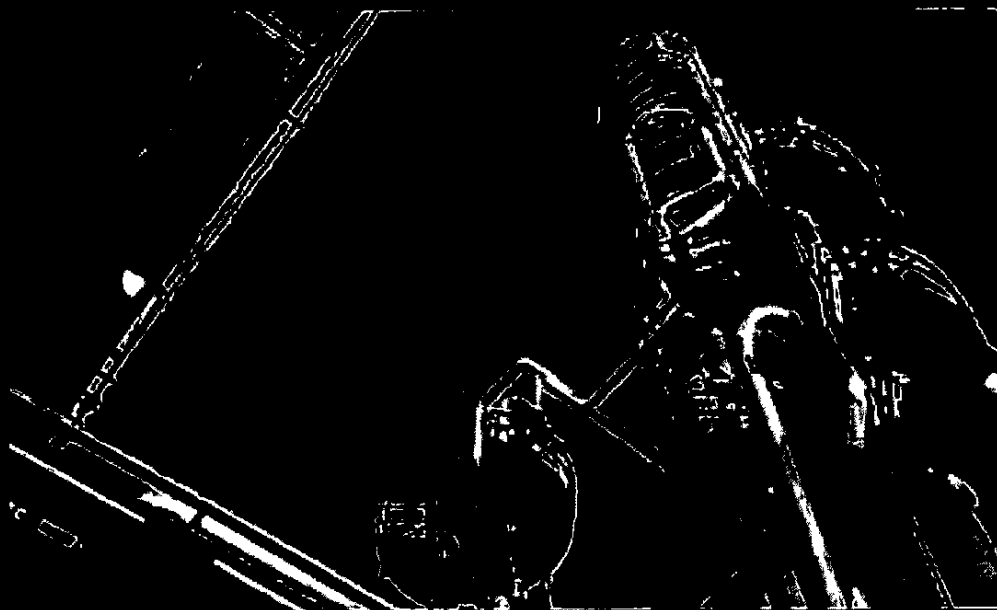
The Group remains steadfast in its goal to become the GCC Merchant Bank of choice, with market leadership in its portfolio of activities. To this end, we aim to further identify and develop opportunities in the GCC region and the wider Middle East in 2005. At a time when economic policies in the region are building on the theme of liberalisation and reform across a broad spectrum of sectors, such opportunities are likely to be multiple and diverse. This will allow us to employ our extensive range of skills in treasury, asset management, investment banking, corporate finance, Islamic banking, and project and structured finance.

In addition, GIB is committed to supporting the economic development and growth of the GCC region. Our pioneering character and excellent track record in a variety of areas are testimony to this determination, and we will continue to develop our capabilities in offering new and more sophisticated services as the opportunities arise.

On behalf of the Group, I would like to take this opportunity to express my gratitude to the retiring members of the Board of Directors. Their hard work and diligence has made a valuable contribution to the success of GIB during their tenure, and I wish them every success for the future. I would also like to welcome Dr. Khalid Bin Abdulla Al-Sweilem, Mr. Khalid Bin Abdulla Al-Suwaidi and Mr. Nasser Bin Khamis Al-Suwaidi, as our new members of the Board, with certainty that they will serve the Bank with diligence and distinction.

I am confident that the tremendous support of GIB's shareholders and the broad expertise of our Board of Directors will continue to remain the foundation of our success. Their commitment has endowed the Group with a spirit of dedication and hard work that has long been prevalent across our highly experienced management and staff, while it has also sustained their enterprising spirit in continuously exploring new business avenues.

Ebrahim Bin Khalifa Al Khalifa  
*Chairman*



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GIB's Merchant Banking Group successfully syndicated a US\$1.1 billion facility for  
Sohar Refinery in the Sultanate of Oman.

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## MANAGEMENT REVIEW

A BROAD-BASED AND LARGELY BUOYANT GLOBAL RECOVERY DURING MUCH OF 2004, coupled with the robust pace of expansion throughout the Gulf region has created a dynamic operating environment for GIB. As a result, the Group has recorded its highest ever financial performance, supported by strong contributions across the major business activities.

Prospects for 2005 are encouraging, sustained by the vigorous rate of economic activity underway across the GCC countries and the wider Middle East. GIB's improved earnings potential, commitment to furthering its business development, and steadily rising international credit ratings are expected to enable the Group to further benefit from the attractive opportunities. Moreover, as the pace of structural reform becomes more evident in the region, increasing demand for GIB's merchant and investment banking products is anticipated.

### ECONOMIC AND BUSINESS OVERVIEW

Global economic growth maintained its upward path in 2004, rising by 4%, the highest level since 2000. Stock markets around the world experienced strong trading momentum, with emerging markets in particular enjoying higher than average returns. On commodity exchanges, crude oil and precious metals exhibited exceptional performance, while default rates in global credit markets declined considerably.

However, during the course of the year, confidence generated by the rising year-on-year

quarterly expansion across the US, Eurozone and Asian economies was overshadowed by concerns over the higher oil prices and indications of rising interest rates. Investors have increasingly focused on the potential of these factors to derail the global recovery, while excessive fiscal and current account deficits in the leading economies have added to the concerns.

Confidence across regional governments and businesses remains firm, with prospering local economies and markets. A broad range of influences underlie the dynamic regional environment including high oil prices which have not only reduced financial pressures, but have also injected new liquidity and further enhanced the already favourable risk profile of the GCC countries.

Nevertheless, in spite of increasing oil revenues, GCC countries have maintained a prudent fiscal policy stance that has been largely focused on the reduction of budget deficits and outstanding domestic debt. This has not only earned regional governments international plaudits, but has also been conducive to providing a more stable environment within which non-oil activity has thrived.

As the pace of reform has become increasingly evident in the region, this has allowed GCC economies to benefit from improved transparency in fiscal policy and government finance, alongside regulations permitting increased foreign ownership and competition, and the

emergence of new capital markets laws in individual states. Most notably, vibrant private sector activity and the growing significance of privatisation are also expected to provide further stimulus to economic growth.

The concept of privatisation is also becoming more widely accepted around the Gulf region, with public authorities progressively divesting key services, industries and infrastructure installations, as well as reorganising and corporatising other public concerns. This in turn has enabled governments to pass some of the financing of the investment and working capital needs of public entities to regional capital markets.

In 2004, the GCC economies hosted significant private and joint sector expansion in the base metals, information technology, liquefied natural gas, petrochemicals, power generation, telecommunications and transportation industries. Meanwhile, tourism related activity is growing in prominence throughout the Gulf region, as the sector's contribution to regional economic activity has consistently expanded along side providing a variety of jobs for nationals.

The Gulf region's potential to further bolster its position as one of the world's more rapidly expanding economic areas remains significant, particularly given the advantageous position of the local companies and financial institutions to not only participate but also benefit as opportunities emerge in Iraq. Beyond this, the attraction of the GCC countries also emanates from their infrastructure investment needs estimated at

between US\$300 billion to US\$400 billion, over the coming decade, together with the huge demand potential of the region's markets driven by the favourable social and demographic factors.

#### **MERCHANT BANKING**

The Merchant Banking Group was successful during 2004 in further implementing the expansion strategy of the bank within the GCC market. The Group was reorganised during 2004 so as to position itself to support growth targets and further exploit the emerging opportunities particularly in the GCC markets. Business development and client servicing responsibilities are now vested in three teams, while product and distribution functions with inherent synergies were consolidated into a single platform consisting of project finance, structured finance, loan syndications, Islamic banking, asset trading and loan agency.

The Merchant Banking Group improved its contribution to the overall income of the Bank during the year, through the implementation of a carefully formulated business strategy focussing on increased market penetration and product diversification. The Group has also maintained its dominance in the GCC project finance market, a critical element of the overall Bank strategy.

The increasing appeal of Islamic banking products as a means of diversifying available funding sources for our clients has been recognised and efforts have been made to increase the Bank's profile in the Islamic banking market.

The Kingdom of Saudi Arabia continues to

be our major market and Merchant Banking continued its marketing thrust in the Central and Eastern Provinces of the Kingdom through its Riyadh Branch as well as the offshore relationship and structured finance teams in Bahrain. A new branch was established in Jeddah in October 2004 in order to achieve greater market penetration in the Western Province. Major transactions undertaken by the Bank in Saudi Arabia during the year include mandated lead arranger in the US\$460 million term financing for the integrated twin projects of Saudi Chevron Phillips Company and Jubail Chevron Phillips Company, mandated lead arranger in the US\$330 million expansion financing for Saudi Arabian Fertilizer Company, lead arranger in the US\$2.35 billion Sharia'a compliant bridge financing for Ettihad Etisalat's GSM project, lead arranger in the US\$510 million term financing for the first ever independent cogeneration power project Tihama Power Generation Company, lead arranger in the SR6 billion corporate funding for the Saudi Electricity Company and lead arranger in the US\$500 million maiden borrowing by SAMBA Financial Group.

In Kuwait, the Bank played an active role in supporting the corporate sector in the country and in the fund raising by Kuwaiti banks during the year. The significant transactions during 2004 include lead arranger in the US\$600 million refinancing for Equate Petrochemical Company, which included conventional as well as Islamic tranches, mandated lead manager in the US\$60 million floating rate note issue for National

Industries Group of Kuwait, mandated lead arranger in the US\$150 million term loan for Bank of Kuwait and the Middle East, mandated lead arranger in the US\$100 million facility for the Kuwait Commercial Facilities Co. and arranger in the US\$225 million facility for Al Ahli Bank of Kuwait.

In Bahrain, the Bank acted as a mandated lead arranger in the US\$492 million financing for Al Ezzel Power Company. In addition, the Bank has been mandated as a lead arranger in the US\$1 billion multi-tranche financing for Bahrain Petroleum Company's refinery expansion and has also secured the role of the commercial facility agent.

GIB has historically played a major role in supporting projects in Qatar, which is in the process of implementing several large projects. In addition to being mandated a lead arranger in the US\$350 million loan for the State of Qatar, the Bank acted as a mandated lead arranger and facility agent in the US\$150 million term financing for the Commercial Bank of Qatar. In the field of project and corporate financing, the Bank acted as mandated lead arranger, lead arranger or arranger in financings for Qatar Vinyl Company, Qatar Cement Co., Al Fardan Group, Qatar Airways and Ras Laffan Liquefied Gas Company. The most noteworthy transaction concluded during the year, in which the Bank acted as a mandated lead arranger, was the US\$4 billion Qatar Gas II financing, one of the largest project financing transactions to be undertaken in the region.

## MANAGEMENT REVIEW continued

Following the successful syndication and closing during the year of the US\$1.1 billion Sohar Refinery transaction in the Sultanate of Oman, the Bank also acted as one of the mandated lead arrangers for Oman LNG and Qalhat LNG. The Bank took an active interest in the development of infrastructure and tourism projects in Oman by financing Salalah Port Services Company, Barr Al Jissah Resort Company and Sohar Power Company. The Group's ability to structure and arrange on a fully underwritten basis limited recourse financing for LNG shipping projects was successfully demonstrated in the execution of a US\$155 million multi-tranche term financing for Energy Spring LNG Shipping Co.

The Bank's presence in the UAE banking market was strengthened during 2004 by enlarging the marketing team in our Abu Dhabi Representative Office. The Bank was one of the senior lenders and mandated lead arrangers in the US\$1.2 billion, 5 year bridge financing arranged for Dolphin Energy Ltd. The Bank was also involved in arranging financing for Emirates Airlines, First Gulf Bank and Mashreq Bank. GIB's experience in structuring and integrating multiple sources of funds for project finance transactions were showcased in our role as coordinator in the US\$530 million Islamic facility as well as one of the six mandated lead managers for the world's largest Islamic Sukuk issue arranged for the Dubai Government for the expansion of Dubai International Airport.

At the international level, the Bank provided

selective support to international contractors and project sponsors undertaking projects in the region through the issuance of performance and project related guarantees and working capital facilities.

### INVESTMENT BANKING

GIB's investment banking work in 2004 took place against a background of strong stock markets across the GCC. The market capitalisation of the region's stock exchanges climbed to well over US\$400 billion by year-end, with a standout performance from the Saudi stock market, which rose by around 85 per cent.

Regional governments remain committed to the strengthening and expansion of their capital markets with further regulation and encouragement to companies to list their shares. This was perhaps best illustrated in Saudi Arabia, where the Capital Market Authority was launched and quickly became operational. These measures in the Kingdom and elsewhere in the GCC are expected to lead to more general corporate activity and a quickening pace of privatisation.

The Group retained its role as the region's pre-eminent advisor and arranger for private placements and IPOs in 2004, and successfully targeted a range of new opportunities throughout the GCC. GIB's intellectual capital and skill-sets were especially well demonstrated in 2004 through its role as the exclusive financial adviser to the Saudi Electric Company. The mandate involved structuring the largest and longest tenor corporate loan ever in Saudi Arabia, a SR6 billion (US\$1.6

billion), 15-year facility signed in May 2004

Earlier in the year, GIB, acted as advisor to the listed Aseer Trading, Tourism and Manufacturing Company in its acquisition of Dallah Industrial Investment Company. A private placement of SR290 million, representing a sale of 40% of the shares in Al Tayyar Travel Group, was also successfully completed.

Throughout the year, progress was made on the IPO for Bank Al-Bilad, which brought together 8 of Saudi Arabia's former money exchanges to form a new bank, and for which GIB is the exclusive financial adviser. This SR1.5 billion IPO involving the sale of 3 million shares is now expected to take place early in 2005.

GIB's investment banking activity suggests that a significant number of new ground-breaking transactions in Saudi Arabia are poised to come to market, including the public listing of a series of previously, privately held family companies and, eventually, the issue of corporate bonds to be traded on the Saudi exchange. Nevertheless, Investment Banking's activities were not confined to Saudi Arabia alone, with mandates having also been won in Oman and the UAE to assist family and other companies to raise new equity through a private placement or IPO. It is anticipated that these latter transactions will be in the market in 2005.

Outside of the stock markets, GIB actively pursued project finance advisory mandates (including both debt and equity placements) from major industrial concerns in the GCC. The Saudi

Electric Company loan will be used for project finance purposes, as with a US\$200 million equity raising for the Advanced Polypropylene Company's grassroots petrochemical project, which was also completed during 2004.

Investment Banking continues to pursue its objectives of bringing international class investment banking services to the GCC public and private sectors.

## **FINANCIAL MARKETS AND ASSET MANAGEMENT**

GIB's financial markets and asset management activities continued to grow, seizing the opportunities provided by its success and the continued recovery of global markets in 2004.

Client asset under management by GIB's UK based investment banking subsidiary registered steady advances, growing from just over US\$11 billion to over the US\$13 billion mark, and have now doubled over the past three years. Fees derived from the discretionary portfolio and fund management activities have continued to rise, with the prospect of further growth based on a sustainable platform.

Financial markets trading continued to generate profits in an environment characterised by strong credit markets, variable equity markets and volatile interest and currency markets.

Complementing its unique franchise as the only Gulf-based institution with an in-house global asset management capability, GIB UK's skill-sets were recognised in June 2004 by Fitch Ratings. The

## MANAGEMENT REVIEW continued

agency awarded the firm one of the highest ratings achieved by a structured products manager, sighting GIB's "expertise in underwriting and asset selection, as reflected by the sound performance of the transactions to date "

GIB's UK-based investment teams manage a range of internationally orientated investment products and assets, covering global and regional equity markets, global convertible bonds, corporate debt, asset-backed securities, government debt including emerging markets, global interest rates and currencies

The investment strategies are diverse, and include enhancing indexed equity portfolios and hedge fund trading strategies, which target an absolute return over LIBOR. A key event in this context was the July re-launch of the Falcon Relative Value Fund, incorporating four separate hedge funds into a single multi-strategy equity hedge fund that utilises up to eight different hedge fund strategies

GIB has also continued to develop its structured products range, utilising the extensive experience gained from trading these securities on its own account and for the benefit of a growing client base in Europe, with institutional funds now worth more than US\$12 billion. Following on from the issues in 2002 and 2003 of Euro denominated collateralised debt obligations (CDOs), GIB confirmed its status within Europe as a leading manager of mezzanine ABS products through the issue of a sterling denominated GBP 200 million CDO. Further structured products are envisaged for 2005

## TREASURY

GIB's Treasury is responsible for the funding activities of the GIB Group and the capital market investment activities. Over the years it has successfully established GIB's name in international and regional money markets and established its own reputation as a reliable and professional business partner. With its specialist skills and global reach, GIB's Treasury continued to cater to the diverse financial needs of a broad client base of regional corporates, financial institutions and government entities

2004 saw another outstanding performance by Treasury, making a substantial contribution to the bank's net income, even as market conditions remained difficult with low interest rates, tight credit spreads and volatile exchange rates prevailing for the most part

A key feature of Treasury's investment activities in recent years has been the steady growth of a large portfolio of investment grade floating rate securities, which stabilised during 2004 at a level of around US\$7 billion. This available-for-sale securities portfolio is highly liquid and generates a stable income stream, besides providing considerable diversification of risk

In order to achieve an efficient asset mix with adequate diversification, Treasury also makes selective investments in specialised markets and asset classes through external fund managers. Similar to 2003, several of these funds turned in exceptionally strong performances in 2004, particularly in emerging market debt



A strategic objective of the bank is to lengthen the maturity of its funding and, accordingly, the total term liabilities have reached a strong level of US\$1.8 billion. The positive trend of the bank's credit ratings will provide Treasury with the opportunity to further tap other sources of competitively priced longer-term funds in early 2005. The continuation of GIB's historically stable trend of customers' deposit retention further strengthens the bank's liquidity profile.

GCC capital markets witnessed some successful new bond issues in 2004, both for conventional floating rate notes and the emerging class of Islamic bond, or Sukuk, instruments. GIB participated in these issues, thereby clearly demonstrating its strategic commitment to the region and reiterating its dominant position in the Gulf's banking industry.

Owing to the prevailing low levels of interest rates and volatile exchange rate movements during 2004, GIB saw a continuation of the strong customer demand for derivatives to hedge their interest rate and currency risks. This is expected to continue in 2005.



GIB plays a major role in supporting development projects in the GCC, including the expansion of key aluminium and petrochemical plants, and oil, gas and power generation projects.

## FINANCIAL REVIEW

**C**ONSOLIDATED NET INCOME WAS AT A HISTORICAL RECORD LEVEL IN 2004. Consolidated net income after tax at US\$150.2 million for the year was US\$44.1 million or 41.6 per cent up on the prior year. This represented a return on average shareholder's equity of 10.3 per cent compared to a return of 8.4 per cent in 2003.

The strong performance reflected further improvements across all of the bank's principal business activities, demonstrating the continued success of the Group's GCC-focused merchant banking strategy. The significant year-on-year increase in the Group's profit was attributable to increases in both interest and non-interest earnings, the containment of expenses, and a lower level of provisions. The increase in interest earnings was principally due to significantly higher loan volumes and margins, related in particular to GCC project and structured financings. Non-interest income benefited from strong fee-based income derived from the Group's strategically important merchant banking activities, including asset and fund management and corporate advisory. Operating expenses were US\$1.7 million down on the prior year. The reduction in expenses was achieved despite the negative impact of the weaker US Dollar on foreign currency denominated expenses. The year-on-year decrease in expenses reflected the Group's continued disciplined approach to cost control. As referred to in the section on operating expenses, GIB's profit per employee and cost to income ratios are extremely efficient by international comparison. 2004 net income was net of a US\$23.8 million provision charge for credit losses. This compared to a US\$55.2 million provision charge in the prior year. The provision charge largely represented an addition to the loan non-specific

provision resulting from substantial growth in the loan portfolio during the year. The net charge for specific provisions was only US\$4.0 million.

### NET INTEREST INCOME

Net interest income at US\$173.1 million was US\$5.8 million or 3.5 per cent up on the prior year. Net interest income is derived from five principal sources: earnings on the investment of the Group's net free capital, margin income on the commercial lending and available-for-sale security portfolios, and interest earnings from the securities trading portfolio and money book activities. Money book earnings represent the differential between the funding cost of interest-bearing assets based on internal transfer pricing methodologies and the actual funding cost incurred by the Bank. This includes benefits derived from the mismatch of the repricing profile of the Group's interest-bearing assets and liabilities. Net interest income is also reported net of the funding cost of non-interest bearing investments from which income is derived in the form of dividends and capital gains, and reported in the relevant category in other income.

Short term US interest rates began to rise in the second half of 2004 following a prolonged period of low absolute interest rates. The Federal Reserve raised interest rates five times in the second half of the year from 1.0 per cent to 2.25 per cent at the end of 2004. The increases in interest rates impacted the Group's interest earnings in three specific respects, although had an overall positive impact on net interest income. They firstly contributed to an enhancement of the interest earnings on the investment of the Group's net free capital. The net free capital was largely uninvested during the year

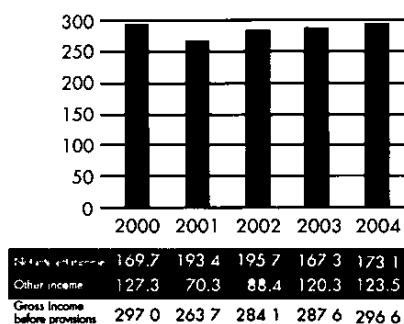
## FINANCIAL REVIEW continued

with the uninvested funds placed on a short term basis in the money market. This position had been adopted in late 2003 in anticipation of a rising interest rate environment, and resulted in a higher overall yield on the net free capital funds in 2004. Secondly, while the Group's money book activity continued to generate strong interest earnings in 2004, they were nevertheless 15 per cent lower than in 2003. Money book earnings in the previous year had benefited from the declining and low interest rate environment. Lastly, the higher interest rate environment also resulted in an increase in the funding cost of non-interest bearing investments. However, for those investments for which the related income is derived in the form of dividends, there was also an associated and compensating increase in dividend income as referred to in the section on other income.

The year-on-year increase in net interest income was also attributable to higher net interest earnings derived from the Group's commercial lending portfolio. Loan margin income was 37 per cent up on the previous year. This reflected a significant growth in the loan portfolio during the year as well as a further improvement in margins. In particular, the volume of GCC loans grew by US\$1.0 billion or one third during 2004. The increase in margins was attributable to a continued focus on higher value-added, skill-based commercial banking activities, including project and structured financings and lead manager roles in syndicated facilities.

Margin income on the available-for-sale securities portfolio continued to be the largest contributor to the Group's interest earnings, accounting for almost 40 per cent of net interest income in 2004. Margin income on available-for-sale securities nevertheless decreased in 2004 with maturing assets being replaced at lower spreads following the significant narrowing in credit spreads

**Gross income development (US\$ millions)**



that has taken place over the last two years as a result of the improvement in the credit environment. The credit quality of the available-for-sale securities portfolio continued to be emphasised with 97.7 per cent of available-for-sale debt securities at the 2004 year end being investment grade-rated.

Trading-related interest earnings were 13 per cent up on the prior year. This component of interest earnings is, however, relatively volatile from period to period, depending on the composition of the trading portfolio.

### OTHER INCOME

Other income at US\$123.5 million for the year was US\$3.2 million up on the prior year level. An analysis of other income with prior year comparatives is set out in note 19 to the consolidated financial statements.

Dividend income of US\$32.8 million was US\$9.1 million higher than in 2003. Dividend income was principally received from investments in leveraged finance vehicles and from externally managed funds. The funding cost of these investments is reported in net interest income. The year-on-year increase in dividend income reflected the positive impact of the higher interest rate environment on the

income from the underlying investments within the leveraged finance vehicles. The underlying investments of these vehicles are principally high quality, investment grade-rated debt securities.

The Group's various trading activities, including foreign exchange, generated a US\$30.4 million profit for the year compared to a US\$50.8 million profit in 2003. Strong trading revenues were generated from emerging market and corporate debt in particular, although material contributions were also made by the Group's trading activities in foreign exchange and equities. 2004 was characterised by strong performances across most credit-related asset classes, notably corporate debt, asset backed securities and emerging market debt despite the tight spreads prevailing during the year. Trading revenues benefited from relative value, arbitrage and non-directional trading strategies. These strategies contributed in particular to the return on emerging market debt trading significantly outperforming the EMBI Plus Index. Equity markets during 2004 were largely range bound thereby limiting trading opportunities compared to 2003.

Profits on available-for-sale securities amounted to US\$23.2 million for the year. This included a \$5.9 million profit realised on the sale of a strategic equity holding through an IPO and profits of US\$4.0 million realised on the sale of shares received in previous years as part of loan restructurings. Profits were also realised on the sale and early redemption of securities in the Treasury floating rate debt security portfolio. The portfolio is commented on in more detail in the section on available-for-sale securities.

Investment banking and management fees at US\$23.6 million were US\$4.8 million or 25.5 per cent up on the prior year. This followed year-on-year increases of 10.6 per cent and 45.3 per cent in 2003

and 2002 respectively. This income category comprises fees generated by the Group's asset management, fund management, corporate advisory and underwriting activities. The significant year-on-year increases reflect the Group's successful efforts in diversifying revenues through the development of a wide range of customer-related products and services. The increase in asset and fund management fees in 2004 was attributable to a higher volume of funds under management and also to a higher level of performance fees. As referred to in note 29 to the consolidated financial statements, assets held in a fiduciary capacity increased by US\$2.2 billion or 20 per cent during the year to US\$13.6 billion at 31<sup>st</sup> December 2004.

Commissions on letters of credit and guarantee at US\$10.1 million were US\$1.2 million or 13.5 per cent up on the prior year and therefore continued to make an important contribution to non-interest income. The year-on-year advance was attributable to an increase in guarantee commissions on GCC-related business activities. Other fee and sundry income principally comprised loan commitment and Islamic finance arrangement fees.

#### OPERATING EXPENSES

Operating expenses at US\$124.4 million were US\$1.7 million down on the prior year. The year-on-year decrease in expenses was achieved despite the negative impact of the weaker US Dollar prevailing during the year. This resulted in an increase in the US\$ equivalent of the foreign currency denominated expenses of overseas offices. GIB continues to maintain one of the highest profit per employee ratios for any bank in the world in addition to an extremely low cost to income ratio. According to a survey of the top 1,000 banks in the world published by *The Banker* magazine in July 2004, GIB's profit

## FINANCIAL REVIEW continued

per employee in 2003 was one of the highest among the top 1,000 banks ranked by Tier 1 capital. In addition, the cost to income ratio of 43.8 per cent in 2003 was significantly lower than the average ratio for each geographic region, including the Middle East (50.2 per cent), U.S.A. (59.6 per cent), Europe (61.8 per cent) and Japan (81.6 per cent). In 2004, the Group's cost to income ratio was 41.9 per cent, an extremely efficient ratio by international comparison.

Staff expenses were US\$5.4 million or 6.5 per cent up on the prior year. This was attributable to higher performance-related remuneration as a result of the Group's significantly stronger performance and higher release expenses associated with a further reduction in the Group's headcount. The Group's total headcount at the 2004 year end of 559 was 23 less than at the end of 2003. The decrease was largely the result of further efficiencies achieved within back office functions. In particular, during 2004 the London branch back office functions, which had previously been outsourced to GIBUK, were transferred to GIB's Head Office in Bahrain giving rise to material cost savings. Premises and other operating expenses were both successfully contained below prior year levels. Premises expenses benefited from the reversal of an unrequired office dilapidation reserve following the renegotiation of the London office lease, as well as from a reduction in the

office space occupied by the London based subsidiary, GIBUK. Other operating expenses benefited from ongoing cost control measures.

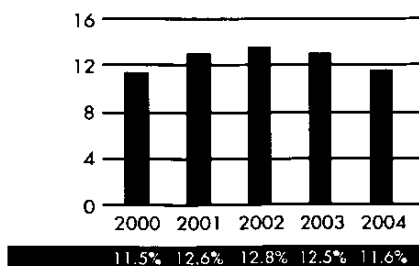
### CAPITAL STRENGTH

Shareholders' equity amounted to US\$1,534.7 million at 31<sup>st</sup> December 2004. This is the first time that the bank's shareholders' equity has exceeded US\$1.5 billion. At the 2004 year end the ratio of shareholders' equity and Tier 1 capital to total assets were 8.0 per cent and 7.5 per cent respectively, ratios that are high by international comparison. The average Tier 1 capital to total assets ratio of the top 1,000 world banks was 4.5 per cent according to a survey published in *The Banker* magazine in July 2004.

A US\$145.9 million increase in shareholders' equity during 2004 comprised the net of the US\$150.2 million profit for the year, a US\$53.1 million dividend paid in respect of 2003, and a US\$48.8 million net increase in the fair value of available-for-sale securities and derivative cash flow hedges. In accordance with IAS 39, changes in the fair values of available-for-sale securities and derivative cash flow hedges are accounted for in shareholders' equity.

With a total regulatory capital base of US\$1,774.3 million and total risk-weighted exposure of US\$15,305.7 million, the risk asset ratio calculated in accordance with the guidelines of the Basel Committee on Banking Supervision was 11.6 per cent. In accordance with international regulatory guidelines, the fair value adjustments to equity arising under IAS 39 in relation to available-for-sale securities and derivative cash flow hedges are excluded from the regulatory capital base, with the exception of unrealised gains and losses on equity investments. As a result, at the 2004 year end net fair value gains of US\$101.7 million were deducted from shareholder's

**BIS risk asset ratio (%)**



equity to derive the regulatory capital base for capital adequacy purposes. The Bank's regulatory capital base is enhanced by two 10 year subordinated loan facilities amounting in total to US\$150.0 million. The subordinated loans are approved for inclusion in Tier 2 capital for capital adequacy purposes by the Bank's regulator, the Bahrain Monetary Agency (BMA). The risk asset ratio incorporates market risk-weighted exposure. Exposure to general market risk is calculated utilising a Value-at-Risk model in accordance with the provisions of the Amendment to the Capital Accord to Incorporate Market Risk. The use of the internal model approach for the calculation of the capital requirement for general market risk has been approved by the BMA. The high proportion of shareholders' equity within the total capital base resulted in a Tier 1 ratio of 9.4 per cent. Note 28 to the consolidated financial statements provides further details on capital adequacy. The risk asset ratio calculated in accordance with the guidelines of the Bank's regulatory authority, the BMA, was 13.2 per cent at the 2004 year end. Under the BMA guidelines, GCC governments and government-owned entities are accorded the same preferential risk weighting as for

OECD governments. The BMA applies a minimum risk asset ratio of 12 per cent compared to a minimum of 8 per cent prescribed by the Basel Committee.

Factors which contribute to the Group's favourable capital adequacy position are the strong capital base, the level of non-specific provisions and significant exposure to major OECD country governments, including Saudi Arabia, as well as the banking sector.

#### ASSET QUALITY

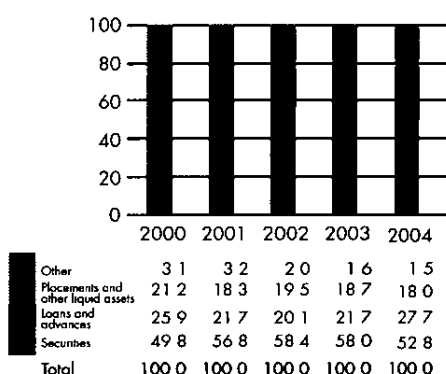
The geographical diversification of risk assets is set out in note 22 to the consolidated financial statements. Further assessment of asset quality can be facilitated by reference to note 30 to the consolidated financial statements on the fair value of financial instruments. Based on the valuation methodologies set out in that note, the net fair values of all on- and off-balance sheet financial instruments exceeded their net book values at 31<sup>st</sup> December 2004 by US\$4.1 million. All non-trading securities are classified as available-for-sale and measured at fair value. Available-for-sale securities are accordingly stated at fair value in the consolidated balance sheet.

At the 2004 year end, available-for-sale securities accounted for 44.4 per cent of total assets while loans and advances represented 27.7 per cent.

#### AVAILABLE-FOR-SALE SECURITIES

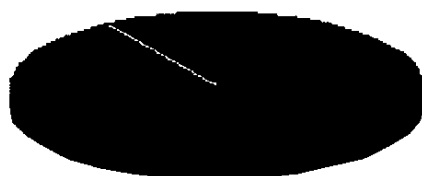
Available-for-sale (AFS) securities totalled US\$8,469.1 million at 31<sup>st</sup> December 2004. The available-for-sale securities portfolio represents not only a substantial and effective liquidity reserve but also an effective international geographical diversification of the Group's risk assets with 81.7 per cent of the portfolio comprising securities of North American and European issuers. The

**Asset mix by category (%)**



## FINANCIAL REVIEW continued

### Available-for-sale securities rating profile



	US\$ millions	%
AAA/Aaa rated debt securities	1,459.2	17.2
Debt securities of other investment grade issuers	6,218.4	73.4
Other debt securities	186.0	2.2
Equities and equity funds	605.5	7.2
Total	8,469.1	100.0

remaining balance largely comprises securities issued by GCC country governments

AFS securities principally comprise two types of debt security portfolios and a more limited investment in equities and equity funds. The larger debt security portfolio comprises floating rate securities or fixed rate securities that have been swapped to yield constant spreads over LIBOR. These accounted for 84.8 per cent of the total AFS securities portfolio at the 2004 year end. The smaller debt security portfolio comprises fixed income securities. This portfolio amounted to US\$681.6 million at the end of 2004. This largely comprised GCC country government bonds with original maturities of up to two years.

An analysis of the AFS securities portfolio by rating category is set out in note 6(a) to the consolidated financial statements. US\$1,459.2 million or 17.6 per cent of the AFS debt securities at the 2004 year end represented AAA/Aaa rated securities. Based on the rating of the issuer, a further US\$6,218.4 million or 79.1 per cent of the AFS debt securities represented other investment grade-rated securities. Thus 97.7 per cent of the total debt

securities comprised investment grade-rated securities. Other debt securities, the issuers of which are rated below BBB-/Baa3 or are unrated, amounted to US\$186.0 million at the end of 2004, thus comprising only 2.3 per cent of the total AFS debt securities portfolio. The credit risk associated with these securities is rigorously monitored within the overall credit risk management process. The securities are therefore subject to the same stringent credit requirements as standard lending and credit-related contingent transactions. Equities and equity funds at 31<sup>st</sup> December 2004 amounted to US\$605.5 million. The equities and equity fund portfolio is principally invested in the equity tranches of leveraged finance, specialised investment vehicles and, to a very limited extent, in a number of externally managed investments which provide a diversified exposure to private equity and real estate markets. The underlying investments of the leveraged finance vehicles principally comprise high quality investment grade-rated floating rate debt securities. The investments generate an attractive and stable margin over LIBOR by means of the leveraged characteristics of the investment vehicles.

### LOANS AND ADVANCES

Loans and advances amounted to US\$5,286.3 million at the 2004 year end. This represented a US\$1,526.7 million or 40.6 per cent increase compared to the 2003 year end. The increase principally reflected further growth in the GCC loan portfolio and, in particular, project and structured finance-related facilities within the region, in line with the Group's strategic emphasis on relationship banking in the GCC. 74.2 per cent, or almost three quarters, of the loan portfolio at the 2004 year end represented lending within GIB's core market in the GCC states.



The geographical diversification of the Group's overall credit risk is achieved through the international securities markets rather than through participation in international syndicated lending transactions

Based on contractual maturities at the balance sheet date, 48.7 per cent of the loan portfolio was due to mature within one year while 74.6 per cent was due to mature within three years. Details of exposure within the loan portfolio to GCC and OECD country governments are contained in note 7 to the consolidated financial statements while the geographical distribution of loans and advances is set out in note 22. The portfolio contained no significant concentrations by industrial sector. As discussed in note 30, the net fair value of loans and advances exceeded their net book value by US\$4.1 million.

Total loan loss provisions at 31<sup>st</sup> December 2004 amounted to US\$721.8 million. Counterparty specific provisions amounted to US\$519.6 million while non-specific provisions were US\$202.2 million. Specific provisions at the 2004 year end represented 90.2 per cent of loans against which a specific provision had been made. Specific provision utilisations during 2004 totalled US\$28.5 million. The utilisations arose on the sale or settlement of the related loans. While loans were sold or settled at less than the nominal values, the proceeds exceeded the provisioned net book values in all cases. The provision charge for loans and advances was US\$18.6 million for the year. This comprised the net of a US\$1.2 million release of specific loan provisions as a result of the sale and settlement of provisioned loans above their net book values, and a US\$19.8 million charge for non-specific loan provisions. The increase in the non-specific loan provision resulted from the substantial increase in the loan portfolio during the year. Specific provisions are

#### Loan maturity profile



	US\$ millions	%
Year 1	2,575.8	48.7
Years 2 & 3	1,370.0	25.9
Years 4 & 5	606.7	11.5
Over 5 years	733.8	13.9
Total	5,286.3	100.0

maintained in the currencies of the related exposures. The further weakening in the US Dollar during the year resulted in a US\$10.2 million increase in the US Dollar equivalent of specific loan provisions maintained in foreign currencies. This increase was, however, offset by an equivalent increase in the related loan exposures. The non-specific provision at the year end represented 3.7 per cent of loans which had not been specifically provided against.

Specific provisions are determined based on the recoverable amount of the loan. The recoverable amount is measured as the present value of the expected future cash flows discounted based on the interest rate at the inception of the facility. Non-specific provisions are determined utilising an expected loss model based on applicable credit ratings and associated historical default probabilities, loss severity and rating migrations, and reflecting the current macroeconomic, political and business environment and other pertinent indicators. Loans are written off only after all reasonable restructuring and collection activities have taken place and the possibility of further recovery is considered to be remote.

## FINANCIAL REVIEW continued

The gross and net book values of past due loans amounted to US\$532.7 million and US\$26.6 million respectively. The provisioning coverage for past due loans was therefore 95.0 per cent. Past due loans are defined as those loans for which either principal or interest is over 90 days past due. Under IAS 39, interest on impaired loans should be recognised in income based on the net book value of the loan and the interest rate that was used to discount the future cash flows for the purpose of measuring the recoverable amount. However, in accordance with guidelines issued by the Bank's regulator, the BMA, interest on past due loans is only to be recognised in income on a cash basis. In view of the Group's high provisioning coverage for impaired loans, the difference between the two bases of accounting is not material. An ageing analysis of past due loans is set out in note 7(c) to the consolidated financial statements. US\$46.9 million or 8.73 per cent of gross past due loans were overdue by more than five years and are therefore historical in nature. These are all fully provided against. There were no new past due loans in 2004 and only US\$33.9 million of loans had become past due over the preceding two years. The gross volume of past due loans also continued to be substantially less than total provisions. Total provisions for loan

losses exceeded the gross volume of past due loans by US\$189.1 million. This means that rather than earnings being impaired by the funding cost of the net book value of past due loans, there is an earnings enhancement. Past due loans at their net book value of US\$26.6 million represented just 0.5 per cent of net loans. Past due loans at their net book value also represented only 1.7 per cent of shareholders' equity.

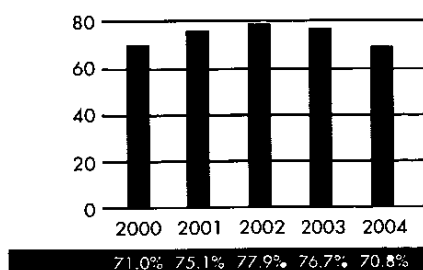
### OTHER ASSET CATEGORIES

Cash and other liquid assets, which amounted to US\$144.6 million at the 2004 year end, are analysed in note 3 to the consolidated financial statements. In addition to cash and balances with banks, other liquid assets included certificates of deposit and Treasury bills held for balance sheet management purposes.

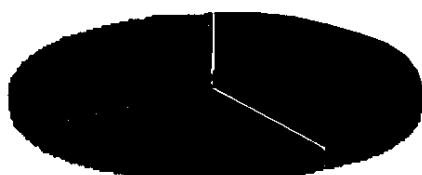
Placements with banks totalled US\$3,286.5 million at the 2004 year end and were well diversified by geography as illustrated in note 22 to the consolidated financial statements. Interbank placements were largely with GCC and European bank counterparties, representing the Group's two principal operating locations. Placements with banks represented 17.2 per cent of total assets at the 2004 year end contributing to a very strong Liquid Assets Ratio of 70.8 per cent.

Trading securities at US\$1,612.4 million largely comprised listed debt securities amounting to US\$974.0 million. Trading securities also included US\$247.1 million of managed funds. The funds, which are managed by international institutions with acknowledged expertise in their field, provide diversified exposure to foreign exchange, hedge funds, and equity and international debt markets.

**Liquid assets ratio (%)**



### Risk asset and commitment exposure



	US\$ millions	%
GCC	8,146.3	38.4
Other Middle East & North Africa	588.3	2.8
North America	5,405.7	25.5
Europe	6,061.3	28.5
Asia	875.5	4.1
Latin America	151.0	0.7
Total	21,228.1	100.0

#### RISK ASSET AND COMMITMENT EXPOSURE

Risk asset and commitment exposure at 31<sup>st</sup> December 2004 amounted to US\$21,228.1 million. Risk assets and commitments comprise all assets included in the balance sheet (with the exception of fixed and other assets) and credit-related contingent items. As alluded to earlier, an analysis of risk asset and commitment exposure by category and geography is contained in note 22 to the consolidated financial statements. An analysis of derivative and foreign exchange products is set out in note 25 while a further analysis of credit-related contingent items together with their risk-weighted equivalents is contained in note 26.

#### FUNDING

Bank and customer deposits at 31<sup>st</sup> December 2004 totalled US\$10,814.5 million. Customer deposits amounted to US\$6,068.3 million at the 2004 year end being US\$1,158.1 million higher than at the previous year end. Customer deposits represented 56.1 per cent of total deposits compared to 47.5 per cent at the end of 2003. A US\$683.7 million decrease in bank deposits compared to the 2003 year end reflected a reduced requirement for interbank

funding as a result of an increase in customer deposits and term financing during the year. Funding was also enhanced by an increase in securities sold under agreements to repurchase (repos). Repos increased by US\$812.3 million during the year to US\$3,818.8 million at 31<sup>st</sup> December 2004. The substantial volume of investment grade rated AFS securities facilitated the Group's ability to fund through this mechanism. Repos represent a more stable and cost effective source of funding, thereby enhancing both liquidity management and profitability. As is evident from note 33 to the consolidated financial statements, total deposits averaged US\$10,755.4 million during 2004. Total deposits at the year end were therefore representative of the level of deposits maintained throughout the year. As illustrated in note 11 to the consolidated financial statements, 64.5 per cent or two thirds of total deposits were from the GCC. GIB is a net placer of funds in the international interbank market. Term financing at 31<sup>st</sup> December 2004 totalled US\$1,678.3 million. An additional US\$177.0 million of term financing was raised during the year as part of an ongoing programme to enhance the Group's funding profile. Further commentary on liquidity and funding is provided in the Risk Management Review.

### Deposits - geographical profile



	US\$ millions	%
GCC countries	6,970.2	64.5
Other countries	3,844.3	35.5
Total	10,814.5	100.0



GIB confirmed its status within Europe as a leading manager of mezzanine asset-backed security products through the issue of a Sterling denominated £200 million collateralised debt obligation.

## RISK MANAGEMENT REVIEW

THE GIB GROUP MAINTAINS A PRUDENT AND DISCIPLINED APPROACH TO RISK TAKING by upholding a comprehensive set of risk management policies, processes and limits, employing professionally qualified people with the appropriate skills, investing in technology and training, and actively promoting a culture of sound risk management at all levels. A key tenet of this culture is the clear segregation of duties and reporting lines between personnel transacting business and personnel processing that business. The Group's risk management is underpinned by its ability to identify, measure, aggregate and manage the different types of risks it faces.

The Board of Directors has created from among its members a Board Risk Policy Committee to review the Group's risk taking activities and report to the Board in this regard. The Board sets the overall risk parameters and tolerances within which the Group conducts its activities. The Board periodically reviews the Group's overall risk profile and significant risk exposures as well as the Group's major risk policies, processes and controls.

The Management Committee, chaired by the CEO, has the primary responsibility for sanctioning risk taking policies and activities within the tolerances defined by the Board. The Group Risk Committee assists the Management Committee to perform its risk related functions. The Group Risk Committee, comprising the bank's most senior risk professionals, provides a forum for the review and approval of new products, risk measurement methodologies and risk control processes. The Committee also reviews all risk policies and limits

that require approval by the Management Committee.

From a control perspective, the process of risk management is facilitated through a set of independent functions, which report directly to senior management. These functions include Risk Management, Credit Risk Control, Market Risk Control, Financial Control and Internal Audit. This multi-faceted approach aids the effective management of risk by identifying, measuring and monitoring risks from a variety of perspectives. Risks associated with off-balance sheet derivative instruments are managed within the overall risk management framework.

The major risks associated with the Group's business are credit, market, liquidity and operational risks. These risks and the related risk management processes are commented on in note 21 to the consolidated financial statements and are discussed in detail in the following sections.

### CREDIT RISK

Credit risk is the risk that a customer, counterparty or an issuer of securities or other financial instruments fails to perform under its contractual payment obligations thus causing the Group to suffer a loss in terms of cash flow or market value. Credit risk is the predominant risk type faced by the Group in its banking, investment and treasury activities both on and off balance sheet. Where appropriate the Group seeks to minimise its credit exposure using a variety of techniques including but not limited to the following:

- entering netting agreements with counterparties that permit offsetting of receivables and payables
- obtaining collateral against the Group's exposure

## RISK MANAGEMENT REVIEW continued

- seeking third party guarantees of the counterparty's obligations
- imposing restrictions and covenants on borrowers

Credit risk is actively managed and rigorously monitored in accordance with well-defined credit policies and procedures. Prior to the approval of a credit proposal, a detailed credit risk assessment is carried out which includes an analysis of the obligor's financial condition, market position, business environment and quality of management. The risk assessment generates an internal credit risk rating for each exposure, which affects the credit approval decision and the terms and conditions of the transaction. For cross border transactions an analysis of country risk is also conducted. The Group bases its credit decision for an individual counterparty on the aggregate Group exposure to that counterparty and all its related entities. Groupwide credit limit setting and approval authorisation requirements are conducted within Board approved guidelines, and the measurement, monitoring and control of credit exposures are done on a Groupwide basis in a consistent manner.

Overall exposures are evaluated to ensure broad diversification of credit risk. Potential concentration risks by product, industry, single obligor, credit risk rating and geography are regularly assessed with a view to improving overall portfolio diversification. Established limits and actual levels of exposure are regularly reviewed by the Chief Credit Officer and other members of senior management. In general, all credit decisions are reviewed at least once a year. Credit policies and procedures are designed to identify, at an early stage, exposures which require more detailed monitoring and review.

### Credit risk rating profile as at 31<sup>st</sup> December 2004



	US\$ millions	%
AAA/Aaa	2,792.3	13.2
AA/Aa	4,031.9	19.0
A/A	5,539.5	26.1
BBB/Baa	5,869.0	27.6
BB/Ba	2,144.3	10.1
B/B	694.4	3.3
Below B/B	156.7	0.7
Total	21,228.1	100.0

The credit risk associated with foreign exchange and derivative instruments is assessed in a manner similar to that associated with on-balance sheet activities. The Group utilises derivative transactions for proprietary trading, to facilitate customer transactions and for the management of interest and foreign exchange risks associated with the Group's longer-term lending, borrowing and investment activities. Unlike on-balance sheet products, where the principal amount and interest generally represent the maximum credit exposure, the notional amount relating to a foreign exchange or derivative transaction typically exceeds the credit exposure by a substantial margin. The measure of credit exposure for foreign exchange and derivative instruments is therefore more appropriately considered to be the replacement cost at current market rates plus an add-on amount commensurate with the position's size, volatility and remaining life.

Derivative contracts may also carry legal risk such as not having been authorised, appropriate or enforceable for a counterparty and documentation.

not being properly executed. The Group seeks to minimise these risks by the use of standard contract agreements and by obtaining the opinion of legal counsel regarding enforceability of agreements and the authority of a counterparty to transact.

The current gross positive market values or credit risk amounts of foreign exchange and derivative transactions are set out in note 25 to the consolidated financial statements. The total credit risk amount in respect of all such transactions outstanding at the 2004 year end amounted to US\$62.6 million before taking account of the risk-reducing benefits of any collateral held or legally enforceable netting agreements. The note highlights that 74.0 per cent of the total credit risk was concentrated on major OECD-based banks and was predominantly short-term in nature with 63.4 per cent of notional amounts of the transactions outstanding at the end of 2004 contracted to mature within one year. Transactions maturing beyond one year represented either hedging transactions entered into for asset and liability management purposes or fully offset customer transactions.

#### **MARKET RISK**

Market risk is the risk of loss of value of a financial instrument or a portfolio of financial instruments as a result of changes in market prices and rates. Market risk arises from the Group's trading, asset and liability management and investment activities. A description of the categories of market risk faced by the Group is set out below.

- interest rate risk results from exposure to changes in the level, slope, curvature and volatility of interest rates and credit spreads. The credit spread risk is the risk that the interest yield for a

security will increase, with a reduction in the security price, relative to benchmark yields as a result of the general market movements for that rating and class of security. Interest rate risk is the principal type of market risk faced by the Group and arises from the Group's investment activities in debt securities, asset and liability management and the trading of debt and off-balance sheet derivative instruments.

- foreign exchange risk results from exposure to changes in the price and volatility of currency spot and forward rates. For the Group, the principal foreign exchange risk arises from its investments in externally managed currency funds and from its foreign exchange forward and derivatives trading activities.
- equity risk arises from exposures to changes in the price and volatility of individual equities or equity indices. The Group's equity risk principally arises from its trading activities in US and European equities, equity derivatives and convertibles.
- commodity risk results from exposure to changes in the price and volatility of commodities. The Group's commodity risk arises entirely from its derivative trading activities.

The Group seeks to manage the market risks it faces through diversification of exposures across dissimilar markets and establishment of hedges in related securities or off balance sheet derivative instruments. To manage the Group's exposures in addition to the exercise of business judgment and management experience, the Group utilises limit structures including those relating to positions, portfolios, maturities and maximum allowable losses.

## RISK MANAGEMENT REVIEW continued

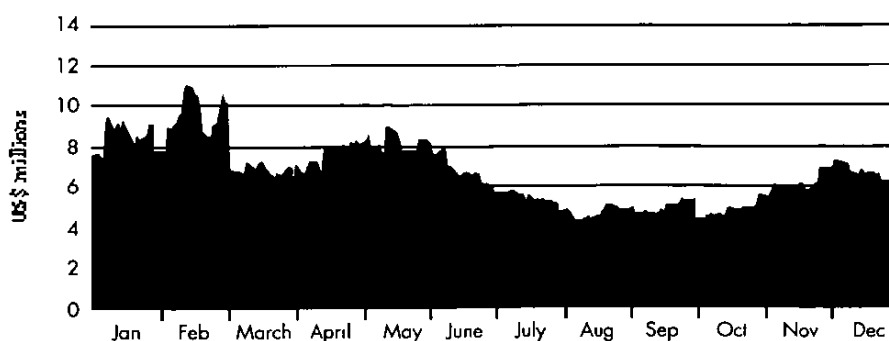
A key element in the Group's market risk management framework is the estimation of potential future losses that may arise from adverse market movements. The Group utilises Value-at-Risk (VaR) to estimate such losses. The VaR is derived from quantitative models that use statistical and simulation methods that take account of all market rates and prices that may cause a change in a position's value. These include interest rates, foreign exchange rates and equity prices, their respective volatilities and the correlations between these variables. The Group's VaR is calculated on a variance/co-variance basis using exponentially weighted one-year historical daily movements in market rates and prices, giving greater importance to the more recent observations in estimating potential future losses. The VaR takes account of potential diversification benefits of different positions both within and across different portfolios. Consistent with general market practice, VaR is computed for all financial instruments for which there are readily available daily prices or a suitable proxy.

VaR is viewed as an effective risk management tool and a valuable addition to the non-statistically based limit structure. It permits a consistent and uniform measure of market risk across all applicable products and activities. Exposures are monitored against a range of limits both by risk category and portfolio and are regularly reported to and reviewed by senior management and the Board of Directors.

For internal risk management purposes, the Group measures losses that are anticipated to occur within a 95 per cent confidence level. This implies that there is on average a 5 per cent or a 1 in 20 chance of a loss exceeding the VaR over the prescribed time horizon or holding period. The Group measures VaR utilising a one month assumed holding period for both trading and available-for-sale positions.

The graph below sets out the total Value-at-Risk for all the Group's trading activities at the close of each business day throughout the year. The

**Trading Value-at-Risk daily development**





figures are calculated using the regulatory VaR basis at a 1 per cent risk level (2.33 standard deviations) and at the ten-day horizon using one-year unweighted historical daily movements in market rates and prices. On this basis, total diversified VaR over the year averaged US\$6.4 million and varied within the range of US\$5.1 million to US\$10.1 million with a 2004 yearend value of US\$7.1 million.

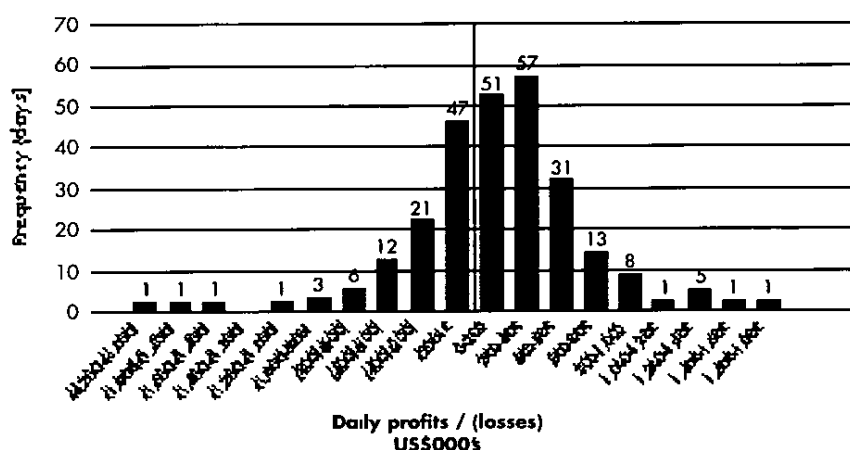
The Group conducts daily VaR back testing both for regulatory compliance with the Basel Committee on Banking Supervision market risk capital rules and for internal evaluation of VaR against trading profits and losses. During 2004, there was one occasion on which a daily trading loss exceeded the trading VaR at the close of business on the previous business day. The Basel Committee's guidelines on back testing permit a maximum of five excesses beyond which the multiplication factor determined by the regulator may be increased.

An inherent limitation of VaR is that past market movements may not provide an accurate

prediction of future market losses. Historic analyses of market movements have shown that extreme market movements (e.g. beyond the 99 per cent confidence level) occur more frequently than VaR models predict. Stress tests are designed to estimate the potential economic losses in such abnormal markets. Therefore, stress testing combined with VaR provides a more comprehensive picture of market risk. The Group regularly performs stress tests that are constructed around changes in market rates and prices that result from pre-specified market scenarios, including both historical and hypothetical market events. Historical scenarios include the 1994 bond market sell-off, the 1995 Mexican Peso crisis, the 1998 Russian crisis and the 2001 September 11 market disruption. Stress testing is performed for all material trading and available-for-sale portfolios.

A major objective of asset and liability management is the maximisation of net interest income through the proactive management of the

**Histogram of daily trading profits & losses**



## RISK MANAGEMENT REVIEW continued

asset and liability repricing profile based on anticipated movements in interest rates. VaR-based limits are utilised to control fluctuations in interest earnings resulting from changes in interest rates. The asset and liability repricing profile and details of the effective interest rates prevailing at the year end on the various asset and liability categories are set out in note 24 to the consolidated financial statements. The repricing profiles of individual asset and liability categories incorporate the effect of interest rate swaps used to modify the interest rate characteristics of specific transactions. As illustrated in note 24, the substantial majority of assets and liabilities reprice within one year. The volume of interest-bearing assets repricing over one year amounted to only US\$545.4 million or 2.9 per cent of total assets. This mainly represented investments in fixed rate government securities with a maximum original maturity of two years. At 31<sup>st</sup> December 2004 the modified duration of these fixed rate government securities was 1.2.

### LIQUIDITY RISK AND FUNDING

Liquidity risk is the risk of the Group's financial obligations not being met fully and punctually as they fall due. The risk arises from the timing differences between the maturity profiles of the Group's assets and liabilities. It includes the risk of losses arising from the following:

- forced sale of assets at below normal market prices
- raising of deposits or borrowing funds at excessive rates
- investment of surplus funds at below market rates

The Group maintains a strong liquidity

position by managing the liquidity structure of assets, liabilities and commitments to ensure the Group has access to adequate funds to meet its obligations even under adverse market conditions. In normal market conditions the Group endeavours to ensure that there are sufficient funds not only to meet current obligations but also to provide the flexibility to capitalise on market opportunities.

The Group applies a prudent mixture of liquidity controls that provide security of access to funds without undue exposure to increased costs from the liquidation of assets or the aggressive bidding for deposits. The liquidity controls ensure that over the short term, by major currency, the projected profile of future cash flows from maturing assets is adequately matched to the maturity of liabilities. Liquidity is managed and monitored on a daily basis at the parent company and subsidiary levels, enabling senior management to identify changes and to react accordingly to fluctuations in market conditions.

The Group maintains strong balance sheet liquidity ratios and regularly monitors its depositors to ensure it retains a diversified deposit base in terms of name concentration, range of counterparties and maturities. The Group maintains a stock of liquid and marketable securities that can be readily sold or repoed. The funding base is enhanced through term financing of US\$1,828.3 million as at 31<sup>st</sup> December 2004, an increase of US\$177.0 million over the year. Deposits from customers provide a further stable source of funding. Contingency plans also exist that can be quickly implemented to maintain liquidity in crisis situations without hindering long-term business objectives.

The asset and liability maturity profile by individual asset and liability category based on contractual repayment arrangements is set out in note 23 to the consolidated financial statements. At 31<sup>st</sup> December 2004, 45.3 per cent of total assets were contracted to mature within one year. A significant portion of assets with longer-term maturities comprised readily realisable securities. With regard to deposits, retention records demonstrate that there is considerable divergence between their contractual and effective maturities. By way of example, average deposits in 2004 from those counterparties with deposits over US\$10 million at 31<sup>st</sup> December 2004 amounted to US\$9,508.3 million. These deposits of a core nature together with shareholders' equity and term financing were three times the least liquid asset category, loans and advances. The more stable deposits from the GCC region also comfortably exceed the loan portfolio. At 31<sup>st</sup> December 2004 deposits from GCC country governments and central banks and other institutions headquartered in the GCC states amounted to US\$6,970.2 million. GCC deposits to total loans cover was therefore 1.3 times. Total deposits and term financing coverage to loans was 2.4 times while the liquid assets ratio, which expresses the sum total of bank balances, money market instruments, placements with banks and securities as a percentage of total assets, was a high 70.8 per cent.

#### **OPERATIONAL RISK**

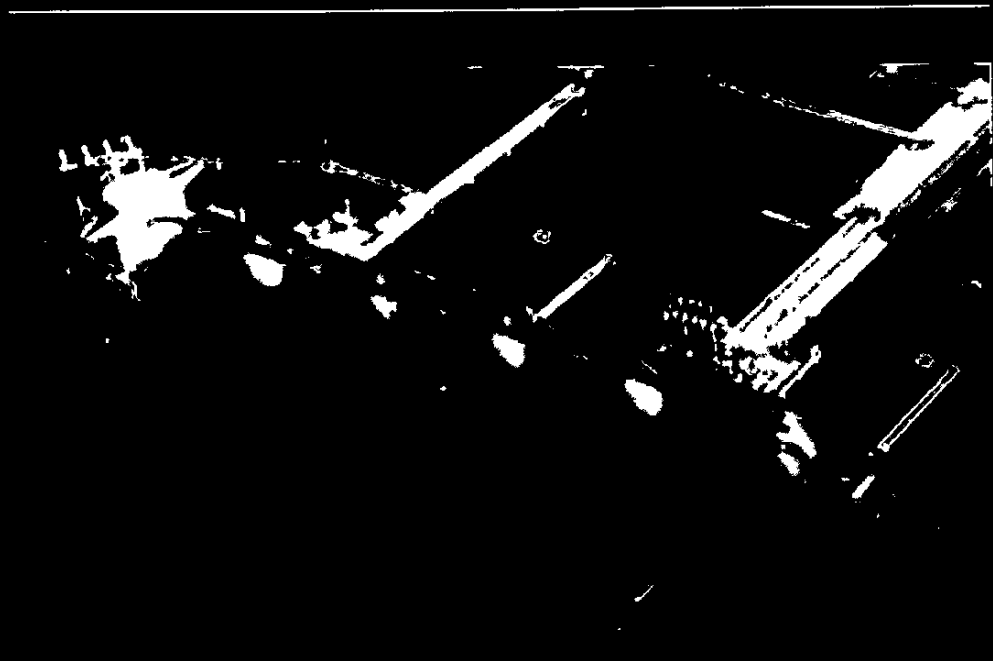
Operational risk is the risk of loss arising from inadequate or failed internal processes, people and systems or from external events. It is an inherent risk faced by all businesses and covers a large number of vulnerabilities including business interruption and

systems failures, internal and external fraud, employment practices and workplace safety, customer and business practices, transaction execution and process management, and damage to physical assets.

Whilst operational risk cannot be eliminated in its entirety, the Group endeavours to minimise it by ensuring that a strong control infrastructure is in place throughout the organisation. The various procedures and processes used to manage operational risk include effective staff training, appropriate controls to safeguard assets and records, regular reconciliation of accounts and transactions, close monitoring of risk limits, segregation of duties, and financial management and reporting. In addition, other control strategies, including business continuity planning and insurance, are in place to complement the procedures, as applicable.

A risk assessment has been compiled which identifies the operational risks inherent in the Group's activities, processes and systems, and the controls required to mitigate these risks are constantly under review and updated as necessary. A database of measurable operational losses is maintained, together with a record of key risk indicators, which can provide an early warning of possible operational risk. The process of management reporting is currently under review.

The Group ensures that its processes are in line with best practice and that it takes account of lessons learnt from published failures within the global financial services industry. In addition, the Group has a strong Internal Audit function, which undertakes periodic, independent appraisals of the actual functioning of the controls in all the identified risk areas and reports on their findings to the Audit Committee of the Board of Directors.



GIB was the mandated lead arranger in the US\$4 billion Qatar Gas II financing, one of the largest project finance transactions undertaken in the Middle East.

## FINANCIAL STATEMENTS

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## REPORT OF THE AUDITORS TO THE SHAREHOLDERS

We have audited the consolidated financial statements of Gulf International Bank B S C (the Bank) and its subsidiaries (the Group) as at, and for the year ended, 31<sup>st</sup> December 2004 as set out on pages 37 to 73

### **Respective responsibilities of Directors and Auditors**

These financial statements are the responsibility of the Board of Directors of the Bank. Our responsibility is to express an opinion on these financial statements based on our audit.

### **Basis of opinion**

We conducted our audit in accordance with International Standards on Auditing. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the consolidated financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the consolidated financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audit provides a reasonable basis for our opinion.

### **Opinion**

In our opinion, the consolidated financial statements present fairly, in all material respects, the financial position of the Group as at 31<sup>st</sup> December 2004, the results of its operations, changes in its shareholders' equity and its cash flows for the year then ended, in accordance with International Financial Reporting Standards.

### **Other regulatory matters**

In addition, in our opinion, the Group has maintained proper accounting records and the consolidated financial statements are in agreement therewith. We have reviewed the accompanying Chairman's Statement and confirm that the information contained therein is consistent with the consolidated financial statements. To the best of our knowledge and belief, no violations of the Bahrain Commercial Companies Law 2001 or the Bahrain Monetary Agency Law, 1973 (as amended) or the terms of the Bank's licence, or its Agreement of Establishment, or its Articles of Association have occurred during the year that might have had a material adverse effect on the business of the Bank or on its financial position. Satisfactory explanations and information have been provided to us by management in response to all our requests.

KPMG  
Public Accountants  
Manama, Kingdom of Bahrain  
9<sup>th</sup> February 2005

# **CONSOLIDATED BALANCE SHEET**

	Note	At 31 12 04 US\$ millions	At 31 12 03 US\$ millions
<b>Assets</b>			
Cash and other liquid assets	3	144 6	215 0
Placements with banks	4	3,286 5	3,023 1
Trading securities	5	1,612 4	1,583 6
Available-for-sale securities	6	8,469 1	8,451 8
Loans and advances	7	5,286 3	3,759 6
Fixed assets	8	17 8	18 8
Other assets	9	270 1	250 5
<b>Total assets</b>		<b>19,086 8</b>	<b>17,302 4</b>
<b>Liabilities</b>			
Deposits from banks	11	4,746 2	5,429 9
Deposits from customers	11	6,068 3	4,910 2
Securities sold under agreements to repurchase	12	3,818 8	3,006 5
Securities sold but not yet purchased		564 9	271 2
Other liabilities	13	525 6	644 5
Term financing	14	1,678 3	1,501 3
Subordinated term loans	15	150 0	150 0
<b>Total liabilities</b>		<b>17,552 1</b>	<b>15,913 6</b>
<b>Shareholders' equity</b>			
Share capital	16	1,000 0	1,000 0
Share premium		7 6	7 6
Reserves	17	302 1	226 8
Retained earnings		225 0	154 4
<b>Shareholders' equity</b>		<b>1,534 7</b>	<b>1,388 8</b>
<b>Total liabilities &amp; shareholders' equity</b>		<b>19,086 8</b>	<b>17,302 4</b>

The consolidated financial statements were approved by the Board of Directors on 9<sup>th</sup> February 2005 and signed on their behalf by -

Ebrahim Bin Khalifa Al Khalifa  
Chairman

Dr. Khaled M. Al-Fayez  
Chief Executive Officer

The notes on pages 41 to 73 form part of these consolidated financial statements

## CONSOLIDATED STATEMENT OF INCOME

	Note	Year ended 31 12 04 US\$ millions	Year ended 31 12 03 US\$ millions
<b>Interest revenue</b>			
Interest on securities		255.1	271.3
Interest and fees on loans		122.0	97.2
Interest on placements and other liquid assets		80.5	60.8
		<u>457.6</u>	<u>429.3</u>
<b>Interest expense</b>		<u>284.5</u>	<u>262.0</u>
<b>Net interest income</b>		173.1	167.3
Provisions for securities	6	5.2	50.8
Provisions for loans and advances	7	18.6	4.4
<b>Net interest income after provisions</b>		<u>149.3</u>	<u>112.1</u>
<b>Other income</b>	19	<u>123.5</u>	<u>120.3</u>
<b>Net interest and other income</b>		<u>272.8</u>	<u>232.4</u>
<b>Operating expenses</b>			
Staff		88.5	83.1
Premises		6.9	10.0
Other		29.0	33.0
		<u>124.4</u>	<u>126.1</u>
<b>Net income before tax</b>		<u>148.4</u>	<u>106.3</u>
Taxation (credit) / charge on overseas activities		(1.8)	0.2
<b>Net income after tax</b>		<u>150.2</u>	<u>106.1</u>
 <i>Earnings per share</i>	 31	 <u>US\$0.15</u>	 <u>US\$0.11</u>

The notes on pages 41 to 73 form part of these consolidated financial statements



## CONSOLIDATED STATEMENT OF CASH FLOWS

	Year ended 31 12 04 US\$ millions	Year ended 31 12 03 US\$ millions
<b>Operating activities</b>		
Net income	150.2	106.1
Adjustments to reconcile net income to net cash inflow / outflow from operating activities		
Provisions for securities	5.2	50.8
Provisions for loans and advances	18.6	4.4
Profit on available-for-sale securities	(23.2)	(15.6)
Amortisation of available-for-sale securities	1.1	6.3
Depreciation of fixed assets	4.8	6.4
(Increase) / decrease in accrued interest receivable	(28.0)	26.4
Increase / (decrease) in accrued interest payable	17.6	(25.1)
(Increase) / decrease in other net assets	(97.2)	131.5
Net increase in trading securities	(28.8)	(382.2)
<b>Net cash inflow / (outflow) from operating activities</b>	<b>20.3</b>	<b>(91.0)</b>
<b>Investing activities</b>		
Net (increase) / decrease in placements with banks	(263.4)	0.9
Net increase in loans and advances	(1,545.3)	(508.2)
Purchase of available-for-sale securities	(1,421.5)	(2,724.8)
Sale and maturity of available-for-sale securities	1,439.0	2,650.2
Purchase of fixed assets	(3.8)	(4.6)
<b>Net cash outflow from investing activities</b>	<b>(1,795.0)</b>	<b>(586.5)</b>
<b>Financing activities</b>		
Net decrease in deposits from banks	(683.7)	(312.1)
Net increase / (decrease) in deposits from customers	1,158.1	(169.3)
Net increase in securities sold under agreements to repurchase	812.3	429.8
Net increase in securities sold but not yet purchased	293.7	217.9
Increase in term financing	177.0	621.3
Dividends paid	(53.1)	(42.7)
<b>Net cash inflow from financing activities</b>	<b>1,704.3</b>	<b>744.9</b>
<b>(Decrease) / increase in cash and cash equivalents</b>	<b>(70.4)</b>	<b>67.4</b>
<b>Cash and cash equivalents at 1<sup>st</sup> January</b>	<b>215.0</b>	<b>147.6</b>
<b>Cash and cash equivalents at 31<sup>st</sup> December</b>	<b>144.6</b>	<b>215.0</b>

The notes on pages 41 to 73 form part of these consolidated financial statements

# **CONSOLIDATED STATEMENT OF CHANGES IN SHAREHOLDERS' EQUITY**

	Share capital US\$ millions	Share premium US\$ millions	Reserves US\$ millions	Retained earnings US\$ millions	Total US\$ millions
<b>At 31<sup>st</sup> December 2002</b>	<b>1,000.0</b>	<b>7.6</b>	<b>37.1</b>	<b>83.5</b>	<b>1,128.2</b>
Arising in the year -					
- Available-for-sale securities net fair value gains	-	-	171.4	-	171.4
- Cash flow hedges net fair value gains	-	-	0.8	-	0.8
Transfers in the year -					
- Transfers to net income	-	-	(3.7)	28.7	25.0
Net gains recognised directly in equity	-	-	168.5	28.7	197.2
Dividend for 2002	-	-	-	(42.7)	(42.7)
Net income for the year	-	-	-	106.1	106.1
Transfers from retained earnings	-	-	21.2	(21.2)	-
<b>At 31<sup>st</sup> December 2003</b>	<b>1,000.0</b>	<b>7.6</b>	<b>226.8</b>	<b>154.4</b>	<b>1,388.8</b>
Arising in the year -					
- Available-for-sale securities net fair value gains	-	-	56.9	-	56.9
- Cash flow hedges net fair value losses	-	-	(0.1)	-	(0.1)
Transfers in the year -					
- Transfers to net income	-	-	(11.5)	3.5	(8.0)
Net gains recognised directly in equity	-	-	45.3	3.5	48.8
Dividend for 2003	-	-	-	(53.1)	(53.1)
Net income for the year	-	-	-	150.2	150.2
Transfers from retained earnings	-	-	30.0	(30.0)	-
<b>At 31<sup>st</sup> December 2004</b>	<b>1,000.0</b>	<b>7.6</b>	<b>302.1</b>	<b>225.0</b>	<b>1,534.7</b>

The notes on pages 41 to 73 form part of these consolidated financial statements

## NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

For the year ended 31<sup>st</sup> December 2004

### 1. INCORPORATION AND REGISTRATION

The parent company of the Group (the Group), Gulf International Bank B S C. (the Bank), is a Bahraini Shareholding Company incorporated in the Kingdom of Bahrain by Amiri Decree Law No. 30 dated 24<sup>th</sup> November 1975 and is registered as an offshore banking unit with the Bahrain Monetary Agency. The registered office of the Bank is located at Al-Dowali Building, 3 Palace Avenue, Manama, Kingdom of Bahrain.

The Group is principally engaged in the provision of wholesale commercial and investment banking services. The Group operates through subsidiaries, branch offices and representative offices located in six countries worldwide. The total number of staff employed by the Group at the end of the financial year was 559.

### 2. ACCOUNTING POLICIES

The principal accounting policies adopted in the preparation of the consolidated financial statements are set out below -

#### 2.1 Basis of presentation

The consolidated financial statements have been prepared in accordance with International Financial Reporting Standards. The consolidated financial statements have been prepared under the historical cost convention as modified by the revaluation of trading securities, available-for-sale securities and derivative financial instruments as explained in more detail in the following accounting policies. Recognised assets and liabilities that are hedged by derivative financial instruments are also stated at fair value in respect of the risk that is being hedged. The accounting policies have been consistently applied by the Bank and its subsidiaries and are consistent with those of the previous year.

#### 2.2 Consolidation principles

The consolidated financial statements include the accounts of Gulf International Bank B S C. and its subsidiaries. Subsidiary undertakings are companies and other entities, including special purpose entities, in which the Bank holds, directly or indirectly, more than one half of the voting rights, or otherwise has the power to exercise effective control over the financial and operating policies of the entity. All intercompany balances and transactions, including unrealised gains and losses on transactions between Group companies, have been eliminated.

#### 2.3 Trade and settlement date accounting

All regular way purchases and sales of financial assets held for trading are recognised on the trade date, i.e. the date on which the Group commits to purchase or sell the financial asset. All regular way purchases and sales of other financial assets are recognised on the settlement date, i.e. the date on which the asset is delivered to or received from the counterparty. Regular way purchases or sales are purchases or sales of financial assets that require delivery within the time frame generally established by regulation or convention in the market place.

#### 2.4 Foreign currencies

The reporting currency of the Group is the US Dollar. The share capitals of the Bank and its principal subsidiaries are also denominated in US Dollars. Transactions in foreign currencies are converted to US Dollars at the rate of exchange prevailing at the date of the transaction. Monetary assets and liabilities denominated in foreign currencies are translated into US Dollars at market rates of exchange prevailing on the balance sheet date. Realised and unrealised foreign exchange profits and losses are included in other income.

## NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS continued

For the year ended 31<sup>st</sup> December 2004

### 2 ACCOUNTING POLICIES (continued)

#### 2.5 Offsetting

Financial assets and liabilities are only offset and the net amount reported in the consolidated balance sheet when there is a legally enforceable right to set off the recognised amounts and there is an intention to settle on a net basis, or to realise the asset and settle the liability simultaneously

#### 2.6 Derivative financial instruments

Derivative financial instruments are contracts, the value of which is derived from one or more underlying financial instruments or indices, and include futures, forwards, swaps and options in the interest rate, foreign exchange and equity markets

Derivative financial instruments are initially recognised in the consolidated balance sheet at cost, including transaction costs, and subsequently remeasured to fair value. Fair values are derived from prevailing market prices, discounted cash flow models or option pricing models as appropriate. In the consolidated balance sheet, derivative financial instruments with positive fair values (unrealised gains) are included in other assets and derivative financial instruments with negative fair values (unrealised losses) are included in other liabilities.

The changes in the fair values of derivative financial instruments entered into for trading purposes or to hedge other trading positions are included in other income in the consolidated statement of income.

The recognition of changes in the fair values of derivative financial instruments entered into for hedging purposes is determined by the nature of the hedging relationship. For the purposes of hedge accounting, derivative financial instruments are designated as a hedge of either (i) the fair value of a recognised asset or liability (fair value hedge), or (ii) the future cash flows attributable to a recognised asset or liability or a firm commitment (cash flow hedge).

The Group's criteria for a derivative financial instrument to be accounted for as a hedge include -

- the hedging instrument, the related hedged item, the nature of the risk being hedged, and the risk management objective and strategy must be formally documented at the inception of the hedge,
- it must be clearly demonstrated that the hedge is expected to be highly effective in offsetting the changes in fair values or cash flows attributable to the hedged risk in the hedged item,
- the effectiveness of the hedge must be capable of being reliably measured, and
- the hedge must be assessed on an ongoing basis and determined to have actually been highly effective throughout the financial reporting period.

Changes in the fair values of derivative financial instruments that are designated, and qualify, as fair value hedges and that prove to be highly effective in relation to the hedged risk, are included in other income in the consolidated statement of income together with the corresponding change in the fair value of the hedged asset or liability that is attributable to the risk that is being hedged. Unrealised gains and losses arising on hedged assets or liabilities which are attributable to the hedged risk are adjusted against the carrying amounts of the hedged assets or liabilities in the consolidated balance sheet. If the hedge no longer meets the criteria for hedge accounting, any adjustment to the carrying amount of a hedged interest-bearing financial instrument is amortised to income over the remaining period to maturity.

## **2 ACCOUNTING POLICIES (continued)**

### **2.6 Derivative financial instruments (continued)**

Changes in the fair values of derivative financial instruments that are designated, and qualify, as cash flow hedges and that prove to be highly effective in relation to the hedged risk, are recognised in a separate component of shareholders' equity. Unrealised gains or losses recognised in shareholder's equity are transferred to the consolidated statement of income at the same time that the income or expense of the corresponding hedged item is recognised in the income statement and are included in the same income or expense category as the hedged item. Unrealised gains or losses on any ineffective portion of cash flow hedging transactions are recognised in other income in the consolidated statement of income.

The interest component of derivatives that are designated, and qualify, as fair value or cash flow hedges is recognised in interest income or interest expense over the life of the derivative instrument.

Certain derivative transactions, while providing effective economic hedges within the Group's risk management positions, do not qualify for hedge accounting under the specific rules in IAS 39. Such derivative transactions are categorised as derivatives held for trading and related fair value gains and losses included in other income in the consolidated statement of income.

Hedge accounting is discontinued when the derivative hedging instrument either expires or is sold, terminated or exercised, or no longer qualifies for hedge accounting.

### **2.7 Interest income and expense**

Interest income and interest expense are recognised for all interest-bearing financial instruments on an accruals basis using the effective yield method based on the original settlement amount. Loan origination fees are deferred and recognised as an adjustment to the effective yield on the loan. Interest income is suspended when interest or principal on a credit facility is overdue by more than 90 days whereupon all unpaid and accrued interest is reversed from income. Interest on non-accrual facilities is included in income only when received. Credit facilities are restored to accrual status only after all delinquent interest and principal payments have been brought current and future payments are reasonably assured.

### **2.8 Securities financing arrangements**

Securities purchased under agreements to resell (reverse repurchase agreements) and securities sold under agreements to repurchase (repurchase agreements) are treated as collateralised lending and borrowing transactions and are recorded in the consolidated balance sheet at the amounts the securities were initially acquired or sold. Interest earned on reverse repurchase agreements and interest incurred on repurchase agreements are included in interest income and interest expense respectively. Securities purchased under agreements to resell are included in cash and other liquid assets.

### **2.9 Securities**

Trading securities are securities which are either acquired for the purpose of generating a profit from short term fluctuations in price or are included in a portfolio in which a pattern of short-term profit taking exists. Trading securities are initially recognised at cost, including transaction costs, and subsequently remeasured to fair value based on quoted market prices. Realised and unrealised gains and losses are included in other income. Interest earned on trading securities and interest incurred on securities sold but not yet purchased are included in interest income and interest expense respectively.

## NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS continued

For the year ended 31<sup>st</sup> December 2004

### 2. ACCOUNTING POLICIES (continued)

#### 2 9 Securities (continued)

Available-for-sale securities are intended to be held for an indefinite period of time and may be sold in response to needs for liquidity, changes in interest rates or concerns with respect to credit deterioration. Available-for-sale securities are initially recognised at cost, including transaction costs, and subsequently remeasured to fair value based on quoted market prices or amounts derived from cash flow models as appropriate. Unquoted and illiquid equity investments for which fair values cannot be reliably measured are stated at cost less provision for impairment. Unrealised gains and losses arising from changes in the fair values of available-for-sale securities after the adoption of IAS 39 on 1<sup>st</sup> January 2001 are recognised in a separate revaluation reserve in shareholders' equity. The cumulative fair value adjustments on available-for-sale securities which are sold or otherwise disposed of, or become impaired, and which had previously been recognised in shareholder's equity are transferred to the consolidated statement of income.

Dividends received on trading and available-for-sale securities are included in other income.

#### 2 10 Loans and advances

Loans originated by the Group by providing money directly to the borrower or to a sub-participation agent at the drawdown date are categorised as loans originated by the Group. Originated loans are stated at amortised cost less provision for impairment.

Purchased loans, including sub-participations purchased subsequent to the provision of the original loan, which are acquired for the purpose of generating a profit in the short term are categorised as held-for-trading assets. Loans categorised as held-for-trading are initially recognised at cost, including transaction costs, and subsequently remeasured to fair value based on available market prices. Realised and unrealised gains and losses are included in other income. Interest earned on trading loans is included in interest income. Purchased loans which are intended to be held to maturity are categorised as held-to-maturity assets and stated at amortised cost less provision for impairment.

Loans are written off after all restructuring and collection activities have taken place and the possibility of further recovery is considered to be remote. Subsequent recoveries are included in other income.

#### 2 11 Provisions for impairment

A provision for impairment is established where there is objective evidence that the Group will not collect all amounts due, including both principal and interest, in accordance with the contractual terms of the credit facility. The provision for impairment is determined based on the difference between the net carrying amount and the recoverable amount of the financial asset. The recoverable amount is measured as the present value of expected future cash flows, including amounts recoverable from guarantees and collateral, discounted based on the interest rate at the inception of the credit facility or, for debt instruments remeasured to fair value, at the current market rate of interest for a similar financial asset.

Provisions for impairment are also measured and recognised on a portfolio basis where there is objective evidence that probable losses are present in groups of similar credit exposures. These exposures are collectively evaluated for impairment with the provisions for expected losses based on the applicable credit ratings and associated historical default probabilities, loss severity and rating migrations, and reflect the macroeconomic, political and business environment and other pertinent indicators.

Provisions for impairment are released where a subsequent increase in the recoverable amount is related objectively to an event occurring after the provision for impairment was established.

## 2. ACCOUNTING POLICIES (continued)

### 2.12 Other provisions

Other provisions are recognised when the Group has a present legal or constructive obligation as a result of a past event, it is probable that an outflow of resources embodying economic benefits will be required to settle the obligation, and a reliable estimate can be made of the amount of the obligation

### 2.13 Fixed assets

Land is stated at cost. Other fixed assets are stated at cost less accumulated depreciation. Where the carrying amount of a fixed asset is greater than its estimated recoverable amount, the asset is written down to its recoverable amount.

Generally, costs associated with the maintenance of existing computer software are recognised as an expense when incurred. However, expenditure that enhances and extends the benefits of computer software programs beyond their original specifications and lives is recognised as a capital improvement and capitalised as part of the original cost of the software.

### 2.14 Post retirement benefits

The majority of the Group's employees are eligible for post retirement benefits under either defined benefit or defined contribution pension plans which are provided through separate trustee-administered funds or insurance plans. The Group also pays contributions to Government defined contribution pension plans in accordance with the legal requirements in each location.

The Group's contributions to defined contribution pension plans are charged to income in the year to which they relate.

The pension costs for defined benefit pension plans are assessed using the projected unit credit method. The cost of providing pensions is charged to income so as to spread the regular cost of pensions over the service lives of the employees, in accordance with the advice of an independent qualified actuary who conducts a full valuation of the plan every three years. The pension obligation is measured as the present value of the estimated future cash flows using interest rates of government securities which have terms to maturity approximating the terms of the related liability. Actuarial gains and losses are recognised in income over the average remaining service lives of employees.

### 2.15 Deferred income taxes

Deferred income taxes are provided, using the liability method, for temporary differences arising between the tax bases of assets and liabilities and their carrying values for financial reporting purposes. Deferred tax assets are recognised only to the extent that it is probable that future taxable profits will be available against which the unused tax losses and credits can be utilised. Currently enacted tax rates are used to determine deferred income taxes.

### 2.16 Cash and cash equivalents

For the purposes of the consolidated statement of cash flows, cash and cash equivalents comprise cash and other liquid assets.

## NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS continued

For the year ended 31<sup>st</sup> December 2004

### 2 ACCOUNTING POLICIES (continued)

#### 2 17 Segment reporting

A segment is a distinguishable component of the Group that is engaged in providing products or services (business segment) or in providing products or services within a particular economic environment (geographical segment), which is subject to risks and rewards that are different from those of other segments. Segments whose revenue, result or assets comprise 10 per cent or more of the total for all segments are reported separately.

#### 2 18 Fiduciary activities

The Group administers and manages assets owned by clients which are not reflected in the consolidated financial statements. Asset management fees are earned for providing investment management services and for managing mutual fund products. Asset administration fees are earned for providing custodial services. Fees are recognised as the services are provided and are included in other income.

#### 2 19 Comparatives

Where necessary, comparative figures have been adjusted to conform with changes in presentation in the current year.

### 3 CASH AND OTHER LIQUID ASSETS

	31.12.04 US\$ millions	31.12.03 US\$ millions
Cash and balances with banks	63.0	141.9
Certificates of deposit	57.0	38.4
Treasury bills	13.3	21.2
Securities purchased under agreements to resell	11.3	13.5
	<u>144.6</u>	<u>215.0</u>

Certificates of deposit and treasury bills are categorised as assets held-to-maturity and are stated at amortised cost.

### 4 PLACEMENTS WITH BANKS

Placements with banks are categorised as assets held-to-maturity and are stated at cost.

Placements with banks at 31<sup>st</sup> December 2004 included placements with non-bank financial institutions amounting to US\$193.8 million (2003: US\$77.5 million).



## 5. TRADING SECURITIES

	31 12 04 US\$ millions	31 12 03 US\$ millions
Government bonds	315 6	149 6
Listed debt securities	974 0	1,168 0
Unlisted debt securities	6 8	39 8
Managed funds	247 1	159 6
Equities	68 9	66 6
	<u>1,612 4</u>	<u>1,583 6</u>

Managed funds represent funds placed for investment with external asset managers. The funds provide a diversified exposure to foreign exchange, equity and international debt markets.

## 6 AVAILABLE-FOR-SALE SECURITIES

### a) Classification of available-for-sale securities

	31 12 04 US\$ millions	31 12 03 US\$ millions
AAA/Aaa rated debt securities	1,459 2	1,722 4
Debt securities of other investment grade issuers	6,218 4	5,973 0
Other debt securities	186 0	218 5
Equities and equity funds	605 5	537 9
	<u>8,469.1</u>	<u>8,451 8</u>

The Group's available-for-sale securities predominantly comprise higher quality, investment grade-rated debt securities. At 31<sup>st</sup> December 2004, 90.7 per cent of available-for-sale securities were investment grade-rated (2003: 91.0 per cent).

Equities and equity funds principally comprised investments of a structured finance nature managed by international investment banks, the underlying investments of which are high quality, investment-grade rated debt securities.

Debt securities of other investment grade issuers at 31<sup>st</sup> December 2004 included GCC country government securities of US\$913.9 million (2003: US\$1,000.2 million).

## NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS continued

For the year ended 31<sup>st</sup> December 2004

### 6 AVAILABLE-FOR-SALE SECURITIES (continued)

#### b) Provisions for impairment

The movements in the provisions for the impairment of available-for-sale securities were as follows -

	2004 US\$ millions	2003 US\$ millions
At 1 <sup>st</sup> January	92.2	125.6
Exchange rate movements	1.8	3.5
Amounts utilised	(8.5)	(87.7)
Charge for the year	5.2	50.8
At 31 <sup>st</sup> December	90.7	92.2

#### c) Unquoted equity investments

Available-for-sale securities at 31<sup>st</sup> December 2004 included US\$54.2 million (2003 US\$58.9 million) of unquoted equity investments for which fair values cannot be reliably measured. These investments are stated at cost less provision for impairment. They principally comprise investments in managed entities, the underlying investments of which are primarily of either a corporate debt or private equity nature, managed by external specialist managers and international investment banks. There are no active markets or other appropriate methods from which to derive reliable fair values for these investments.

### 7 LOANS AND ADVANCES

	31.12.04 US\$ millions	31.12.03 US\$ millions
Loans originated by the Group	5,211.8	4,079.5
Advances to brokers	591.4	201.3
Loans purchased by the Group		
- held to maturity	197.0	156.1
- held for trading	7.9	44.2
Gross loans and advances	6,008.1	4,481.1
Provisions for impairment	(721.8)	(721.5)
Net loans and advances	5,286.3	3,759.6

#### a) Concentrations of loans and advances

Net loans and advances at 31<sup>st</sup> December 2004 included exposure to GCC country governments of US\$183.1 million (2003 US\$299.8 million) and OECD country central government and agency risk of US\$88.3 million (2003 US\$98.9 million).

There were no significant concentrations by industrial sector at either 31<sup>st</sup> December 2004 or at 31<sup>st</sup> December 2003.

## 7. LOANS AND ADVANCES (continued)

### b) Provisions for impairment

The movements in the provisions for the impairment of loans and advances were as follows -

	2004			2003		
	Specific provision US\$ millions	Non-specific provision US\$ millions	Total US\$ millions	Specific provision US\$ millions	Non-specific provision US\$ millions	Total US\$ millions
At 1 <sup>st</sup> January	539.1	182.4	721.5	560.8	190.4	751.2
Exchange rate and other movements	10.2	-	10.2	20.7	-	20.7
Amounts utilised	(28.5)	-	(28.5)	(54.8)	-	(54.8)
(Release) / charge for the year	(1.2)	19.8	18.6	12.4	(8.0)	4.4
At 31 <sup>st</sup> December	519.6	202.2	721.8	539.1	182.4	721.5

Total specific provisions at 31<sup>st</sup> December 2004 represented 90.2 per cent (2003: 89.1 per cent) of loans against which a specific provision had been made. Total non-specific provisions at 31<sup>st</sup> December 2004 represented 3.7 per cent (2003: 4.7 per cent) of loans which had not been specifically provided against. Total provisions at 31<sup>st</sup> December 2004 exceeded the gross book value of past due loans by US\$189.1 million (2003: US\$159.1 million).

At 31<sup>st</sup> December 2004 there was no accrued but uncollected interest on impaired loans included in interest income (2003: nil).

### c) Past due loans

The gross and net book value of loans for which either principal or interest was over 90 days past due were as follows -

	31.12.04		31.12.03	
	Gross US\$ millions	Net book value US\$ millions	Gross US\$ millions	Net book value US\$ millions
Sovereign	450.1	0.8	440.5	0.8
Corporate	65.6	22.0	108.9	41.3
Financial institutions	17.0	3.8	13.0	0.8
	532.7	26.6	562.4	42.9

## NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS continued

For the year ended 31<sup>st</sup> December 2004

### 7. LOANS AND ADVANCES (continued)

#### c) Past due loans (continued)

The overdue status of past due loans based on original contractual maturities was as follows -

	31 12.04 US\$ millions	31 12 03 US\$ millions
Within 6 months	-	-
7 months to 1 year	-	33 9
2 to 5 years	67 8	73 6
Over 5 years	464 9	454 9
	<u>532 7</u>	<u>562 4</u>

At 31<sup>st</sup> December 2004 uncollected interest-in-suspense on past due loans amounted to US\$681 3 million (2003 US\$522 3 million)

### 8. FIXED ASSETS

	Freehold land US\$ millions	Buildings US\$ millions	Premises and equipment US\$ millions	Total US\$ millions
<b>At 31<sup>st</sup> December 2004</b>				
Cost	8 9	27 2	55 2	91 3
Accumulated depreciation	-	27 0	46 5	73 5
<b>Net book value</b>	<u>8 9</u>	<u>0 2</u>	<u>8.7</u>	<u>17 8</u>
<b>At 31<sup>st</sup> December 2003</b>				
Net book value	8 9	0 5	9 4	18 8

### 9. OTHER ASSETS

	31.12.04 US\$ millions	31 12 03 US\$ millions
Accrued interest, fees and commissions	184 8	156 8
Derivative financial instruments	26 3	35 5
Outstanding security settlements	20 0	12 2
Deferred items	10 2	12 6
Prepaid pension cost	2 1	5 6
Other prepayments	3 0	3 0
Other, including accounts receivable	23 7	24 8
	<u>270 1</u>	<u>250 5</u>

Derivative financial instruments represent the positive fair values of derivative financial instruments entered into for trading purposes, or designated as fair value or cash flow hedges. An analysis of the fair value of derivative financial instruments is set out in Note 25(d).

An analysis of the prepaid pension cost is set out in Note 10.

## 10 POST RETIREMENT BENEFITS

The Group contributes to defined benefit and defined contribution pension plans which cover substantially all its employees

The Bank maintains defined contribution pension plans for the majority of its employees. Contributions are based on a percentage of salary. The amounts to be paid as retirement benefits are determined by reference to the amounts of the contributions and investment earnings thereon. The total cost of contributions to defined contribution pension plans for the year ended 31<sup>st</sup> December 2004 amounted to US\$3.5 million (2003: US\$3.2 million).

The Bank's principal subsidiary, Gulf International Bank (UK) Limited (GIBUK), maintains a defined benefit pension plan for substantially all its employees. The assets of the plan are held independently of the subsidiary's assets in a separate trustee administered fund. The pension costs are charged to income so as to spread the regular cost of the pensions over the service lives of the employees, in accordance with the advice of an independent qualified actuary who conducts a full valuation of the plan every three years using the projected unit credit method. In the intervening years the calculation is updated based on information received from the actuary. The latest full actuarial valuation was carried out at 1<sup>st</sup> January 2004.

The amount recognised in the consolidated balance sheet is analysed as follows -

	31 12 04 US\$ millions	31 12 03 US\$ millions
Fair value of plan assets	100.0	80.2
Present value of fund obligations	134.4	94.1
	(34.4)	(13.9)
Unrecognised actuarial loss	36.5	19.5
Net asset in the consolidated balance sheet	2.1	5.6

The movements in the net asset recognised in the consolidated balance sheet were as follows -

	2004 US\$ millions	2003 US\$ millions
At 1 <sup>st</sup> January	5.6	9.9
Net expense included in staff expenses	(6.6)	(6.2)
Contributions paid	3.1	3.2
Exchange differences	-	(1.3)
At 31 <sup>st</sup> December	2.1	5.6

The amounts recognised in the consolidated statement of income were as follows -

	2004 US\$ millions	2003 US\$ millions
Current service cost	5.9	5.1
Interest cost	6.0	3.9
Expected return on plan assets	(6.0)	(4.1)
Amortisation of actuarial loss	0.7	1.3
Total included in staff expenses	6.6	6.2

The principal actuarial assumptions used for accounting purposes were as follows -

	2004	2003
Discount rate	5.3%	5.8%
Expected return on plan assets	6.8%	7.0%
Future salary increases	4.3%	4.0%
Future increases to pensions in payment	2.8%	2.7%

## NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS continued

For the year ended 31<sup>st</sup> December 2004

### 11 DEPOSITS

Deposits from customers include deposits from central banks

The geographical composition of total deposits was as follows -

	31 12 04 US\$ millions	31 12 03 US\$ millions
GCC countries	6,970.2	6,940.3
Other countries	3,844.3	3,399.8
	<u>10,814.5</u>	<u>10,340.1</u>

GCC deposits comprise deposits from GCC country governments and central banks and other institutions headquartered in the GCC states

### 12. SECURITIES SOLD UNDER AGREEMENTS TO REPURCHASE

The Group enters into collateralised borrowing transactions (repurchase agreements) in the ordinary course of its financing activities. Collateral is provided in the form of securities held within the available-for-sale and trading security portfolios. At 31<sup>st</sup> December 2004, the fair value of available-for-sale and trading securities that had been pledged as collateral under repurchase agreements was US\$3,730.2 million and US\$74.0 million respectively (2003: US\$3,015.5 million and US\$9.0 million respectively).

### 13. OTHER LIABILITIES

	31 12 04 US\$ millions	31 12 03 US\$ millions
Derivative financial instruments	200.5	257.8
Accrued interest	143.8	126.2
Deferred items	66.0	70.7
Minority interests	40.5	84.9
Outstanding security settlements	20.1	45.6
Other, including accounts payable and accrued expenses	54.7	59.3
	<u>525.6</u>	<u>644.5</u>

Derivative financial instruments represent the negative fair values of derivative financial instruments entered into for trading purposes, or designated as fair value or cash flow hedges. An analysis of the fair value of derivative financial instruments is set out in Note 25(d).

Minority interests represent minority interests in fund products managed by the Bank and its subsidiaries. Fund products in which the Bank holds, directly or indirectly, more than half of the net asset value are accounted for on a consolidated basis.

#### 14 TERM FINANCING

	<b>Maturity</b>	<b>31 12 04</b>	<b>31 12 03</b>
		<b>US\$ millions</b>	<b>US\$ millions</b>
Floating rate loans	2005	503.1	501.0
Islamic murabaha term facilities	2005	70.3	70.3
Floating rate loan	2006	55.0	30.0
Islamic murabaha term facilities	2006	82.4	-
Floating rate note	2007	325.0	325.0
Islamic murabaha term facilities	2007	57.4	-
Floating rate loan	2008	6.1	-
Floating rate repo	2007-2009	500.0	500.0
Floating rate loan	2009	50.0	-
Islamic murabaha term facilities	2009	29.0	-
Floating rate loan	2004	-	75.0
		<b>1,678.3</b>	<b>1,501.3</b>

#### 15. SUBORDINATED TERM LOANS

	<b>31 12 04</b>	<b>31 12 03</b>
	<b>US\$ millions</b>	<b>US\$ millions</b>
Floating rate loan due 2011	100.0	100.0
Floating rate loan due 2011	50.0	50.0
	<b>150.0</b>	<b>150.0</b>

The subordinated term loans represent unsecured obligations of the Group and are subordinated in right of payment to the claims of depositors and other creditors of the Group that are not also subordinated. The subordinated loans have been approved for inclusion in Tier 2 capital for capital adequacy purposes by the Bank's regulator, the Bahrain Monetary Agency.

#### 16 SHARE CAPITAL

The authorised share capital at 31<sup>st</sup> December 2004 comprised 3.0 billion shares of US\$1 each (2003: 3.0 billion shares of US\$1 each). The issued share capital at 31<sup>st</sup> December 2004 comprised 1.0 billion shares of US\$1 each (2003: 1.0 billion shares of US\$1 each). All issued shares are fully paid.

## NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS continued

For the year ended 31<sup>st</sup> December 2004

### 17. RESERVES

	Compulsory reserve US\$ millions	Voluntary reserve US\$ millions	Cash flow hedge reserve US\$ millions	Available- for-sale securities revaluation reserve US\$ millions	Total US\$ millions
<b>At 31<sup>st</sup> December 2002</b>	<b>99.6</b>	<b>37.1</b>	<b>11.7</b>	<b>(111.3)</b>	<b>37.1</b>
Arising in the year -					
- Available-for-sale securities net fair value gains	-	-	-	171.4	171.4
- Cash flow hedges net fair value gains	-	-	0.8	-	0.8
Transfers in the year -					
- Transfers to net income	-	-	(4.1)	0.4	(3.7)
Net (losses) / gains recognised directly in equity	-	-	(3.3)	171.8	168.5
Transfers from retained earnings	10.6	10.6	-	-	21.2
<b>At 31<sup>st</sup> December 2003</b>	<b>110.2</b>	<b>47.7</b>	<b>8.4</b>	<b>60.5</b>	<b>226.8</b>
Arising in the year -					
- Available-for-sale securities net fair value gains	-	-	-	56.9	56.9
- Cash flow hedges net fair value losses	-	-	(0.1)	-	(0.1)
Transfers in the year -					
- Transfers to net income	-	-	(3.9)	(7.6)	(11.5)
Net (losses)/gains recognised directly in equity	-	-	(4.0)	49.3	45.3
Transfers from retained earnings	15.0	15.0	-	-	30.0
<b>At 31<sup>st</sup> December 2004</b>	<b>125.2</b>	<b>62.7</b>	<b>4.4</b>	<b>109.8</b>	<b>302.1</b>

In accordance with the Bank's articles of association, 10 per cent of the Bank's net profit for the year is required to be transferred to each of the compulsory and voluntary reserves. Transfers to the non-distributable compulsory reserve are required until such time as this reserve represents 50 per cent of the issued share capital of the Bank. The voluntary reserve may be utilised at the discretion of the Board of Directors.

### 18. DIVIDENDS

Dividends are not accounted for until they have been ratified at the general assembly meeting. The dividend ratified in respect of 2004 will be accounted for in shareholders' equity as an appropriation of retained earnings in the year ending 31<sup>st</sup> December 2005.

### 19. OTHER INCOME

	2004 US\$ millions	2003 US\$ millions
Dividend income	32.8	23.7
Profit on trading securities	23.9	39.6
Investment banking and management fees	23.6	18.8
Profit on available-for-sale securities	23.2	15.6
Commissions on letters of credit and guarantee	10.1	8.9
Profit on foreign exchange	6.5	11.2
Other fee and sundry income	3.4	2.5
	<b>123.5</b>	<b>120.3</b>



## 19 OTHER INCOME (continued)

Dividend income comprised dividends received of US\$7.6 million and US\$25.2 million from equities and equity funds in the trading and available-for-sale security portfolios respectively (2003: US\$2.2 million and US\$21.5 million respectively). The funding cost in respect of the equities and equity funds is included in interest expense in the consolidated statement of income.

Investment banking and management fees comprised fees relating to the provision of investment management and financial services, including asset and fund management, underwriting activities and services relating to structured financing, privatisations, IPO's, and mergers and acquisitions.

## 20. SEGMENTAL INFORMATION

Segmental information is presented in respect of the Group's business and geographical segments. The primary reporting format, business segments, is based on the products and services provided or the type of customer serviced and reflects the manner in which financial information is evaluated by management and the Board of Directors.

### a) Business segments

For financial reporting purposes, the Group is organised into three main business segments -

- Corporate and institutional banking - the provision of wholesale commercial financing and other credit facilities for corporate and institutional customers
- Treasury and financial markets - the provision of a broad range of treasury and capital market products and services to corporate and financial institution clients, money market, proprietary trading and investment activities and the management of the Group's balance sheet, including funding
- Investment management and banking - the provision of investment management and financial advisory services, including asset management and services relating to structured financing, privatisations, IPO's and mergers and acquisitions

The results reported for the business segments are based on the Group's internal financial reporting systems. The accounting policies of the segments are the same as those applied in the preparation of the Group's consolidated financial statements as set out in Note 2. Transactions between business segments are conducted on normal commercial terms and conditions. Transfer pricing between the business units is based on the market cost of funds.

Segment results, assets and liabilities comprise items directly attributable to the business segments. The corporate and other category comprises items which are not directly attributable to specific business segments, including investments of a strategic nature and the investment of, and earnings on, the Group's net free capital. Unallocated overheads and exceptional charges are reported separately.

## NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS continued

For the year ended 31<sup>st</sup> December 2004

### 20 SEGMENTAL INFORMATION (continued)

The business segment analysis is as follows -

	Corporate and institutional banking US\$ millions	Treasury and financial markets US\$ millions	Investment management and banking US\$ millions	Corporate and other US\$ millions	Total US\$ millions
<b>2004</b>					
Net interest and other income	51.0	163.4	15.7	42.7	272.8
Segment result	40.5	144.1	7.4	41.6	233.6
Unallocated overhead					(85.2)
Taxation credit on overseas activities					1.8
Net income after tax					150.2
Segment assets	5,357.5	13,500.2	-	229.1	19,086.8
Segment liabilities	-	16,311.9	-	1,240.2	17,552.1
Shareholders' equity					1,534.7
Total liabilities and shareholders' equity					19,086.8
<b>2003</b>					
Net interest and other income	40.4	138.3	12.8	40.9	232.4
Segment result	31.1	119.5	4.9	39.4	194.9
Unallocated overhead					(88.6)
Taxation charge on overseas activities					(0.2)
Net income after tax					106.1
Segment assets	3,813.5	13,334.3	-	154.6	17,302.4
Segment liabilities	-	14,838.1	-	1,075.5	15,913.6
Shareholders' equity					1,388.8
Total liabilities and shareholders' equity					17,302.4

## 20 SEGMENTAL INFORMATION (continued)

### b) Geographical segments

Although the Group's three main business segments are managed on a worldwide basis, they are considered to operate in two geographical markets: the GCC and the rest of the world.

The geographical composition of net interest and other income based on the location in which transactions are booked and income is recorded was as follows:

	2004 US\$ millions	2003 US\$ millions
GCC countries	182.2	174.5
Other countries	90.6	57.9
	<u>272.8</u>	<u>232.4</u>

The geographical analyses of deposits and risk assets are set out in Notes 11 and 22 respectively.

## 21. RISK MANAGEMENT

The principal risks associated with the Group's businesses are credit risk, market risk, liquidity risk and operational risk. The Group has a comprehensive risk management framework in place for managing these risks which is constantly evolving as the business activities change in response to credit, market, product and other developments. The risk management framework is guided by a number of overriding principles including the formal definition of risk management governance, an evaluation of risk appetite expressed in terms of formal risk limits, risk oversight independent of business units, disciplined risk assessment and measurement including Value-at-Risk (VaR) methodologies and portfolio stress testing, and risk diversification. The Board of Directors set the Group's overall risk parameters and risk tolerances, and the significant risk management policies. A Board Risk Policy Committee reviews and reports to the Board of Directors on the Group's risk profile and risk taking activities. A Management Committee, chaired by the Group Chief Executive Officer, has the primary responsibility for sanctioning risk taking activities and risk management policies within the overall risk parameters and tolerances defined by the Board of Directors. A Group Risk Committee, under the chairmanship of the Chief Operating Officer and comprising the Group's most senior risk professionals, provides a forum for the review and approval of risk measurement methodologies, risk control processes and the approval of new products. The Group Risk Committee also reviews all risk policies and limits that require the formal approval of the Management Committee. The risk management control process is based on a detailed structure of policies, procedures and limits, and comprehensive risk measurement and management information systems for the control, monitoring and reporting of risks. Periodic reviews by internal and external auditors and regulatory authorities subject the risk management processes to additional scrutiny which help to further strengthen the risk management environment.

## NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS continued

For the year ended 31<sup>st</sup> December 2004

### 21 RISK MANAGEMENT (continued)

The principal risks associated with the Group's businesses and the related risk management processes are commented on as follows -

#### Credit risk

Credit risk is the risk that counterparties will be unable to meet their obligations to the Group. Credit risk arises principally from the Group's lending and investment activities in addition to other transactions involving both on and off balance sheet financial instruments. Disciplined processes are in place at both the business unit and corporate level that are intended to ensure that risks are accurately assessed and properly approved and monitored. Formal credit limits are applied at the individual transaction, counterparty, country and portfolio levels. Overall exposures are also evaluated to ensure a broad diversification of credit risk. The credit management process involves the monitoring of concentrations by product, industry, single obligor, risk grade and geography, and the regular appraisal of counterparty credit quality through the analysis of qualitative and quantitative information. The Group also mitigates its credit exposures on foreign exchange and derivative financial instruments through the use of master netting agreements and collateral arrangements.

The geographical distribution of risk assets is set out in Note 22. An analysis of the credit risk in respect of foreign exchange and derivative financial instruments is set out in Note 25 while the notional and risk-weighted exposures for credit-related financial instruments are detailed in Note 26.

#### Market risk

Market risk is the risk of loss due to adverse changes in interest rates, foreign exchange rates, equity prices and market conditions, such as liquidity. The principal market risks to which the Group is exposed are interest rate risk, foreign exchange risk and equity price risk associated with its trading, investment and asset and liability management activities. The portfolio effects of holding a diversified range of instruments across a variety of businesses and geographic areas contribute to a reduction in the potential negative impact on earnings from market risk factors.

- **Trading market risk** The Group's trading activities principally comprise trading in debt and equity securities, foreign exchange and derivative financial instruments. Derivative financial instruments include futures, forwards, swaps and options in the interest rate, foreign exchange and equity markets. The Group manages and controls the market risk within its trading portfolios through limit structures of both a VaR and non-VaR nature. Non-VaR based constraints relate, inter alia, to positions, volumes, concentrations, allowable losses and maturities. VaR is a risk measurement concept which uses statistical models to estimate, within a given level of confidence, the maximum potential negative change in the market value of a portfolio over a specified time horizon resulting from an adverse movement in rates and prices. The Group supplements daily VaR calculations with portfolio stress testing which measures the impact of simulated abnormal changes in market rates and prices on the market values of the portfolios. It is recognised that VaR is not a measure of the absolute limit of market risk and that losses in excess of the VaR amounts will, on occasion, arise. The composition of the debt and equity trading securities is set out in Note 5. An analysis of derivative financial instruments, including the VaR of foreign exchange and derivative trading contracts, is set out in Note 25.

## 21. RISK MANAGEMENT (continued)

### Market risk (continued)

The VaR by risk class for the Group's trading positions, as calculated in accordance with the basis set out in Note 28, was as follows -

	31 12 04 US\$ millions	2004 average US\$ millions	31 12 03 US\$ millions	2003 average US\$ millions
Interest rate risk	5.5	4.8	4.4	4.6
Foreign exchange risk	1.1	1.3	2.5	1.5
Equity risk	3.1	2.4	1.7	2.4
Total diversified risk	7.1	6.4	7.0	8.0

- Non-trading market risk: Structural interest rate risk arises in the Group's core balance sheet as a result of mismatches in the repricing of interest rate sensitive financial assets and liabilities. The associated interest rate risk is managed within VaR limits and through the use of models to evaluate the sensitivity of earnings to movements in interest rates. The repricing profile and related interest rate sensitivity of the Group's financial assets and liabilities is set out in Note 24. The Group does not maintain material non trading foreign currency open positions. In general, the Group's policy is to match assets and liabilities in the same currency or to mitigate currency risk through the use of currency swaps. Details of significant foreign currency net open positions are set out in Note 25(e).

The more significant market risk-related activities of a non-trading nature undertaken by the Group, the related risks associated with those activities and the types of derivative financial instruments used to manage and mitigate such risks are summarised as follows -

Activity	Risk	Risk mitigant
Management of the return on variable rate assets funded by shareholders' funds	Reduced profitability due to a fall in short term interest rates	Receive fixed interest rate swaps
Fixed rate assets funded by floating rate liabilities	Sensitivity to increases in short term interest rates	Pay fixed interest rate swaps
Investment in foreign currency assets	Sensitivity to strengthening of US\$ against other currencies	Currency swaps
Profits generated in foreign currencies	Sensitivity to strengthening of US\$ against other currencies	Forward foreign exchange contracts and purchased currency options

## NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS continued

For the year ended 31<sup>st</sup> December 2004

### 21. RISK MANAGEMENT (continued)

#### Liquidity risk

Liquidity management policies are designed to ensure that funds are available at all times to meet the funding requirements of the Group, even in adverse conditions. In normal conditions the objective is to ensure that there are sufficient funds available not only to meet current financial commitments but also to facilitate business expansion. These objectives are met through the application of prudent liquidity controls. These controls provide security of access to funds without undue exposure to increased costs from the liquidation of assets or the aggressive bidding for deposits. The Group's liquidity controls ensure that, over the short term, the future profile of cash flows from maturing assets is adequately matched to the maturity of liabilities. Liquidity controls also provide for the maintenance of a stock of liquid and readily realisable assets and a diversified deposit base in terms of both maturities and range of depositors.

An analysis of available-for-sale securities by rating classification is set out in Note 6 (a). The maturity profile of assets and liabilities is set out in Note 23.

#### Operational risk

Operational risk is the risk of unexpected losses resulting from inadequate or failed internal controls or procedures, systems failures, fraud, business interruption, compliance breaches, human error, management failure or inadequate staffing.

A framework and methodology has been developed to identify and control the various operational risks. While operational risk cannot be entirely eliminated, it is managed and mitigated by ensuring that the appropriate infrastructure, controls, systems, procedures and trained and competent people are in place throughout the Group. A strong internal audit function makes regular, independent appraisals of the control environment in all identified risk areas. Adequately tested contingency arrangements are also in place to support operations in the event of a range of possible disaster scenarios.

### 22. GEOGRAPHICAL DISTRIBUTION OF RISK ASSETS

	31.12.04				31.12.03
	Placements & other liquid assets	Securities	Loans and advances	Credit-related contingent items	Total
	US\$ millions	US\$ millions	US\$ millions	US\$ millions	US\$ millions
GCC	1,174.1	1,161.9	3,921.7	1,888.6	8,146.3
Other Middle East & North Africa	146.3	88.2	274.3	79.5	588.3
Europe	1,625.9	3,471.6	762.2	201.6	6,061.3
North America	139.6	4,818.1	188.5	259.5	5,405.7
Asia	345.2	390.7	139.6	-	875.5
Latin America	-	151.0	-	-	151.0
	<u>3,431.1</u>	<u>10,081.5</u>	<u>5,286.3</u>	<u>2,429.2</u>	<u>21,228.1</u>
					<u>19,127.4</u>

An analysis of derivative and foreign exchange instruments is set out in Note 25.

## 23 MATURITIES OF ASSETS AND LIABILITIES

The maturity profile of assets and liabilities based on the remaining periods to contractual maturity dates was as follows -

	Within 3 months US\$ millions	4 months to 1 year US\$ millions	Years 2 and 3 US\$ millions	Years 4 and 5 US\$ millions	Over 5 years and other US\$ millions	Total US\$ millions
<b>At 31<sup>st</sup> December 2004</b>						
Cash and other liquid assets	116.6	28.0	-	-	-	144.6
Placements	3,088.1	198.4	-	-	-	3,286.5
Trading securities	1,612.4	-	-	-	-	1,612.4
Available-for-sale securities	44.5	745.6	1,109.8	1,227.4	5,341.8	8,469.1
Loans and advances	1,613.7	962.1	1,370.0	606.7	733.8	5,286.3
Fixed & other assets	202.8	42.6	-	-	42.5	287.9
<b>Total assets</b>	<b>6,678.1</b>	<b>1,976.7</b>	<b>2,479.8</b>	<b>1,834.1</b>	<b>6,118.1</b>	<b>19,086.8</b>
Deposits	9,502.4	1,220.9	91.2	-	-	10,814.5
Securities sold under agreements to repurchase	2,766.5	1,052.3	-	-	-	3,818.8
Securities sold but not yet purchased	564.9	-	-	-	-	564.9
Other liabilities	255.5	44.3	21.6	23.7	180.5	525.6
Term financing	10.0	563.4	719.8	385.1	150.0	1,828.3
Shareholders' equity	-	-	-	-	1,534.7	1,534.7
<b>Liabilities &amp; shareholders' equity</b>	<b>13,099.3</b>	<b>2,880.9</b>	<b>832.6</b>	<b>408.8</b>	<b>1,865.2</b>	<b>19,086.8</b>
<b>At 31<sup>st</sup> December 2003</b>						
<b>Total assets</b>	<b>5,889.9</b>	<b>1,386.0</b>	<b>2,043.2</b>	<b>1,656.2</b>	<b>6,327.1</b>	<b>17,302.4</b>
<b>Liabilities &amp; shareholders' equity</b>	<b>11,778.1</b>	<b>2,189.6</b>	<b>656.4</b>	<b>753.8</b>	<b>1,924.5</b>	<b>17,302.4</b>

The asset and liability maturities are based on contractual repayment arrangements and as such do not take account of the effective maturities of deposits as indicated by the Group's deposit retention records. Counterparties each with deposits over US\$10.0 million at 31<sup>st</sup> December 2004 had average deposits throughout 2004 amounting to US\$9,508.3 million (2003 US\$8,849.6 million). Formal liquidity controls are nevertheless based on contractual asset and liability maturities.

## NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS continued

For the year ended 31<sup>st</sup> December 2004

### 24. INTEREST RATE RISK

The repricing profile and effective interest rates of the various asset and liability categories were as follows -

	Within 3 months US\$ millions	Months 4 to 6 US\$ millions	Months 7 to 12 US\$ millions	Over 1 year US\$ millions	Non-interest bearing items US\$ millions	Total US\$ millions	Effective Interest Rates %
<b>At 31<sup>st</sup> December 2004</b>							
Cash and other liquid assets	116.6	28.0	-	-	-	144.6	1.58
Placements	2,838.1	212.4	61.0	175.0	-	3,286.5	2.74
Trading securities	1,296.4	-	-	-	316.0	1,612.4	4.82
Available-for-sale securities -							
- Fixed rate	-	216.2	107.9	357.5	-	681.6	3.13
- Floating rate	6,293.2	826.8	62.0	-	-	7,182.0	3.27
- Equities & equity funds	-	-	-	-	605.5	605.5	-
Loans and advances	3,994.0	1,319.7	161.9	12.9	(202.2)	5,286.3	3.38
Fixed & other assets	-	-	-	-	287.9	287.9	-
<b>Total assets</b>	<b>14,538.3</b>	<b>2,603.1</b>	<b>392.8</b>	<b>545.4</b>	<b>1,007.2</b>	<b>19,086.8</b>	
Deposits	9,575.0	1,009.3	230.2	-	-	10,814.5	2.28
Securities sold under agreements to repurchase	3,284.2	284.6	250.0	-	-	3,818.8	2.10
Securities sold but not yet purchased	564.9	-	-	-	-	564.9	2.03
Other liabilities	-	-	-	-	525.6	525.6	-
Term financing	1,793.0	35.3	-	-	-	1,828.3	2.55
Shareholders' equity	-	-	-	-	1,534.7	1,534.7	-
Liabilities & shareholders' equity	15,217.1	1,329.2	480.2	-	2,060.3	19,086.8	
Interest rate sensitivity gap	(678.8)	1,273.9	(87.4)	545.4	(1,053.1)		
Cumulative interest rate sensitivity gap	(678.8)	595.1	507.7	1,053.1	-	-	
<b>At 31<sup>st</sup> December 2003</b>							
Cumulative interest rate sensitivity gap	285.2	1,635.7	819.1	1,250.5	-	-	



## 24 INTEREST RATE RISK (continued)

The repricing profile is based on the remaining period to the next interest repricing date. The repricing profile of placements incorporates the effect of interest rate swaps used to lock-in a return on the Group's net free capital funds. Derivative financial instruments that have been used for asset and liability management purposes to hedge exposure to interest rate risk are incorporated in the repricing profiles of the related hedged assets and liabilities. The non-specific loan provision is deducted from non-interest bearing assets.

The substantial majority of assets and liabilities reprice within one year. Accordingly there is a limited exposure to interest rate risk. The principal interest rate risk beyond one year as set out in the asset and liability repricing profile, represents investments in fixed rate government securities with a maximum original maturity of two years. At 31<sup>st</sup> December 2004 the modified duration of these fixed rate government securities was 1.2. Modified duration represents the approximate percentage change in the portfolio value resulting from a 100 basis point change in yield. More precisely in dollar terms, the price value of a basis point of the fixed rate government securities was US\$25,000.

Based on the repricing profile at 31<sup>st</sup> December 2004, and assuming that the financial assets and liabilities were to remain until maturity or settlement with no action taken by the Group to alter the interest rate risk exposure, an immediate and sustained 1 per cent increase in interest rates across all maturities would result in a reduction in net income before tax for the following year and in the Group's equity by approximately US\$6.1 million and US\$7.6 million respectively (2003: US\$7.4 million and US\$9.4 million respectively). The impact on the Group's equity represents the cumulative effect of the increase in interest rates over the entire duration of the mismatches in the repricing profile of the interest rate sensitive financial assets and liabilities.

The Value-at Risk by risk class for the Group's trading positions is set out in Note 21. The market risk relating to foreign exchange and derivative trading instruments is set out in Note 25.

## 25 DERIVATIVE AND FOREIGN EXCHANGE INSTRUMENTS

The Group utilises derivative and foreign exchange instruments to meet the needs of its customers, to generate trading revenues and as part of its asset and liability management (ALM) activity to hedge its own exposure to market risk. Derivative instruments are contracts whose value is derived from one or more financial instruments or indices. They include futures, forwards, swaps and options in the interest rate, foreign exchange and equity markets. Derivatives and foreign exchange are subject to the same types of credit and market risk as other financial instruments. The Group has appropriate and comprehensive Board-approved policies and procedures for the control of exposure to both market and credit risk from its derivative and foreign exchange activities.

In the case of derivative transactions, the notional principal typically does not change hands. It is simply a quantity which is used to calculate payments. While notional principal is a volume measure used in the derivative and foreign exchange markets, it is neither a measure of market nor credit risk. The Group's measure of credit exposure is the cost of replacing contracts at current market rates should the counterparty default prior to the settlement date. Credit risk amounts represent the gross unrealised gains on non-margined transactions before taking account of any collateral held or any master netting agreements in place.

## NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS continued

For the year ended 31<sup>st</sup> December 2004

### 25. DERIVATIVE AND FOREIGN EXCHANGE INSTRUMENTS (continued)

The Group participates in both exchange traded and over-the-counter (OTC) derivative markets. Exchange traded instruments are executed through a recognised exchange as standardised contracts and primarily comprise futures and options. OTC contracts are executed between two counterparties who negotiate specific agreement terms, including the underlying instrument, notional amount, maturity and, where appropriate, exercise price. In general, the terms and conditions of these transactions are tailored to the requirements of the Group's customers although conform to normal market practice. Industry standard documentation is used, most commonly in the form of a master agreement. The existence of a master netting agreement is intended to provide protection to the Group in the event of a counterparty default.

The Group's principal foreign exchange transactions are forward foreign exchange contracts, currency swaps and currency options. Forward foreign exchange contracts are agreements to buy or sell a specified quantity of foreign exchange on a specific future date at an agreed rate. A currency swap involves the exchange, or notional exchange, of equivalent amounts of two currencies and a commitment to exchange interest periodically until the principal amounts are re-exchanged on a specified future date. Currency options provide the buyer with the right, but not the obligation, either to purchase or sell a fixed amount of a currency at a specified exchange rate on or before a specified future date. As compensation for assuming the option risk, the option seller (or writer) receives a premium at the start of the option period.

The Group's principal interest rate-related derivative transactions are interest rate swaps, forward rate agreements, futures and options. An interest rate swap is an agreement between two parties to exchange fixed rate and floating rate interest by means of periodic payments based upon a notional principal amount and the interest rates defined in the contract. Certain agreements combine interest rate and foreign currency swap transactions, which may or may not include the exchange of principal amounts. In a forward rate agreement, two parties agree a future settlement of the difference between an agreed rate and a future interest rate, applied to a notional principal amount for an agreed period. The settlement, which generally occurs at the start of the contract period, is the discounted present value of the payment that would otherwise be made at the end of that period. An interest rate future is an exchange traded contract for the delivery of a standardised amount of a fixed income security or time deposit at a future specified date. Interest rate options, including caps, floors and collars, provide the buyer with the right, but not the obligation, either to purchase or sell an interest rate financial instrument at a specified price or rate on or before a specified future date.

The Group's principal equity related derivative transactions are equity and stock index options. An equity option provides the buyer with the right, but not the obligation, either to purchase or sell a specified stock or index at a specified price or level on or before a specified future date.

## 25 DERIVATIVE AND FOREIGN EXCHANGE INSTRUMENTS (continued)

### a) Product analysis

The table below summarises the aggregate notional and credit risk amounts of foreign exchange and interest rate-related derivative contracts

	Trading US\$ millions	Notional amounts Hedging US\$ millions	Total US\$ millions	Credit risk amounts US\$ millions
<b>At 31<sup>st</sup> December 2004</b>				
Foreign exchange contracts -				
Unmatured spot, forward and futures contracts	2,265 1	2,449 3	4,714 4	39 0
Options purchased	24 5	-	24 5	0 1
Options written	19 1	-	19 1	-
	<u>2,308 7</u>	<u>2,449 3</u>	<u>4,758 0</u>	<u>39 1</u>
Interest rate contracts -				
Futures	1,614 3	-	1,614 3	-
Interest rate swaps and swaptions	1,229.8	5,873 0	7,102 8	22 7
Options, caps and floors purchased	-	13.6	13 6	-
	<u>2,844 1</u>	<u>5,886 6</u>	<u>8,730 7</u>	<u>22 7</u>
Equity contracts -				
Contracts for differences	30 4	-	30.4	0 8
<b>Total</b>	<u>5,183.2</u>	<u>8,335 9</u>	<u>13,519.1</u>	<u>62 6</u>
<b>At 31<sup>st</sup> December 2003</b>				
<b>Total</b>	<u>15,651 9</u>	<u>8,816 1</u>	<u>24,468 0</u>	<u>94 2</u>

Financial futures are exchange traded and therefore not subject to credit risk. There is no credit risk in respect of options, caps and floors written as they represent obligations of the Group.

At 31<sup>st</sup> December 2004 the Value-at-Risk of the foreign exchange, interest rate and equity-related derivative trading contracts analysed in the table above, as calculated in accordance with the basis set out in Note 28, was US\$1.4 million, US\$0.2 million and nil respectively (2003: US\$1.7 million, US\$0.5 million and nil respectively). Value-at-Risk is a measure of market risk exposure and is accordingly separate and in addition to the credit risk exposure represented by the credit risk amounts in the table above.

### b) Counterparty analysis

	31 12 04			31 12 03
Credit risk amounts	Government US\$ millions	Banks US\$ millions	Other US\$ millions	Total US\$ millions
OECD countries	-	46 3	0 8	47 1
GCC countries	1 1	2.3	11 4	14 8
Other countries	-	0.7	-	0 7
	<u>1 1</u>	<u>49 3</u>	<u>12 2</u>	<u>62 6</u>
				<u>94 2</u>

Credit risk is concentrated on major OECD-based banks.

## NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS continued

For the year ended 31<sup>st</sup> December 2004

### 25 DERIVATIVE AND FOREIGN EXCHANGE INSTRUMENTS (continued)

#### c) Maturity analysis

Notional amounts	Year 1	Years 2 & 3	Years 4 & 5	Over 5 years	Total
	US\$ millions	US\$ millions	US\$ millions	US\$ millions	US\$ millions
<b>At 31<sup>st</sup> December 2004</b>					
Foreign exchange contracts	4,754.4	-	3.6	-	4,758.0
Interest rate contracts	3,821.8	1,825.3	1,323.9	1,759.7	8,730.7
Equity contracts	-	-	-	30.4	30.4
<b>Total</b>	<b>8,576.2</b>	<b>1,825.3</b>	<b>1,327.5</b>	<b>1,790.1</b>	<b>13,519.1</b>
<b>At 31<sup>st</sup> December 2003</b>					
<b>Total</b>	<b>18,982.8</b>	<b>2,988.5</b>	<b>561.1</b>	<b>1,935.6</b>	<b>24,468.0</b>

The Group's derivative and foreign exchange activities are predominantly short-term in nature. Transactions with maturities over one year represent either fully offset trading transactions or transactions that are designated, and qualify, as fair value and cash flow hedges.

#### d) Fair value analysis

	31 12 04		31 12 03	
	Positive fair value US\$ millions	Negative fair value US\$ millions	Positive fair value US\$ millions	Negative fair value US\$ millions
Derivatives held for trading -				
Forward foreign exchange contracts	8.1	(14.1)	6.8	(20.1)
Foreign exchange options	0.4	(0.4)	-	-
Interest rate futures	0.1	-	-	(0.4)
Interest rate swaps and swaptions	13.2	(12.5)	19.0	(24.0)
Interest rate options, caps and floors	-	-	4.0	(4.0)
Equities - contracts for differences	0.8	-	-	-
	<b>22.6</b>	<b>(27.0)</b>	<b>29.8</b>	<b>(48.5)</b>
Derivatives held as fair value hedges -				
Interest rate swaps	3.7	(172.6)	5.7	(209.3)
Derivatives held as cash flow hedges -				
Interest rate swaps	-	(0.9)	-	-
Gross positive/(negative) fair value	<b>26.3</b>	<b>(200.5)</b>	<b>35.5</b>	<b>(257.8)</b>
Effect of master netting agreements	-	-	-	-
<b>Net amount included in other assets/(other liabilities)</b>	<b>26.3</b>	<b>(200.5)</b>	<b>35.5</b>	<b>(257.8)</b>

#### e) Significant net open positions

There were no significant derivative trading or foreign currency net open positions at either 31<sup>st</sup> December 2004 or at 31<sup>st</sup> December 2003.

## 26 CREDIT-RELATED FINANCIAL INSTRUMENTS

Credit-related financial instruments include commitments to extend credit, standby letters of credit and guarantees which are designed to meet the financing requirements of customers. The credit risk on these transactions is generally less than the contractual amount. The table below sets out the notional principal amounts of outstanding credit-related contingent items and the risk-weighted exposures calculated in accordance with the capital adequacy guidelines of the Basel Committee on Banking Supervision.

	31.12.04		31.12.03	
	Notional principal amount US\$ millions	Risk- weighted exposure US\$ millions	Notional principal amount US\$ millions	Risk- weighted exposure US\$ millions
Direct credit substitutes	141.7	113.2	104.6	103.4
Transaction-related contingent items	645.7	317.3	573.7	277.0
Short-term self-liquidating trade-related contingent items	175.4	23.5	215.5	31.1
Commitments, including undrawn loan commitments and underwriting commitments under note issuance and revolving facilities	1,466.4	623.8	1,200.5	515.5
	<u>2,429.2</u>	<u>1,077.8</u>	<u>2,094.3</u>	<u>927.0</u>

## 27. CONTINGENT LIABILITIES

### Litigation

The Bank and its subsidiaries are engaged in litigation in various jurisdictions. The litigation involves claims by and against Group companies which have arisen in the ordinary course of business. The directors of the Bank, after reviewing the claims pending against Group companies and based on the advice of relevant professional legal advisors, are satisfied that the outcome of these claims will not have a material adverse effect on the financial position of the Group.

## NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS continued

For the year ended 31<sup>st</sup> December 2004

### 28. CAPITAL ADEQUACY

The risk asset ratio calculated in accordance with the capital adequacy guidelines of the Basel Committee on Banking Supervision was as follows -

	31 12 04	31 12 03		
	US\$ millions	US\$ millions		
<b>Regulatory capital base</b>				
Tier I capital				
Shareholders' equity	1,534 7	1,388 8		
Adjustment to exclude net fair value gains	(101 7)	(53 2)		
Adjusted Tier I capital	1,433 0	1,335 6		
Tier II capital				
Subordinated loans	150 0	150 0		
Non-specific loan provision subject to 1.25% risk-weighted exposure limitation	191 3	166 2		
Fair value gain on marketable equity securities classified as available-for-sale	-	5 8		
Total Tier II capital	341 3	322 0		
<b>Total regulatory capital base</b>	<b>(a) 1,774 3</b>	<b>1,657 6</b>		
<b>Risk-weighted exposure</b>				
	Notional principal amount US\$ millions	Risk-weighted exposure US\$ millions	Notional principal amount US\$ millions	Risk-weighted exposure US\$ millions
<i>Credit risk</i>				
Balance sheet items				
Cash and other liquid assets	144.6	23 0	215 0	38 2
Placements	3,286.5	800 4	3,023 1	656 7
Securities	10,081 5	7,227 0	10,035 4	7,079 6
Loans and advances	5,286 3	4,523 9	3,759 6	3,346 5
Fixed & other assets	287.9	183 4	269 3	169 3
	19,086 8	12,757 7	17,302 4	11,290 3
Off-balance sheet items				
Credit-related contingent items	2,429 2	1,077 8	2,094 3	927 0
Foreign exchange-related items	4,758.0	14 9	5,223 4	12 0
Interest rate-related items	8,730.7	8 9	19,240 6	8 6
Equity-related items	30.4	0 8	-	-
	15,948 3	1,102 4	26,558 3	947 6
Credit risk-weighted exposure		13,860 1		12,237 9
<i>Market risk</i>				
General market risk		362 6		339 1
Specific market risk		1,083 0		717 5
Market risk-weighted exposure		1,445.6		1,056 6
<b>Total risk-weighted exposure</b>	<b>(b)</b>	<b>15,305 7</b>		<b>13,294 5</b>
<b>Risk asset ratio [ (a)/(b) x 100 ]</b>		<b>11 6%</b>		<b>12 5%</b>

## 28 CAPITAL ADEQUACY (continued)

In accordance with the capital adequacy guidelines of the Bank's regulator, the Bahrain Monetary Agency (BMA), revaluation gains and losses arising on the remeasurement to fair value of available-for-sale securities and derivative cash flow hedging transactions are excluded from Tier I capital with the exception of losses arising on the remeasurement to fair value of marketable equity securities classified as available-for-sale. In accordance with the BMA's guidelines, gains arising on the remeasurement to fair value of marketable equity securities classified as available-for-sale are included in Tier II capital. At 31<sup>st</sup> December 2004 there were no fair value gains or losses in relation to equity securities classified as available-for-sale (2003: net fair value gain of US\$5.8 million).

The Group calculates the capital requirement for general market risk using a Value-at Risk model in accordance with the provisions of the Amendment to the Capital Accord to Incorporate Market Risks issued by the Basel Committee in January 1996. The use of the internal model approach for the calculation of the capital requirement for general market risk has been approved by the Bank's regulator, the BMA. The multiplication factor to be applied to the Value-at Risk calculated by the internal model has been set at the regulatory minimum of 3.0 (2003: 3.0) by the BMA.

Value-at-Risk is calculated based on a 99 per cent confidence level, a ten-day holding period and a twelve-month historical observation period of unweighted data from the DataMetrics™ regulatory data set. Correlations across broad risk categories are excluded. Prescribed additions in respect of specific risk are made to the general market risk. The resultant measure of market risk is multiplied by 12.5, the reciprocal of the 8 per cent minimum capital ratio, to give market risk-weighted exposure on a basis consistent with credit risk-weighted exposure.

## 29 FIDUCIARY ACTIVITIES

The Group conducts investment management and other fiduciary activities on behalf of clients. Assets held in trust or in a fiduciary capacity are not assets of the Group and accordingly have not been included in the consolidated financial statements. The aggregate amount of the funds concerned at 31<sup>st</sup> December 2004 was US\$13,583.7 million (2003: US\$11,348.0 million).

## 30 FAIR VALUE OF FINANCIAL INSTRUMENTS

The table set out on the next page compares the estimated fair values of all on- and off-balance sheet financial instruments with their respective book values. With the exception of trading securities, available-for-sale securities and derivative financial instruments, the Group's financial instruments are accounted for under the historical cost method. By contrast the fair value represents the amount at which an asset could be exchanged, or a liability settled, in a transaction between knowledgeable, willing parties in an arm's length transaction. Differences therefore can arise between book values under the historical cost method and fair value estimates. Underlying the definition of fair value is the presumption that the Group is a going concern without any intention or requirement to curtail materially the scale of its operation or to undertake a transaction on adverse terms. Generally accepted methods of determining fair value include reference to quoted market prices or to the pricing prevailing for similar financial instruments and the use of estimation techniques such as discounted cash flow analysis.

## NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS continued

For the year ended 31<sup>st</sup> December 2004

### 30 FAIR VALUE OF FINANCIAL INSTRUMENTS (continued)

	Book value US\$ millions	Fair value US\$ millions	Excess US\$ millions
<b>At 31<sup>st</sup> December 2004</b>			
<b>Assets</b>			
Cash and other liquid assets	144.6	144.6	-
Placements with banks	3,286.5	3,286.5	-
Trading securities	1,612.4	1,612.4	-
Available-for-sale securities	8,469.1	8,469.1	-
Loans and advances	5,286.3	5,290.4	4.1
Fixed & other assets	287.9	287.9	-
<b>Liabilities</b>			
Deposits	10,814.5	10,814.5	-
Securities sold under agreements to repurchase	3,818.8	3,818.8	-
Securities sold but not yet purchased	564.9	564.9	-
Other liabilities	525.6	525.6	-
Term financing	1,828.3	1,828.3	-
<b>Credit-related contingent items</b>			-
<b>Excess of net fair values over net book values</b>			<u>4.1</u>
<b>At 31<sup>st</sup> December 2003</b>			
<b>Excess of net fair values over net book values</b>			<u>23.5</u>

Based on the valuation methodologies outlined below, the net fair values of all on- and off-balance sheet financial instruments exceeded their net book values as at 31<sup>st</sup> December 2004 by US\$4.1 million (2003: US\$23.5 million)

#### a) Securities

The fair value of securities was based on quoted market prices with the exception of investments in unquoted equity investments, the fair values of which were based on their carrying amounts

#### b) Loans and advances

The fair value of floating rate loans was principally estimated at book value less provisions for impairment. The fair value of troubled sovereign debt was based on market bid prices. The fair value of impaired loans was estimated at the recoverable amount, measured as the present value of expected future cash flows discounted based on the interest rate at the inception of the loan. The fair value of fixed rate loans was estimated on a discounted cash flow basis utilising discount rates equal to prevailing market rates of interest in the respective currencies for loans of similar residual maturity and credit quality. The repricing profile of loans and advances is set out in Note 24. All but US\$12.9 million (2003: US\$10.3 million) of loans and advances reprice within one year.

#### c) Term financing

The fair value of term financing was based on book value as the financing is on a floating rate basis and as the applicable margins approximate the current spreads that would apply for borrowings with similar maturities. The term financing reprices at least semi-annually.



### 30 FAIR VALUE OF FINANCIAL INSTRUMENTS (continued)

#### d) Other on-balance sheet items

The fair values of foreign exchange and derivative financial instruments were based on market prices, discounted cash flow models or option pricing models as appropriate. The fair values of all other on-balance sheet items approximated their respective book values due to their short term nature.

#### e) Credit-related contingent items

There was no material fair value excess or shortfall in respect of credit related off-balance sheet financial instruments, which include commitments to extend credit, standby letters of credit and guarantees, as the related future income streams reflected contractual fees and commissions actually charged at the balance sheet date for agreements of similar credit standing and maturity. Specific provisions have been made in respect of individual transactions, where a potential for loss has been identified. Such provisions are included in provisions for impairment of loans and advances.

### 31 EARNINGS PER SHARE

Basic earnings per share is calculated by dividing the net profit attributable to the shareholders by the weighted average number of shares in issue during the year.

	2004	2003
Net income after tax (US\$ millions)	150.2	106.1
Weighted average number of shares in issue (millions)	1,000.0	1,000.0
Basic earnings per share	US\$0.15	US\$0.11

### 32. PRINCIPAL SUBSIDIARIES

The principal subsidiary companies were as follows -

	Country of Incorporation	Ownership Interest	
		31.12.04	31.12.03
		%	%
Gulf International Bank (UK) Limited	United Kingdom	100	100
GIB (UK) Capital Investments Limited	United Kingdom	100	100
SIB Financial Advisory Services Limited	United Kingdom	100	100
GIBINVEST E.C.	Bahrain	100	100

## NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS continued

For the year ended 31<sup>st</sup> December 2004

### 33 AVERAGE CONSOLIDATED BALANCE SHEET

The average consolidated balance sheet was as follows -

	2004 US\$ millions	2003 US\$ millions
<b>Assets</b>		
Cash and other liquid assets	188 3	269 7
Placements with banks	3,656 1	3,143 4
Trading securities	1,480 2	1,312 4
Available-for-sale securities	8,360 9	8,404 8
Loans and advances	4,510 2	3,555 0
Fixed & other assets	337 0	401 3
<b>Total assets</b>	<b>18,532 7</b>	<b>17,086 6</b>
<b>Liabilities</b>		
Deposits from banks	4,980 5	5,902 6
Deposits from customers	5,774 9	4,499 0
Securities sold under agreements to repurchase	3,531 1	3,131 5
Securities sold but not yet purchased	436 9	146 4
Other liabilities	573 0	763 3
Term financing	1,635 4	1,243 9
Subordinated term loans	150 0	150 0
<b>Total liabilities</b>	<b>17,081 8</b>	<b>15,836 7</b>
<b>Shareholders' equity</b>	<b>1,450 9</b>	<b>1,249 9</b>
<b>Total liabilities &amp; shareholders' equity</b>	<b>18,532 7</b>	<b>17,086 6</b>

### 34 PARENT COMPANY

The condensed unconsolidated financial statements of Gulf International Bank B S C were as follows -

#### a) Condensed balance sheet

	At 31 12 04 US\$ millions	At 31 12 03 US\$ millions
<b>Assets</b>		
Cash and other liquid assets	95 9	87 3
Placements with banks	2,078 2	2,234 9
Trading securities	292 8	192 4
Available-for-sale securities	8,299 4	8,276 8
Investment in GIB (UK) Limited	329 5	308 6
Loans and advances	4,689 3	3,622 1
Fixed & other assets	220 2	209 6
<b>Total assets</b>	<b>16,005 3</b>	<b>14,931 7</b>
<b>Liabilities</b>		
Deposits from banks	4,206 8	4,947 6
Deposits from customers	4,274 9	3,495 8
Securities sold under agreements to repurchase	3,742 9	2,997 8
Other liabilities	417 7	450 4
Term financing	1,678 3	1,501 3
Subordinated term loans	150 0	150 0
<b>Total liabilities</b>	<b>14,470 6</b>	<b>13,542 9</b>
<b>Shareholders' equity</b>	<b>1,534 7</b>	<b>1,388 8</b>
<b>Total liabilities &amp; shareholders' equity</b>	<b>16,005 3</b>	<b>14,931 7</b>

The investment in GIB (UK) Limited is accounted for based on the equity method of accounting

#### b) Condensed income statement

	Year ended 31 12 04 US\$ millions	Year ended 31 12 03 US\$ millions
Net interest income	144 8	126 1
Provisions for securities	10 2	18 3
Provisions for loan and advances	19 2	12 4
Net interest income after provisions	115 4	95 4
Other income	87 3	91 9
Net interest and other income	202 7	187 3
Operating expenses	71 6	70 8
Profit from operations	131 1	116 5
Result of subsidiary	17 3	(10 2)
Net income before tax	148 4	106 3
Taxation (credit) / charge on overseas activities	(1 8)	0 2
<b>Net income after tax</b>	<b>150 2</b>	<b>106 1</b>

## CORPORATE GOVERNANCE REPORT

The Board of Directors and management are committed to high standards of corporate governance. Following the adoption of the Bank's new strategy in 2001, the organisation was restructured to provide the appropriate governance framework, including clearly defined reporting lines for the business and support units.

There is an effective and appropriately constituted Board of Directors which receives from management, such information as is required to properly fulfil its duties.

The Board comprises nine non-executive directors, including the Chairman and Vice Chairman, who together bring a wide range of skills and experience to the Board.

The Board is responsible for the strategic direction of the Bank, maintaining an appropriate organisation structure, approving major policies, monitoring business performance, operations and the integrity of internal controls, nurturing proper and ethical behaviour, providing appropriate oversight and conducting corporate governance in a transparent manner. There is a clear division of roles and responsibilities between the Board of Directors and the Chief Executive Officer.

### MEETINGS OF THE BOARD

As prescribed in the Bank's Articles of Association, the Board plans at least four meetings per year, with further meetings to occur at the discretion of the Board. The Board is generally responsible for its agenda which, when applicable, is prepared in consultation with management.

The Board is assisted by the following committees:

### EXECUTIVE COMMITTEE

The Executive Committee acts for the Board in its absence. The Committee handles matters requiring Board review that arise between full board meetings. It will relieve the Board of detailed reviews of information and operational activities, so that it can concentrate on activities reserved for the full board in accordance with the Bank's Articles of Association and applicable laws.

### AUDIT COMMITTEE

The Audit Committee assists the Board in fulfilling its statutory and fiduciary responsibilities with respect to internal controls, accounting policies, auditing and financial reporting practices. The Committee assists the Board in its oversight of (i) the integrity and reporting of the Bank's quarterly and annual financial statements, (ii) compliance with legal and regulatory requirements, and (iii) the independence and performance of the Bank's internal and external auditors.

In accordance with the Bank's Articles of Association, the General Assembly is directly responsible for the appointment and compensation of the external auditors who audit the Bank's financial statements.

The function of the Audit Committee is oversight. Although the Board of Directors is responsible for the integrity of the Bank's financial statements, the management is responsible for maintaining appropriate accounting and financial reporting principles as well as internal controls and procedures designed to assure compliance with accounting standards and applicable laws and regulations. The independent internal and external

auditors are responsible for planning and performing proper audits on the adequacy of the Bank's internal controls

The Audit Committee is responsible for maintaining an avenue of communication with the external auditors, management, the internal auditor and the Board of Directors

#### *RISK POLICY COMMITTEE*

The primary objective of the risk management strategy adopted by the Board of Directors is to preserve the Bank's capital base, to optimise the allocation of capital and to foster a proactive risk culture bank-wide. The Board of Directors is responsible for setting the Bank's overall risk appetite, parameters and limits within which it conducts its business activities

The Board Risk Policy Committee assists the Board in fulfilling its oversight responsibilities in respect of

- The risk profile of the Bank,
- The risks inherent in the businesses of the Bank, management and the control processes with respect to such risks,
- Determination of overall policy limits using a set of parameters and rules based on the Bank's portfolio, business line economics, overall capital adequacy requirements and target risk rating, and
- The integrity of the Bank's systems of operational controls regarding legal and regulatory compliance

#### *COMPENSATION COMMITTEE*

The Compensation Committee provides assistance to the Board in fulfilling its oversight responsibilities in

matters relating to executive compensation and administration of the Bank's compensation and benefits plans. The Compensation Committee is responsible for periodic reviews of the policy on management succession, including the criteria for the Chief Executive Officer and other executive management positions

All directors are appointed or re-elected every three years according to the Bank's Articles of Association

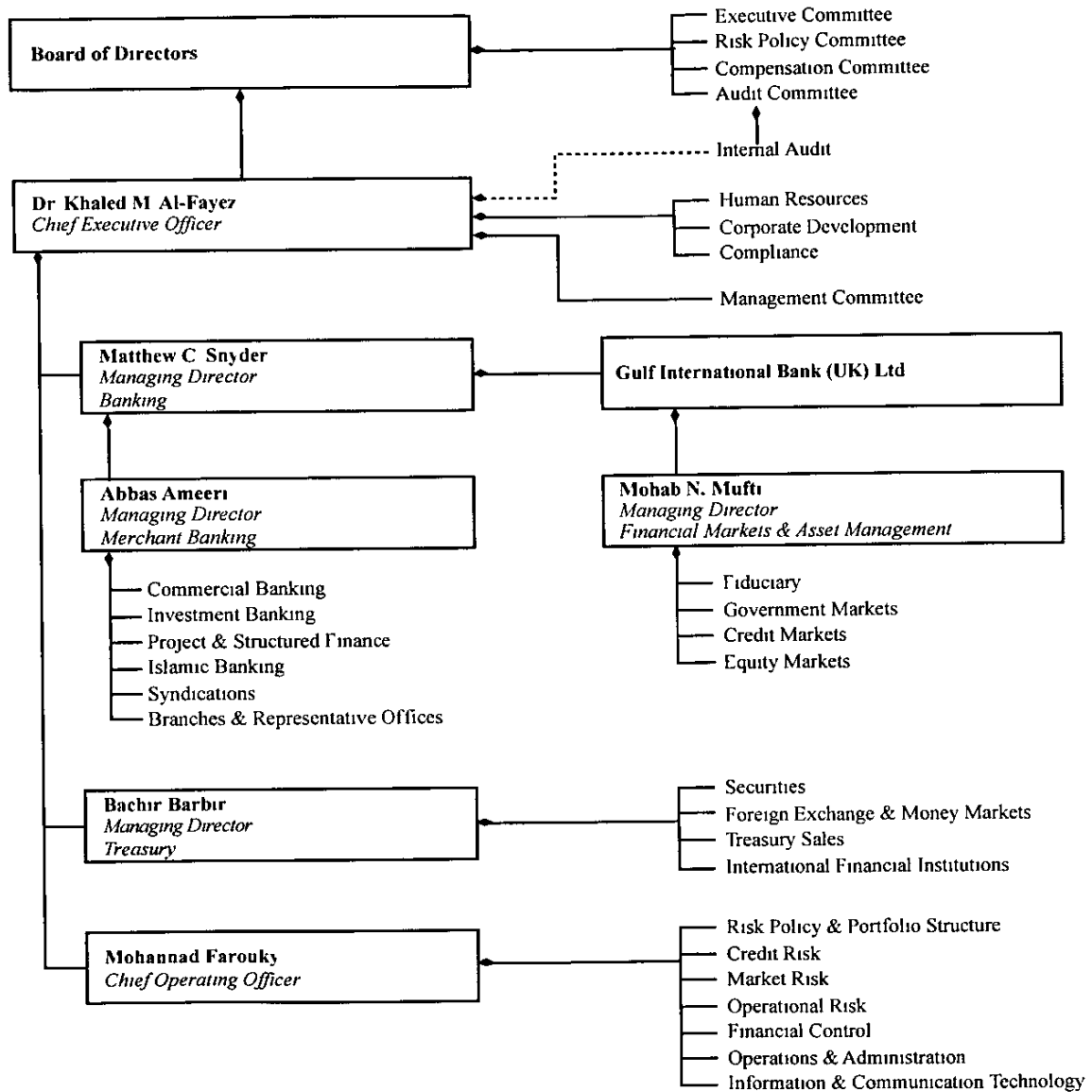
#### **THE MANAGEMENT**

The management, which is responsible for the implementation of Board approved strategy, policies, effective controls and day-to-day management of the Bank, is headed by the Chief Executive Officer, who is assisted by five managing directors responsible for risk management and operations, treasury, banking, merchant banking, and financial markets and asset management. The following management committees have been established to assist the Chief Executive Officer in the management of the Bank – Management, Group Risk, Bank ALCO (Assets and Liabilities Management) and Human Resources

The committees of the Board derive their authorities and powers from the Board of Directors and management committees from the Chief Executive Officer, based on the authorities and limits delegated by the Board of Directors

In accordance with the Bank's Articles of Association, the Bank holds, annually, a properly constituted General Assembly and its Board of Directors, who are elected by the shareholders, encourage and regularly communicate with the Bank's shareholders and other stakeholders

## ORGANISATION CHART



## BIOGRAPHIES OF THE BOARD AND SENIOR MANAGEMENT

### BOARD OF DIRECTORS

#### **Sheikh Ebrahim Bin Khalifa Al Khalifa**

Chairman Bahraini Citizen

LLB, Beirut Arab University Lebanon. Sheikh Ebrahim was appointed as Chairman of the Board of Directors in 2001. Since 1993 he has been Undersecretary at the Ministry of Finance Kingdom of Bahrain. Previously he served as Deputy Governor of the Bahrain Monetary Agency from 1983-1993, Assistant to the Governor of the BMA from 1981-1983 and Head of Banking Control Department between 1975-1981. Other current positions include Chairman and Managing Director of Gulf Aluminium Rolling Mill Company (GARMCO), Chairman of Bahrain Development Bank and Bahrain Institute of Technology and Member of the Board of Aluminium Bahrain (ALBA) and Faysal Islamic Bank of Egypt.

#### **Mr AbdulAziz M Al-Abdulkader** ②

Vice Chairman Saudi Arabian Citizen

BA in Business Administration the University of Washington USA. Mr Al-Abdulkader was appointed to the Board in 2001. He is Chairman of the Risk Policy Committee. He is the founder and owner of the AMA Group of Companies in Saudi Arabia. Other current directorships include Middle East Capital Group, United Gulf Industries Company and National Instalment Company Ltd. He is a former Chairman of the Board of Directors of Bank Al-Jazira.

#### **Mr Bader A Al-Rushaid Al-Bader** ②

Board Member, Kuwaiti Citizen

BA in Commerce Alexandria University, Egypt. Mr Al-Bader was appointed to the Board in 1978. He served as Chairman and Managing Director of Kuwait Investment Company from 1992-2000. He was Deputy Managing Director of Kuwait Investment Authority from 1984-1992. He worked in various positions at the Ministry of Finance & Oil Kuwait from 1969 to 1984. Mr Al-Bader has served as Chairman and Director of a large number of Middle Eastern financial institutions.

#### **Dr Hamad Bin Sulaiman Al-Bazai** ① ④

Board Member Saudi Arabian Citizen

BA in Administrative Sciences, King Saud University Saudi Arabia MS and Ph D in Economics Colorado State University USA. Dr Al-Bazai was appointed to the Board in 1999. He is Deputy Minister of Finance for Economic Affairs at the Ministry of Finance Kingdom of Saudi Arabia. He is a Member of the Preparatory Committee of the Supreme Petroleum Council and a Board Member of the Human Resources Development Fund the Southern Region Cement Company and the Higher Education Fund.

#### **Mr Saud Bin Nassir Al-Shukaily** ①

Board Member, Omani Citizen

BS in Business Administration University of South Carolina and MA in Development Management, American University Washington DC. Mr Al-Shukaily was appointed to the Board in 1999. He is currently the Secretary General for Taxation at the Ministry of Finance, Sultanate of Oman. Earlier he served as Director General of Revenue and Investment at the Ministry of Finance (1996-2004), Director of the Minister's Office at the Ministry of Civil Services (1994-1996) and at the Ministry of

National Economy (1996-1999). He is also a Member of the Board of Directors of Oman Flour Mills, Oman Cement Company and Petroleum Development Of Oman.

#### **Dr Khalid Bin Abdulla Al-Sweilem** ② ③

Board Member, Saudi Arabian Citizen

BS in Industrial Engineering University of Arizona, MA in Economics Boston University, Ph D in Economics, University of Colorado-Boulder, in addition to post-doctoral fellowship in Economics at Harvard University, USA. Dr Al-Sweilem was appointed to the Board in 2004. He is currently the Director General Investment Department at the Saudi Arabian Monetary Agency (SAMA). He served as Deputy Director of Investment at SAMA from 2000-2004. Previous positions at SAMA included Assistant Director General of Investment (1998-2000), Director Investment Management (1994-1998) and Economic Advisor (1991-1994).

#### **Mr Khalid Bin Abdulla Al-Suwaidi** ④

Board Member Qatari Citizen

BA in Accounting from Regence College in the United Kingdom. He joined the Board in 2004. He has been the Office Director at the Deputy Secretary General's Office of the Supreme Council for Economic Affairs and Investment in Qatar since 2003. He served earlier as Director of Finance at the Airport Public Corporation (1997-2003).

#### **Mr Nasser Bin Khamis Al-Suwaidi** ① ③

Board Member, UAE Citizen

BS in Business and Banking Arizona University USA, in addition to specialised courses in macro economics at the International Monetary Fund. He joined GIB's Board in 2004. Currently he is Director of the Minister's Office at the Ministry of Finance and Industry, UAE. Previous positions at the Ministry included Director of Industrial Development, Director of Investments (2003-2004), Minister's Office Manager (2000-2003), Head of Development Institutions-Investment Department (1999-2000). Mr Al-Suwaidi is a Board member at OPEC Fund for Development and a member of the UAE Anti-Dumping Committee and the Central Committee for Statistics Coordination.

#### **Mr Mark Stephen Garvin** ② ④

Board Member, US Citizen

BS Georgetown University and MBA, American University Washington, DC. Mr Garvin was appointed to the Board in 2002. He is Chief Operating Officer of the Europe Middle East Africa region and Senior Country Officer for JPMorgan in the United Kingdom. He assumed his current position in 2001 following the merger between JPMorgan and Chase. Mr Garvin is Chairman or a Director of a number of JPMorgan entities. He is also a Director of CLS Bank Services International and Brush American Business Inc.

① Executive Committee Member

② Risk Policy Committee Member

③ Audit Committee Member

④ Compensation Committee Member

## BIOGRAPHIES OF THE BOARD AND SENIOR MANAGEMENT continued

### SENIOR MANAGEMENT

**Dr Khaled M. Al-Fayez**  
Chief Executive Officer  
Saudi Arabian Citizen

BA in Economics, Whitman College, Washington State, USA, MA in International Relations, MA in Law & Diplomacy and Ph.D. in Economics & International Relations, Fletcher School of Law & Diplomacy, Tufts University, USA. Dr Al-Fayez was Group Chief Executive Officer of Gulf Investment Corporation from 1983 to 2001. Dr Al-Fayez served as GIB's first General Manager from 1976 to 1983. He was previously an Economic Advisor at the Saudi Arabian Ministry of Finance and National Economy and an Economist and Senior Credit Officer at the Saudi Industrial Development Fund. Dr Al-Fayez is Chairman of the Board of Gulf International Bank (UK) Ltd. Member of the Advisory Council and Member of the Privatisation Committee of the Supreme Economic Council, Saudi Arabia, Member of the Advisory Board of The Middle East Institute, Washington, USA and Member of the Board of the Institute of International Finance Inc., Washington, USA.

**Mohannad Farouky**  
Chief Operating Officer  
UK Citizen

BA in Economics, the American University, Cairo and MBA in Finance, the University of Miami, USA. Prior to his recent appointment as COO, Mr Farouky served as Managing Director-Risk Management from 2003-2004. From 2000 until 2002, he was assigned to Gulf International Bank (UK) Ltd. as Deputy Managing Director. From 1994 to 2000, he was Global Head of the Banking Group. Mr Farouky joined GIB in London in 1986 as Head of the Europe and Africa Area. He is a member of the Board of Directors of Gulf International Bank (UK) Ltd. Before joining GIB, he worked at Citibank N.A. in the Middle East in a variety of credit and marketing positions, and at Chase Investment Bank Ltd. in London as a Managing Director.

**Matthew C. Snyder**  
Managing Director - Banking  
US Citizen

BA in Political Science, CW Post College, USA and MA in International Politics, Long Island University, USA. Mr Snyder first joined GIB's principal subsidiary Gulf International Bank (UK) Ltd. (then Saudi International Bank) in 1993. From 1982 to 1993 he was President and Chief Executive Officer of AI International, a US-based diversified, private industrial company. He previously worked for eleven years in the New York offices of Schroders, a London-based merchant bank. He is Managing Director of Gulf International Bank (UK) Ltd.

**Bachir Barbir**  
Managing Director - Treasury  
Lebanese and Canadian Citizen

Degree in Banking Studies and Business Administration from Saint Joseph University, Beirut, Lebanon. Mr Barbir was appointed Assistant General Manager, Assets and Liabilities Management in 1997. In 1988 he was promoted to Executive Vice President and Head of the Assets and Liabilities Group. He was previously the Bahrain Treasurer. Mr Barbir joined GIB in 1981. Before joining GIB he worked for Chase Manhattan Bank in both Bahrain and Lebanon and Credit Hypothecaire in Lebanon.

**Abbas Ameer**  
Managing Director - Merchant Banking  
Bahraini Citizen

Mr Ameer has 22 years of banking experience at GIB, working within the credit and banking groups. He is responsible for GIB's relationship efforts within the GCC, including ministries of finance, government agencies, corporations, financial institutions and investment companies. He also supervises other activities, including project and structured finance syndications and Islamic banking, as well as the activities of GIB's branches in Riyadh, Jeddah, London and New York and the two representative offices in Abu Dhabi and Beirut. Mr Ameer is a member of GIB's Management Committee, the Credit Committee and the Assets and Liabilities Committee.

**Mr Mohab Naji Mufti**  
Managing Director - Financial Markets and Asset Management  
Saudi Arabian Citizen

BSc in Computer Science, University of East Anglia, UK. Mr Mufti is Deputy Managing Director and Executive Board Member of Gulf International Bank (UK) Ltd. He has been responsible for GIB's Financial Markets business since 1999. He rejoined Saudi International Bank, which was subsequently renamed Gulf International Bank (UK) Ltd., in 1996. Prior to that Mr Mufti worked with the National Commercial Bank in Saudi Arabia, where he was the Head of Trading. Between 1987 and 1993 he occupied various senior trading and investment roles within Saudi International Bank in London. Mr Mufti is a Board Member of the Arab Bankers Association, UK.



## CORPORATE DIRECTORY

### **General Management**

**Dr. Khaled M. Al-Fayez**  
Chief Executive Officer  
**Mohannad Farouky**  
Chief Operating Officer  
**Matthew Snyder**  
Managing Director - Banking  
**Bachir Barbir**  
Managing Director - Treasury  
**Abbas Ameer**  
Managing Director - Merchant Banking  
**Mohab N. Mufti**  
Managing Director - Financial Markets & Asset Management

### **Merchant Banking**

#### **GCC Commercial Banking**

**Ali Rahimi**  
Head of Bahrain, Kuwait and Saudi Arabia  
**Srinivas Vemparala**  
Head of Oman, Qatar & UAE

#### **Project & Structured Finance**

**M. Chandrasekaran**  
Head of Project & Structured Finance  
**Munawar Ihsan**  
Syndications  
**Suhail Masood**  
Islamic Banking  
**Ali Al-Qaseer**  
Asset Trading & Loan Agency

#### **International Banking**

**Peter Szalay**  
Head of International Banking  
**Asghar Ali Baba**  
Near & Far East

#### **Investment Banking**

**Salman Al-Deghanther**  
Head of Investment Banking  
**Ian Brameld**  
Project Finance Advisory  
**Bashar Kayyali**  
Senior Manager  
**Abdul Qaiyum**  
Corporate Finance, Abu Dhabi

### **Financial Markets & Asset Management**

#### **Fiduciary**

**David Waite**  
Head of Fiduciary

### **Government Markets**

**Uday Patnaik**  
Head of Government Markets  
**Charles Thomson**  
Portfolio Management  
**Anthony Chisnall**  
Emerging Markets  
**John Benfield**  
G10 Markets

#### **Credit Markets**

**Alex Veroude**  
Head of Credit Markets  
**Uli Gerhard**  
Corporate Debt - Investment Grade  
**Azhar Hussain**  
Corporate Debt - High Yield  
**Andrew Burgess**  
Asset Backed Securities

#### **Equity Markets**

**John Cavaliere**  
Head of Equity Markets  
**Simon English**  
Directional Strategies  
**Paul Harrison**  
Market Neutral Strategies

#### **Private Equity**

**Gregga Baxter**  
Head of Private Equity

#### **Treasury**

**Adel Al-Dosseri**  
Head of Foreign Exchange & Money Markets, Bahrain  
**Steven Moulder**  
Head of London & New York Treasury  
**Adnan Al-Rifaie**  
Riyadh Treasury  
**Mahmood Fikree**  
Investment Securities  
**Salman Al-Zayani**  
Head of Treasury Sales  
**Austin Sequeira**  
Treasury Administration  
**Shahriar Khoshabi**  
International Financial Institutions

### **Risk Management**

**Masood Zafar**  
Chief Credit Officer  
**Stephen Wilhams**  
Group Financial Controller  
**Fouad J. Masrieh**  
Risk Policy & Portfolio Structure

### **Peter Robinson**

Acting Chief Financial Officer - GIBUK  
**Jameel Al-Sairafi**  
Information Security - Bahrain  
**Shane Panjvani**  
Operational Risk - Bahrain

### **Support Functions**

**Abdulla Janahi**  
Head of Operations & Information Technology  
**Ali Buheji**  
Operations - Bahrain  
**Ali Ashoor**  
Administration - Bahrain  
**P. K. Nambiar**  
Information Technology - Bahrain  
**Gordon Brooker**  
Operations & Administration - GIBUK  
**Rashed Abdul-Rahim**  
Operations & Administration - Riyadh Branch

### **Human Resources**

**Hassan Abdul-Ghani**  
Head of Human Resources  
**Jamal Hujris**  
Human Resources - Bahrain  
**Michael Osborne**  
Human Resources Policy & Planning - Bahrain  
**Emad Nabulsi**  
Human Resources - Riyadh Branch

### **Audit, Legal & Compliance**

**Hassan Al-Mulla**  
Group Chief Auditor  
**Julian Anthony**  
Audit - London  
**Dominic Bacon**  
Legal & Compliance - London  
**Sally Wells**  
Company Secretary - GIB UK  
**Hassan Al-Mulla**  
Acting Head of Compliance - Bahrain

### **Board Secretariat**

**Faiz Al Barwani**  
Secretary to the Board

### **Corporate Communications**

**Abdulla Naneesh**

## CORPORATE DIRECTORY continued

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Internet  
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### Principal Subsidiary

#### Gulf International Bank (UK) Limited

Matthew C. Snyder  
Managing Director &  
Chief Executive Officer  
Mohab N. Mufti  
Deputy Managing Director  
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### Branches

#### London Branch

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Acting Branch Manager  
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Treasury (+44) 20 7393 0035  
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Treasury (+44) 20 7393 0430  
Banking (+44) 20 7393 0454  
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ibaconi@gibny.com

#### Cayman Islands Branch C/o New York Branch

#### Riyadh Branch

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Acting Branch Manager  
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