GULF INTERNATIONAL BANK B.S.C.

2006 CONSOLIDATED

FINANCIAL STATEMENTS

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Contents

Consolidated Balance Sheet

	Note	At 31.12.06 US$ millions	At 31.12.05 US$ millions
ASSETS			
Cash and other liquid assets	*3*	268.2	345.4
Due from brokers		950.9	942.2
Placements with banks	*4*	4,322.5	5,079.7
Trading securities	*5*	2,186.1	2,007.5
Available-for-sale securities	*6*	8,422.9	7,839.6
Loans and advances	*7*	8,145.0	6,273.7
Other assets	*8*	491.6	368.5
Total assets		24,787.2	22,856.6
LIABILITIES			
Deposits from banks	*10*	5,704.0	4,091.7
Deposits from customers	*10*	11,163.7	9,370.8
Securities sold under agreements to repurchase	*11*	2,219.6	3,711.5
Securities sold but not yet purchased		862.7	873.5
Other liabilities	*12*	563.5	596.3
Senior term financing	*13*	1,867.1	1,944.5
Subordinated term financing	*14*	550.0	550.0
Total liabilities		22,930.6	21,138.3
EQUITY			
Share capital	*15*	1,000.0	1,000.0
Share premium		7.6	7.6
Reserves	*16*	365.9	334.6
Retained earnings		483.1	376.1
Total equity		1,856.6	1,718.3
Total liabilities & equity		24,787.2	22,856.6

The consolidated financial statements were approved by the Board of Directors on 31st January 2007 and signed on their behalf by:-

Ebrahim Bin Khalifa Al Khalifa
Chairman

Dr. Khaled M. Al-Fayez
Chief Executive Officer

The notes on pages 5 to 34 form part of these consolidated financial statements.

Consolidated Statement of Income

	Note	Year ended 31.12.06 US$ millions	Year ended 31.12.05 US$ millions
Interest income	*18*	1,235.8	750.8
Interest expense	*18*	978.1	541.8
Net interest income		257.7	209.0
Provisions for securities	*6*	(1.6)	14.0
Provisions for loans and advances	*7*	(0.8)	(11.8)
Net interest income after provisions		260.1	206.8
Fee and commission income	*19*	65.8	46.2
Trading income	*20*	48.2	43.6
Profits on available-for-sale securities		28.8	45.6
Other income	*21*	4.9	3.8
Total income		407.8	346.0
Staff expenses		101.9	101.7
Premises expenses		8.2	7.6
Other operating expenses		33.9	29.4
Operating expenses		144.0	138.7
Net income before tax		263.8	207.3
Taxation charge on overseas activities		8.3	4.3
Net income after tax		255.5	203.0
Earnings per share	*34*	*US$0.26*	*US$0.20*

Ebrahim Bin Khalifa Al Khalifa
Chairman

Dr. Khaled M. Al-Fayez
Chief Executive Officer

The notes on pages 5 to 34 form part of these consolidated financial statements.

Consolidated Statement of Cash Flows

	Year ended 31.12.06 US$ millions	Year ended 31.12.05 US$ millions
OPERATING ACTIVITIES		
Net income after tax	**255.5**	203.0
Adjustments to reconcile net income to net cash outflow from operating activities:		
Provisions for securities	**(1.6)**	14.0
Provisions for loans and advances	**(0.8)**	(11.8)
Profit on available-for-sale securities	**(28.8)**	(45.6)
Amortisation of available-for-sale securities	**2.9**	1.7
Increase in accrued interest receivable	**(66.7)**	(87.2)
Increase in accrued interest payable	**15.6**	65.5
(Increase) / decrease in other net assets	**(60.6)**	90.8
Net increase in trading securities	**(178.6)**	(395.1)
Net cash outflow from operating activities	**(63.1)**	(164.7)
INVESTING ACTIVITIES		
Net increase in due from brokers	**(8.7)**	(350.8)
Net decrease / (increase) in placements with banks	**757.2**	(1,793.2)
Net increase in loans and advances	**(1,870.5)**	(1,414.8)
Purchase of available-for-sale securities	**(1,730.1)**	(1,503.0)
Sale and maturity of available-for-sale securities	**1,114.4**	2,087.2
Net cash outflow from investing activities	**(1,737.7)**	(2,974.6)
FINANCING ACTIVITIES		
Net increase / (decrease) in deposits from banks	**1,612.3**	(654.5)
Net increase in deposits from customers	**1,792.9**	3,202.2
Net decrease in securities sold under agreements to repurchase	**(1,491.9)**	(107.3)
Net (decrease) / increase in securities sold but not yet purchased	**(10.8)**	308.6
Net (decrease) / increase in senior term financing	**(77.4)**	266.2
Net increase in subordinated term financing	**-**	400.0
Dividends paid	**(101.5)**	(75.1)
Net cash inflow from financing activities	**1,723.6**	3,340.1
(Decrease) / increase in cash and cash equivalents	**(77.2)**	200.8
Cash and cash equivalents at 1st January	**345.4**	144.6
Cash and cash equivalents at 31st December	**268.2**	345.4

The notes on pages 5 to 34 form part of these consolidated financial statements.

Consolidated Statement of Changes in Equity

	Share capital	Share premium	Reserves	Retained earnings	Total
	US$ millions	US$ millions	US$ millions	US$ millions	US$ millions
At 1st January 2005	**1,000.0**	**7.6**	**289.8**	**289.2**	**1,586.6**
Arising in the year:-					
- Available-for-sale securities:					
net fair value gains	-	-	15.0	-	15.0
- Cash flow hedges:					
net fair value losses	-	-	(3.0)	-	(3.0)
Transfers in the year:-					
- Transfers to net income	-	-	(8.2)	-	(8.2)
Net gains recognised directly in equity	-	-	3.8	-	3.8
Dividend for 2004	-	-	-	(75.1)	(75.1)
Net income for the year	-	-	-	203.0	203.0
Transfers from retained earnings	-	-	41.0	(41.0)	-
At 31st December 2005	**1,000.0**	**7.6**	**334.6**	**376.1**	**1,718.3**
Arising in the year:-					
- Available-for-sale securities:					
net fair value gains	-	-	0.7	-	0.7
- Cash flow hedges:					
net fair value losses	-	-	(2.0)	-	(2.0)
Transfers in the year:-					
- Transfers to net income	-	-	(14.4)	-	(14.4)
Net losses recognised directly in equity	-	-	(15.7)	-	(15.7)
Dividend for 2005	-	-	-	(101.5)	(101.5)
Net income for the year	-	-	-	255.5	255.5
Transfers from retained earnings	-	-	47.0	(47.0)	-
At 31st December 2006	**1,000.0**	**7.6**	**365.9**	**483.1**	**1,856.6**

The notes on pages 5 to 34 form part of these consolidated financial statements.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS
for the year ended 31st December 2006

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 24th November 1975 and is registered as a conventional wholesale bank with the Central Bank of Bahrain. 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 593.

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 and in conformity with the Bahrain Commercial Companies Law and the Central Bank of Bahrain and Financial Institutions Law. The consolidated financial statements have been prepared under the historical cost convention as modified by the revaluation of trading securities, available-for-sale securities, securities sold but not yet purchased, 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 except for changes resulting from amendments to International Accounting Standard (IAS) No. 1 - Presentation of Financial Statements: Capital Disclosures and IAS 19 - Employee Benefits as described in more detail below.

The amendment to IAS 1 - Presentation of Financial Statements: Capital Disclosures, which has been adopted prior to its effective date of 1st January 2007, introduced new disclosure requirements in respect of the management of capital. The relevant disclosure is set out in note 23 to the consolidated financial statements. The amendment had no impact on the Group's consolidated net income or financial position. In accordance with the transitional requirements of the amendment, full comparative information has been disclosed.

During the year, the Group adopted the amendments to IAS 19 - Employee Benefits, which increased the level of disclosure in respect of defined benefit pension plans. The amendments had no impact on the Group's consolidated net income or financial position. In accordance with the transitional requirements of the amendments, full comparative information has been disclosed.

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 Use of estimates and assumptions

The preparation of the consolidated financial statements requires management to make estimates and assumptions that affect the reported amount of financial assets and liabilities at the balance sheet date. The use of estimates and assumptions is principally limited to the determination of impairment provisions for loans and available-for-sale securities, and the valuation of the Group's defined benefit pension plan. The estimates and assumptions relating to provisions for impairment are described in more detail in note 2.14 to the consolidated financial statements. The principal actuarial assumptions for the defined benefit pension plan are set out in note 9 to the consolidated financial statements.

2.4 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.

2.5 Foreign currencies

Items included in the financial statements of the Bank and its principal subsidiaries are measured based on the currency of the primary environment in which the entity operates (the functional currency). The consolidated financial statements are presented in US Dollars, representing the Bank's functional and presentation currency. 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 at the balance sheet date. Realised and unrealised foreign exchange profits and losses are included in trading income.

2. ACCOUNTING POLICIES (continued)

2.6 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.

2.7 Derecognition of financial assets and liabilities

Financial assets are derecognised and removed from the balance sheet when the right to receive cash flows from the assets has expired; the Group has transferred its contractual right to receive the cash flows from the assets, and substantially all the risks and rewards of ownership; or where control is not retained. Financial liabilities are derecognised and removed from the balance sheet when the obligation is discharged, cancelled, or expires.

2.8 Revenue recognition

a) Interest income and interest expense

Interest income and interest expense for all interest-bearing financial instruments except those classified as held for trading are recognised using the effective interest rate method. The effective interest rate method is a method of calculating the amortised cost of a financial asset or liability and of allocating the interest income or interest expense over the expected life of the asset or liability. The effective interest rate is the rate that exactly discounts estimated future cash flows through the expected life of the financial asset or liability or, where appropriate, a shorter period, to the net carrying amount of the financial asset or liability. The application of the effective interest rate method has the effect of recognising interest income and interest expense evenly in proportion to the amount outstanding over the period to maturity or repayment. In calculating the effective interest rate, cash flows are estimated taking into consideration all contractual terms of the financial instrument but excluding future credit losses. Fees, including loan origination fees and early redemption fees, are included in the calculation of the effective interest rate to the extent that they are considered to be an integral part of the effective interest rate.

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.

b) Fees and commissions

Fees and commissions that are integral to the effective interest rate of a financial asset or liability are included in the calculation of the effective interest rate.

Other fees and commissions are recognised as the related services are performed or received, and are included in fee and commission income.

c) Trading income

Trading income arises from earnings generated from customer business and market making, and from changes in fair value resulting from movements in interest and exchange rates, equity prices and other market variables. Changes in fair value and gains and losses arising on the purchase and sale of trading instruments are included in trading income, together with the related interest income, interest expense and dividend income.

d) Dividend income

Dividend income is recognised as follows:-

- dividends from structured finance investments are recognised on an accruals basis and are included in interest income. The structured finance investments are in the form of capital notes and the underlying investments comprise high quality, investment-grade rated debt securities.

- dividends from equity instruments classified as held for trading are recognised when the right to receive payment is established and are included in trading income.

- dividends from equity instruments classified as available for sale are recognised when the right to receive payment is established and are included in other income.

- in the separate financial statements of the Bank, dividends from subsidiaries are recognised when received.

2.9 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.

2.10 Securities

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 are categorised as trading securities. Trading securities are initially recognised at fair value, including transaction costs, and subsequently measured at fair value based on quoted market prices. Realised and unrealised gains and losses together with interest earned on trading securities are included in trading income.

Securities which 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 are categorised as available-for-sale securities. Available-for-sale securities are initially recognised at fair value, including transaction costs, and subsequently measured at 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 are recognised in a separate revaluation reserve in 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 equity are transferred to the consolidated statement of income.

Dividends received on trading and available-for-sale equity instruments are included in trading income and other income respectively.

2.11 Loans and advances

Loans which are acquired for the purpose of generating a profit in the short term are categorised as held-for-trading loans. Loans categorised as held for trading are initially recognised at fair value, including transaction costs, and subsequently measured at fair value based on market prices. Realised and unrealised gains and losses together with interest earned on trading loans are included in trading income. All other loans are 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.

2.12 Premises and equipment

Land is stated at cost. Other premises and equipment are stated at cost less accumulated depreciation. The residual values and useful lives of premises and equipment are reviewed at each balance sheet date, and adjusted where appropriate. Where the carrying amount of premises or equipment is greater than the estimated recoverable amount, the carrying amount is reduced to the 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.

2.13 Financial liabilities

Financial liabilities incurred for the purpose of generating a profit in the short term (securities sold but not yet purchased) are categorised as held-for-trading liabilities. Liabilities categorised as held for trading are initially recognised at fair value, including transaction costs, and subsequently measured at fair value based on quoted market prices. Realised and unrealised gains and losses together with interest incurred on trading liabilities are included in trading income. All other financial liabilities are measured at amortised cost using the effective interest rate method as described in note 2.8.

2.14 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 collective basis in respect of impairments that exist at the balance sheet date but which will only be individually identified in the future. Future cash flows for financial assets that are collectively assessed for impairment are estimated based on contractual cash flows and historical loss experiences for assets with similar credit risk characteristics. Historical loss experience is adjusted, based on current observable data, to reflect the effects of current conditions that did not affect the period on which the historical loss experience is based.

With the exception of provisions for the impairment of available-for-sale equity instruments, provisions for impairment are released and transferred to the consolidated statement of income where a subsequent increase in the recoverable amount is related objectively to an event occurring after the provision for impairment was established. Impairment losses for available-for-sale equity instruments are only released and transferred to the consolidated statement of income on the redemption or sale of the instrument.

2. ACCOUNTING POLICIES (continued)

2.15 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.

2.16 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, equity and commodity markets.

Derivative financial instruments are recognised in the consolidated balance sheet at 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 trading 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 trading 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.

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 equity. Unrealised gains or losses recognised in 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 included in trading income.

The interest component of derivatives that are designated, and qualify, as fair value or cash flow hedges is included 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 trading 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.

2.17 Financial guarantees

Financial guarantees are contracts that require the Group to make specified payments to reimburse the holder for a loss it incurs because a specific debtor fails to make payment when due in accordance with the terms of a debt instrument. Financial guarantees are issued to financial institutions and other counterparties on behalf of customers to secure loans, overdrafts and other banking facilities, and to other parties in relation to the performance of customers under obligations related to contracts, advance payments made by other parties, tenders and retentions.

Financial guarantees are initially recognised at fair value on the date the guarantee is issued. The guarantee liability is subsequently measured at the higher of the initial measurement, less amortisation to recognise the fee income earned over the period, and the present value of any expected financial obligation arising as a result of an anticipated non-recoverable payment under a guarantee. Any increase in a liability relating to guarantees is included in the provision charge in the consolidated statement of income. Financial guarantees are included in other liabilities.

2.18 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 when the net cumulative unrecognised actuarial gain or loss at the end of the previous financial year exceeds 10 per cent of the higher of: (i) the fair value of the plan assets, and (ii) the present value of the fund obligations. That portion of the net cumulative unrecognised actuarial gain or loss is recognised in income over the expected average remaining working lives of the employees participating in the plan. Otherwise, the actuarial gain or loss is not recognised.

2.19 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.

2.20 Cash and cash equivalents

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

2.21 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.

2.22 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 fee and commission income.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS
for the year ended 31st December 2006

2. ACCOUNTING POLICIES (continued)

2.23 Comparatives

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

2.24 Future accounting developments

The International Accounting Standards Board (IASB) have issued a number of new standards, amendments to standards, and interpretations that are not yet effective and have not been applied in the preparation of the consolidated financial statements for the year ended 31st December 2006. The relevant new standards, amendments to standards, and interpretations, are as follows:-

- IFRS 7 - Financial Instruments: Disclosures. IFRS 7 becomes effective for financial years beginning on or after 1st January 2007. This standard prescribes the disclosure requirements related to financial instruments and supercedes IAS 30 - Disclosures in the Financial Statements of Banks and Similar Financial Institutions, and the disclosure requirements in IAS 32 - Financial Instruments: Disclosure and Presentation.

- IFRIC 9 - Reassessment of Embedded Derivatives. IFRIC 9 becomes effective for financial years beginning on or after 1st June 2006. This interpretation establishes that the date to assess the existence of an embedded derivative is the date an entity first becomes a party to the contract with reassessment only if there is a change to the contract that significantly modifies the cash flows. The adoption of this interpretation is not expected to have any impact on the consolidated financial statements.

- IFRIC 10 - Interim Financial Reporting and Impairment. IFRIC 10 becomes effective for financial years beginning on or after 1st November 2006. This interpretation prohibits the reversal of provisions for impairment recognised in a previous interim period in respect of goodwill, an investment in an equity instrument, or a financial asset carried at cost. The adoption of this interpretation is not expected to have any impact on the consolidated financial statements.

3. CASH AND OTHER LIQUID ASSETS

	31.12.06 US$ millions	31.12.05 US$ millions
Cash and balances with banks	117.6	82.6
Certificates of deposit	150.0	233.4
Securities purchased under agreements to resell	-	28.8
Treasury bills	0.6	0.6
	268.2	345.4

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 31st December 2006 included placements with non-bank financial institutions amounting to US$54.6 million (2005: US$171.6 million).

5. TRADING SECURITIES

	31.12.06 US$ millions	31.12.05 US$ millions
Government bonds and bills	534.0	514.3
Listed debt securities	1,192.3	1,164.7
Unlisted debt securities	-	8.1
Managed funds	411.4	262.3
Equities	48.4	58.1
	2,186.1	2,007.5

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

	31.12.06	31.12.05
	US$ millions	US$ millions
AAA/Aaa rated debt securities	1,750.4	1,503.2
Debt securities of other investment grade issuers	5,670.4	5,402.1
Other debt securities	196.2	196.8
Structured finance investments	717.6	677.4
Equities and equity funds	88.3	60.1
	8,422.9	7,839.6

The Group's available-for-sale securities predominantly comprise higher quality, investment grade-rated debt securities. At 31st December 2006, 97.4 per cent of available-for-sale debt securities were investment grade-rated (2005: 97.2 per cent).

Structured finance investments represent investments in special purpose vehicles managed by international investment banks, the underlying investments of which principally comprise high quality, investment-grade rated debt securities. The investments are in the form of capital notes and the returns are based on LIBOR plus margin.

Debt securities of other investment grade issuers at 31st December 2006 included GCC country government securities of US$479.1 million (2005: US$538.5 million).

b) Provisions for impairment

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

	2006	2005
	US$ millions	US$ millions
At 1st January	71.6	90.7
Exchange rate movements	1.0	(3.4)
Amounts utilised	(7.1)	(29.7)
(Release) / charge for the year	(1.6)	14.0
At 31st December	63.9	71.6

c) Unquoted equity investments

Available-for-sale securities at 31st December 2006 included US$81.4 million (2005: US$50.5 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. The Group intends to exit these investments principally by means of IPOs or private placements.

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for the year ended 31st December 2006

7. LOANS AND ADVANCES

	31.12.06	31.12.05
	US$ millions	US$ millions
Gross loans and advances	8,228.0	6,378.6
Provisions for impairment	(83.0)	(104.9)
Net loans and advances	8,145.0	6,273.7

Gross loans and advances at 31st December 2006 included loans held for trading of US$12.7 million (2005: US$27.5 million).

a) Industrial classification

The classification of loans and advances by industry was as follows:-

	31.12.06	31.12.05
	US$ millions	US$ millions
Energy, oil and petrochemical	2,523.6	1,818.8
Trading and services	1,524.1	941.5
Financial services	1,428.1	1,207.7
Construction	607.0	530.8
Manufacturing	594.8	580.5
Transportation	467.9	442.0
Communication	321.3	248.0
Government	299.0	212.3
Other	462.2	397.0
	8,228.0	6,378.6
Provisions for impairment	(83.0)	(104.9)
	8,145.0	6,273.7

The classification of loans and advances by industry reflects the Group's strategic focus on project and structured finance and syndicated lending in the Gulf Cooperation Council (GCC) states.

b) Provisions for impairment

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

	2006	2005
	US$ millions	US$ millions
At 1st January	104.9	569.6
Decrease arising on the transfer of impaired loans off-balance sheet	-	(448.7)
Exchange rate movements	0.3	(1.9)
Amounts utilised	(21.4)	(2.3)
Release for the year	(0.8)	(11.8)
At 31st December	83.0	104.9

Total specific provisions at 31st December 2006 represented 70.7 per cent (2005: 73.8 per cent) of loans against which a specific provision had been made. Total provisions at 31st December 2006 exceeded the gross book value of past due loans by US$64.3 million (2005: US$51.2 million).

At 1st January 2005, fully provisioned impaired loans for which principal was past due by five years or more based on original contractual maturities were transferred off-balance sheet to the memorandum records. This resulted in a decrease in related specific provisions of US$448.7 million. The transfer of the impaired loans to the memorandum records had no impact on the net book value of loans reported in the consolidated balance sheet.

Amounts utilised during 2006 of US$21.4 million (2005: US$2.3 million) represented provisions utilised on the sale, settlement or write off of the related loans.

At 31st December 2006 there was no accrued but uncollected interest on impaired loans included in interest income (2005: nil).

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for the year ended 31st December 2006

7. LOANS AND ADVANCES (continued)

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:-

	31.12.06 Gross	31.12.06 Net book value	31.12.05 Gross	31.12.05 Net book value
	US$ millions	US$ millions	US$ millions	US$ millions
Corporate	8.4	0.3	40.4	5.5
Financial Institutions	10.3	-	12.6	-
Sovereign	-	-	0.7	0.5
	18.7	0.3	53.7	6.0

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

	31.12.06	31.12.05
	US$ millions	US$ millions
7 months to 1 year	-	2.8
2 to 5 years	18.7	43.3
Over 5 years	-	7.6
	18.7	53.7

At 31st December 2006 uncollected interest-in-suspense on past due loans amounted to US$1.4 million (2005: US$3.3 million).

8. OTHER ASSETS

	31.12.06	31.12.05
	US$ millions	US$ millions
Accrued interest, fees and commissions	338.7	272.0
Derivative financial instruments	42.5	36.4
Premises and equipment	32.5	17.1
Outstanding security settlements	30.0	7.9
Deferred items	7.7	10.0
Prepayments	10.5	7.6
Other, including accounts receivable	29.7	17.5
	491.6	368.5

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 27(d).

9. 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 31st December 2006 amounted to US$5.5 million (2005: US$4.6 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 1st January 2004.

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

	31.12.06	31.12.05
	US$ millions	US$ millions
Fair value of plan assets	132.5	105.9
Present value of fund obligations	161.7	138.1
	29.2	32.2
Unrecognised actuarial loss	21.9	30.7
Net liability in the consolidated balance sheet	7.3	1.5

b) The movements in the fair value of plan assets were as follows:-

	2006	2005
	US$ millions	US$ millions
At 1st January	105.9	100.0
Expected return on plan assets	7.4	6.4
Contributions paid by the Group	2.4	2.3
Benefits paid by the plan	(2.3)	(1.8)
Actuarial gains	3.1	10.9
Exchange rate movements	16.0	(11.9)
At 31st December	132.5	105.9

The plan assets at 31st December 2006 comprise equity and debt securities in the ratio of 85 per cent and 15 per cent respectively (2005: 84 per cent and 16 per cent respectively).

The expected and actual returns on the plan assets for the year ended 31st December 2006 were US$7.4 million and US$10.2 million respectively (2005: US$6.4 million and US$15.6 million respectively). The overall expected rate of return on the plan assets is determined based on market prices, applicable to the period over which the obligation is to be settled. The expected return is determined separately for equity and debt securities.

c) The movements in the present value of fund obligations were as follows:-

	2006	2005
	US$ millions	US$ millions
At 1st January	138.1	134.4
Current service cost	3.8	4.0
Interest cost	7.0	6.7
Actuarial (gains) / losses	(4.7)	10.5
Benefits paid by the plan	(2.3)	(1.8)
Exchange rate movements	19.8	(15.7)
At 31st December	161.7	138.1

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9. POST RETIREMENT BENEFITS (continued)

d) The movements in the net liability recognised in the consolidated balance sheet were as follows:-

	2006	2005
	US$ millions	US$ millions
At 1st January	(1.5)	2.1
Net expense included in staff expenses	(5.5)	(6.2)
Contributions paid by the Group	2.4	2.3
Exchange rate movements	(2.7)	0.3
At 31st December	(7.3)	(1.5)

The Group paid US$2.4 million in contributions to the plan during 2006 and expects to pay US$3.6 million during 2007.

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

	2006	2005
	US$ millions	US$ millions
Current service cost	3.8	4.0
Interest cost	7.0	6.7
Expected return on plan assets	(7.4)	(6.4)
Losses on curtailments and settlements	-	0.2
Amortisation of actuarial loss	2.1	1.7
Net expense included in staff expenses	5.5	6.2

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

	2006	2005
Discount rate	5.1%	4.9%
Expected return on plan assets - equities	7.4%	7.4%
Expected return on plan assets - bonds	4.9%	4.4%
Future salary increases	3.9%	4.4%
Future increases to pensions in payment	2.8%	2.9%

g) Historical information

	2006	2005	2004	2003	2002
	US$ millions	US$ millions	US$ millions	US$ millions	US$ millions
Fair value of plan assets	132.5	105.9	100.0	80.2	59.1
Present value of fund obligations	161.7	138.1	134.4	94.1	78.1
Deficit in the plan	29.2	32.2	34.4	13.9	19.0
Experience gains on plan assets	3.5	10.4	11.0	12.8	13.6
Experience gains / (losses) on plan liabilities	0.3	5.0	(3.0)	(0.4)	0.6

10. DEPOSITS

Deposits from customers include deposits from central banks.

The geographical composition of total deposits was as follows:-

	31.12.06	31.12.05
	US$ millions	US$ millions
GCC countries	11,484.3	9,884.9
Other countries	5,383.4	3,577.6
	16,867.7	13,462.5

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

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11. 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 31st December 2006, the fair value of available-for-sale and trading securities that had been pledged as collateral under repurchase agreements was US$2,128.2 million and US$161.1 million respectively (2005: US$3,395.1 million and US$359.6 million respectively).

12. OTHER LIABILITIES

	31.12.06 US$ millions	31.12.05 US$ millions
Accrued interest	224.9	209.3
Derivative financial instruments	79.7	123.8
Deferred items	70.4	70.9
Outstanding security settlements	62.0	28.3
Minority interests	25.2	84.4
Pension plan liability	7.3	1.5
Other, including accounts payable and accrued expenses	94.0	78.1
	563.5	596.3

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 27(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.

An analysis of the pension plan liability is set out in note 9.

13. SENIOR TERM FINANCING

	Maturity	31.12.06 US$ millions	31.12.05 US$ millions
Floating rate note	2007	350.0	350.0
Islamic murabaha term facilities	2007	57.4	57.4
Islamic murabaha term facility	2008	6.1	6.1
Floating rate repo	2007-2009	500.0	500.0
Floating rate loan	2009	50.0	50.0
Islamic murabaha term facilities	2009	29.0	29.0
Floating rate loan	2010	800.0	800.0
Islamic murabaha term facilities	2010	14.6	14.6
Floating rate loan	2011	60.0	-
Floating rate loan	2006	-	55.0
Islamic murabaha term facilities	2006	-	82.4
		1,867.1	1,944.5

14. SUBORDINATED TERM FINANCING

	31.12.06 US$ millions	31.12.05 US$ millions
Floating rate note due in 2015	400.0	400.0
Floating rate loans due in 2016	150.0	-
Floating rate loans due in 2011	-	150.0
	550.0	550.0

The subordinated term financing facilities 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 financing facilities have been approved for inclusion in tier 2 capital for capital adequacy purposes by the Bank’s regulator, the Central Bank of Bahrain.

15. SHARE CAPITAL

The authorised share capital at 31st December 2006 comprised 3.0 billion shares of US$1 each (2005: 3.0 billion shares of US$1 each). The issued share capital at 31st December 2006 comprised 1.0 billion shares of US$1 each (2005: 1.0 billion shares of US$1 each). All issued shares are fully paid.

16. RESERVES

	Compulsory reserve	Voluntary reserve	Cash flow hedge reserve	Available-for-sale securities revaluation reserve	Total
	US$ millions	US$ millions	US$ millions	US$ millions	US$ millions
At 1st January 2005	**125.2**	**62.7**	**4.4**	**97.5**	**289.8**
Arising in the year:-					
- Available-for-sale securities: net fair value gains	-	-	-	15.0	15.0
- Cash flow hedges: net fair value losses	-	-	(3.0)	-	(3.0)
Transfers in the year:-					
- Transfers to net income	-	-	(3.2)	(5.0)	(8.2)
Net (losses) / gains recognised directly in equity	-	-	(6.2)	10.0	3.8
Transfers from retained earnings	20.5	20.5	-	-	41.0
At 31st December 2005	**145.7**	**83.2**	**(1.8)**	**107.5**	**334.6**
Arising in the year:-					
- Available-for-sale securities: net fair value gains	-	-	-	0.7	0.7
- Cash flow hedges: net fair value losses	-	-	(2.0)	-	(2.0)
Transfers in the year:-					
- Transfers to net income	-	-	2.6	(17.0)	(14.4)
Net gains / (losses) recognised directly in equity	-	-	0.6	(16.3)	(15.7)
Transfers from retained earnings	23.5	23.5	-	-	47.0
At 31st December 2006	**169.2**	**106.7**	**(1.2)**	**91.2**	**365.9**

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.

17. DIVIDENDS

Dividends are not accounted for until they have been ratified at the general assembly. The dividend ratified in respect of 2006 will be accounted for in equity as an appropriation of retained earnings in the year ending 31st December 2007.

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18. NET INTEREST INCOME

	2006	2005
	US$ millions	US$ millions
Interest income		
Placements and other liquid assets	283.2	162.8
Due from brokers	36.5	19.3
Available-for-sale securities	441.6	315.1
Loans and advances	474.5	253.6
Total interest income	1,235.8	750.8
Interest expense		
Deposits from banks and customers	722.8	360.4
Securities sold under agreements to repurchase	120.6	98.4
Term financing	134.7	83.0
Total interest expense	978.1	541.8
Net interest income	257.7	209.0

Interest income on available-for-sale securities includes dividends from structured finance investments, the underlying investments of which are high quality, investment-grade rated debt securities.

Interest income on loans and advances includes loan origination fees that form an integral part of the effective interest rate of the loan.

19. FEE AND COMMISSION INCOME

	2006	2005
	US$ millions	US$ millions
Fee and commission income		
Investment banking and management fees	44.2	31.0
Commissions on letters of credit and guarantee	15.7	12.0
Loan commitment fees	4.4	3.2
Other fee and commission income	3.7	2.0
Total fee and commission income	68.0	48.2
Fee and commission expense	(2.2)	(2.0)
Net fee and commission income	65.8	46.2

Investment banking and management fees comprise 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, IPOs, and mergers and acquisitions.

Fee and commission expense principally comprises security custody fees.

20. TRADING INCOME

	2006	2005
	US$ millions	US$ millions
Foreign exchange	8.3	9.1
Debt securities	25.4	13.4
Equity securities	2.8	-
Interest rate derivatives	0.3	2.0
Managed funds	11.0	18.4
Loans held for trading	0.4	0.7
	48.2	43.6

Trading income comprises gains and losses arising both on the purchase and sale, and from changes in the fair value, of trading instruments, together with the related interest income, interest expense and dividend income. Trading income accordingly incorporates all income and expenses related to the Group's trading activities.

Foreign exchange includes spot and forward foreign exchange contracts, and currency futures and options.

Equity securities includes equities, equity convertibles, and contracts for differences.

Interest rate derivatives includes interest rate swaps, forward rate agreements, interest rate options, interest rate futures, and credit derivatives.

21. OTHER INCOME

Other income principally comprises dividends on available-for-sale equity investments, and loan recoveries.

22. 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:-

- Merchant Banking: the provision of wholesale commercial financing and other credit facilities for corporate and institutional customers, and the provision of financial advisory services relating to structured financing, privatisations, IPOs and mergers and acquisitions.

- Treasury: the provision of a broad range of treasury and capital market products and services to corporate and financial institution clients, money market, proprietary investment activities and the management of the Group’s balance sheet, including funding.

- Financial Markets: the provision of asset and fund management services, and proprietary trading activities.

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 income arising on the recharge of the Group’s net free capital to business units. Unallocated overheads and exceptional charges are reported separately.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS
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22. SEGMENTAL INFORMATION (continued)

a) Business Segments (continued)

The business segment analysis is as follows:-

	Merchant Banking	Treasury	Financial Markets	Corporate and other	Total
	US$ millions	US$ millions	US$ millions	US$ millions	US$ millions
2006					
Total income	142.6	146.6	60.0	58.6	407.8
Segment result	126.0	134.9	42.3	57.5	360.7
Unallocated overhead					(96.9)
Taxation charge on overseas activities					(8.3)
Net income after tax					255.5
Segment assets	8,333.6	13,530.8	2,855.3	67.5	24,787.2
Segment liabilities	15.7	20,777.6	117.0	2,020.3	22,930.6
Total equity					1,856.6
Total liabilities and equity					24,787.2
2005					
Total income	124.7	138.5	36.1	46.7	346.0
Segment result	109.5	127.8	21.0	45.6	303.9
Unallocated overhead					(96.6)
Taxation charge on overseas activities					(4.3)
Net income after tax					203.0
Segment assets	6,428.5	13,590.5	2,782.4	55.2	22,856.6
Segment liabilities	6.6	18,907.7	143.6	2,080.4	21,138.3
Total equity					1,718.3
Total liabilities and equity					22,856.6

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 total income based on the location in which transactions are booked and income is recorded was as follows:-

	2006	2005
	US$ millions	US$ millions
GCC countries	294.1	255.5
Other countries	113.7	90.5
	407.8	346.0

The geographical analyses of deposits and risk assets are set out in notes 10 and 24 respectively.

23. 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.

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 24. An analysis of the credit risk in respect of foreign exchange and derivative financial instruments is set out in note 27 while the notional and risk-weighted exposures for credit-related financial instruments are detailed in note 28.

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, equity and commodity 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. It is recognised that there are limitations to the VaR methodology. These limitations include the fact that the historical data may not be the best proxy for future price movements. The Group performs regular back testing exercises to compare actual profits and losses with the VaR estimates to monitor the statistical validity of the VaR model. VaR is calculated based on the Group's market risk exposures at the close of the business each day. Intra-day risk levels may vary from those reported at the end of the day. In addition, losses beyond the specified confidence level are not captured by the VaR methodology. VaR is not a measure of the absolute limit of market risk and losses in excess of the VaR amounts will, on occasion, arise. To manage the risk associated with extreme market movements, the Group conducts stress testing which measures the impact of simulated abnormal changes in market rates and prices on the market values of the portfolios. 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 27.

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23. RISK MANAGEMENT (continued)

The VaR by risk class for the Group's trading positions, as calculated in accordance with the basis set out in note 30, was as follows:-

	2006				2005			
	31.12.06	Average	High	Low	31.12.05	Average	High	Low
	US$ millions	US$ millions	US$ millions	US$ millions	US$ millions	US$ millions	US$ millions	US$ millions
Interest rate risk	6.7	4.7	7.1	3.6	4.6	4.5	5.8	2.7
Foreign exchange risk	0.9	1.4	2.2	0.5	1.3	1.2	2.0	1.0
Equity risk	5.4	4.4	5.6	2.9	2.8	2.9	3.9	2.3
Total diversified risk	9.9	7.3	9.9	5.6	6.4	6.3	7.5	5.0

- **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 26. 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 27(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 shareholder's 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 strenghthening 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

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 25.

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.

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23. RISK MANAGEMENT (continued)

Capital management

The Group's lead regulator, the Central Bank of Bahrain (CBB), sets and monitors capital requirements for the Group as a whole. The parent company and individual banking operations are directly supervised by their local regulators.

In applying current capital requirements, the CBB requires the Group to maintain a prescribed minimum ratio of total regulatory capital to total risk-weighted assets. The CBB's minimum risk asset ratio is 12 per cent compared to a minimum ratio of 8 per cent prescribed by the Basel Committee on Banking Supervision. Under the CBB's guidelines, GCC governments and GCC government-owned companies are accorded preferential risk-weightings of 0 per cent and 20 per cent respectively. The Group calculates regulatory capital requirements for general market risk in its trading portfolios using a Value-at-Risk model and uses the CBB's prescribed risk weightings to determine the risk-weighted amounts for credit risk and specific market risk.

The Group's regulatory capital is analysed into two tiers:-

- Tier 1 capital, comprising issued share capital, share premium, retained earnings and reserves, adjusted to exclude revaluation gains and losses arising on the remeasurement to fair value of available-for-sale securities and derivative cash flow hedging transactions with the exception of unrealised losses arising on the remeasurement to fair value of marketable equity securities classified as available-for-sale.

- Tier 2 capital, comprising qualifying subordinated term finance, collective impairment provisions and 45 per cent of unrealised gains arising on the remeasurement to fair value of marketable equity securities classified as available-for-sale.

The CBB applies various limits to elements of the capital base. The amount of innovative tier 1 securities cannot exceed 15 per cent of total tier 1 capital; qualifying tier 2 capital cannot exceed tier 1 capital; and qualifying subordinated term finance cannot exceed 50 per cent of tier 1 capital. There also are restrictions on the amount of collective impairment provisions that may be included as part of tier 2 capital. Collective impairment provisions cannot exceed 1.25 per cent of total risk-weighted assets.

The Group's risk exposures are categorised as either trading book or banking book, and risk-weighted assets are determined according to specified requirements that seek to reflect the varying levels of risk attached to assets and off-balance sheet exposures.

The Group's policy is to maintain a strong capital base so as to maintain investor, creditor and market confidence and to sustain the future development of the business. The impact of the level of capital on shareholders' return is also recognised as well as the need to maintain a balance between the higher returns that might be possible with greater gearing and the advantages and security afforded by a sound capital position. The Group manages its capital structure and makes adjustments to the structure taking account of changes in economic conditions and strategic business plans. The capital structure may be adjusted through the dividend payout, and the issue of new shares, subordinated term finance, and innovative tier 1 capital securities.

The Group and its individually regulated operations have complied with all externally imposed capital requirements throughout the years ended 31st December 2006 and 31st December 2005.

There have been no material changes in the Group's management of capital during the years ended 31st December 2006 and 31st December 2005.

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24. GEOGRAPHICAL DISTRIBUTION OF RISK ASSETS

	31.12.06					31.12.05
	Placements, due from brokers & other liquid assets	Securities	Loans and advances	Credit-related contingent items	Total	Total
	US$ millions	US$ millions	US$ millions	US$ millions	US$ millions	US$ millions
GCC	728.1	1,497.3	7,468.4	3,358.3	13,052.1	9,921.7
Other Middle East & North Africa	55.5	73.9	303.5	127.3	560.2	554.2
Europe	3,764.8	3,387.6	355.7	243.0	7,751.1	7,803.5
North America	762.1	5,066.2	3.8	355.9	6,188.0	6,205.7
Asia	231.1	320.7	13.6	-	565.4	744.8
Latin America	-	263.3	-	10.0	273.3	207.8
	5,541.6	10,609.0	8,145.0	4,094.5	28,390.1	25,437.7

An analysis of derivative and foreign exchange instruments is set out in note 27.

25. 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	4 months to 1 year	Years 2 and 3	Years 4 and 5	Over 5 years and other	Total
	US$ millions	US$ millions	US$ millions	US$ millions	US$ millions	US$ millions
At 31st December 2006						
Cash and other liquid assets	153.2	115.0	-	-	-	268.2
Due from brokers	950.9	-	-	-	-	950.9
Placements with banks	4,305.2	17.3	-	-	-	4,322.5
Trading securities	2,186.1	-	-	-	-	2,186.1
Available-for-sale securities	126.0	389.8	1,093.3	1,780.8	5,033.0	8,422.9
Loans and advances	1,778.1	1,788.5	1,836.4	923.6	1,818.4	8,145.0
Other assets	379.8	56.2	1.2	2.0	52.4	491.6
Total assets	9,879.3	2,366.8	2,930.9	2,706.4	6,903.8	24,787.2
Deposits	15,554.5	1,313.2	-	-	-	16,867.7
Securities sold under agreements to repurchase	1,749.6	470.0	-	-	-	2,219.6
Securities sold but not yet purchased	862.7	-	-	-	-	862.7
Other liabilities	444.7	16.5	6.5	10.5	85.3	563.5
Term financing	44.0	363.3	585.1	874.7	550.0	2,417.1
Equity	-	-	-	-	1,856.6	1,856.6
Total liabilities & equity	18,655.5	2,163.0	591.6	885.2	2,491.9	24,787.2
At 31st December 2005						
Total assets	10,318.8	1,624.3	2,534.0	2,480.8	5,898.7	22,856.6
Total liabilities & equity	16,812.3	1,713.8	876.7	1,013.8	2,440.0	22,856.6

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. Total average deposits throughout 2006 for counterparties with deposits of US$10.0 million and above at 31st December 2006 amounted to US$13,542.0 million (2005: US$10,740.9 million). Formal liquidity controls are nevertheless based on contractual asset and liability maturities.

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26. INTEREST RATE RISK

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

	Within 3 months	Months 4 to 6	Months 7 to 12	Over 1 year	Non-interest bearing items	Total	*Effective interest rates*
	US$ millions	US$ millions	US$ millions	US$ millions	US$ millions	US$ millions	*%*
At 31st December 2006							
Cash and other liquid assets	153.2	55.0	60.0	-	-	268.2	*4.25*
Due from brokers	950.9	-	-	-	-	950.9	*4.15*
Placements with banks	3,780.2	117.3	300.0	125.0	-	4,322.5	*5.35*
Trading securities	1,726.3	-	-	-	459.8	2,186.1	*5.26*
Available-for-sale securities:-							
- Fixed rate	31.4	28.1	-	303.8	-	363.3	*5.42*
- Floating rate	6,548.3	672.5	32.9	-	-	7,253.7	*5.83*
- Equities & equity funds	-	-	-	-	805.9	805.9	-
Loans and advances	6,095.0	1,910.4	177.4	7.7	(45.5)	8,145.0	*6.45*
Other assets	-	-	-	-	491.6	491.6	-
Total assets	19,285.3	2,783.3	570.3	436.5	1,711.8	24,787.2	
Deposits	16,102.3	556.0	209.4	-	-	16,867.7	*5.06*
Securities sold under agreements to repurchase	1,929.6	290.0	-	-	-	2,219.6	*4.82*
Securities sold but not yet purchased	862.7	-	-	-	-	862.7	*4.84*
Other liabilities	-	-	-	-	563.5	563.5	-
Term financing	2,357.1	60.0	-	-	-	2,417.1	*5.75*
Equity	-	-	-	-	1,856.6	1,856.6	-
Total liabilities & equity	21,251.7	906.0	209.4	-	2,420.1	24,787.2	
Interest rate sensitivity gap	**(1,966.4)**	**1,877.3**	**360.9**	**436.5**	**(708.3)**	**-**	
Cumulative interest rate sensitivity gap	**(1,966.4)**	**(89.1)**	**271.8**	**708.3**	**-**	**-**	
At 31st December 2005							
Cumulative interest rate sensitivity gap	(2,153.1)	170.8	464.3	923.5	-	-	

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 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 the investment of the Group's net free capital in fixed rate government securities and fixed receive interest rate swaps. At 31st December 2006 the modified duration of these fixed rate securities and interest rate swaps was 5.95. 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 securities and interest rate swaps was US$257,000.

Based on the repricing profile at 31st December 2006, 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 one 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$8.4 million and US$11.2 million respectively (2005: US$6.6 million and US$8.3 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 23. The market risk relating to foreign exchange and derivative trading instruments is set out in note 27.

27. 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, equity and commodity 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.

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.

The Group buys and sells credit protection through credit default swaps. Credit default swaps provide protection against the decline in value of a referenced asset as a result of credit events such as default or bankruptcy. It is similar in structure to an option whereby the purchaser pays a premium to the seller of the credit default swap in return for payment related to the deterioration in value of the referenced asset. Credit default swaps purchased by the Group, which are principally entered into to hedge credit risk exposures within the trading securities portfolio, are classified as derivative financial instruments. Credit default swaps sold by the Group are classified as direct credit substitutes within credit-related financial instruments.

The Group also transacts in other derivative products including exchange traded commodity options.

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27. DERIVATIVE AND FOREIGN EXCHANGE INSTRUMENTS (continued)

a) Product analysis

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

	Notional amounts			Credit risk
	Trading	Hedging	Total	amounts
	US$ millions	US$ millions	US$ millions	US$ millions
At 31st December 2006				
Foreign exchange contracts:-				
Unmatured spot, forward and futures contracts	2,272.2	2,940.2	5,212.4	19.7
Options purchased	169.4	-	169.4	5.0
Options written	169.4	-	169.4	-
	2,611.0	2,940.2	5,551.2	24.7
Interest rate contracts:-				
Futures	3,893.5	-	3,893.5	-
Interest rate swaps and swaptions	2,119.2	5,130.8	7,250.0	40.1
Options, caps and floors purchased	3,783.1	13.2	3,796.3	1.1
Options, caps and floors written	5,109.2	13.2	5,122.4	-
	14,905.0	5,157.2	20,062.2	41.2
Equity contracts:-				
Contracts for differences	1.7	-	1.7	0.2
Credit contracts:-				
Protection bought	391.1	-	391.1	1.4
Total	17,908.8	8,097.4	26,006.2	67.5
At 31st December 2005				
Total	12,766.2	9,112.8	21,879.0	49.8

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 31st December 2006 the Value-at-Risk of the foreign exchange, interest rate, equity, and credit derivative trading contracts analysed in the table above, as calculated in accordance with the basis set out in note 30, was US$0.5 million, US$0.5 million, nil and US$0.6 million respectively (2005: nil, US$0.7 million, nil and US$1.2 million 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

	31.12.06			31.12.05
Credit risk amounts	Banks	Other	Total	Total
	US$ millions	US$ millions	US$ millions	US$ millions
OECD countries	43.9	-	43.9	39.9
GCC countries	1.4	20.8	22.2	9.8
Other countries	0.1	1.3	1.4	0.1
	45.4	22.1	67.5	49.8

Credit risk is concentrated on major OECD-based banks.

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27. DERIVATIVE AND FOREIGN EXCHANGE INSTRUMENTS (continued)

c) Maturity analysis

	Year 1	Years 2 & 3	Years 4 & 5	Over 5 years	Total
	US$ millions	US$ millions	US$ millions	US$ millions	US$ millions
At 31st December 2006					
Foreign exchange contracts	5,547.6	3.6	-	-	5,551.2
Interest rate contracts	14,292.9	2,678.0	1,291.0	1,800.3	20,062.2
Equity contracts	-	-	-	1.7	1.7
Credit contracts	80.4	96.5	34.8	179.4	391.1
Total	19,920.9	2,778.1	1,325.8	1,981.4	26,006.2
At 31st December 2005					
Total	17,404.4	1,430.6	1,351.2	1,692.8	21,879.0

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

d) Fair value analysis

	31.12.06		31.12.05	
	Positive fair value	Negative fair value	Positive fair value	Negative fair value
	US$ millions	US$ millions	US$ millions	US$ millions
Derivatives held for trading:-				
Forward foreign exchange contracts	0.6	(0.5)	5.1	(2.7)
Foreign exchange options	8.4	(8.5)	5.8	(5.8)
Interest rate futures	1.5	-	0.7	-
Interest rate swaps and swaptions	19.4	(16.4)	13.7	(12.6)
Interest rate options, caps and floors	-	-	0.4	(0.5)
Equities - contracts for differences	1.2	-	2.1	(4.2)
Credit default swaps	1.4	(2.0)	0.4	(1.2)
	32.5	(27.4)	28.2	(27.0)
Derivatives held as fair value hedges:- Interest rate swaps	10.0	(51.1)	8.2	(93.0)
Derivatives held as cash flow hedges:- Interest rate swaps	-	(1.2)	-	(3.8)
Amount included in other assets / (other liabilities)	42.5	(79.7)	36.4	(123.8)

e) Significant net open positions

There were no significant derivative trading or foreign currency net open positions at either 31st December 2006 or at 31st December 2005.

f) Hedge effectiveness

There were no ineffective portions of fair value or cash flow derivative hedging transactions recognised in the consolidated statement of income in either the year ended 31st December 2006 or the year ended 31st December 2005.

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28. 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.

	31.12.06		31.12.05	
	Notional principal amount	**Risk-weighted exposure**	Notional principal amount	Risk-weighted exposure
	US$ millions	US$ millions	US$ millions	US$ millions
Direct credit substitutes	**398.7**	**350.6**	335.7	271.7
Transaction-related contingent items	**969.5**	**455.5**	838.2	388.2
Short-term self-liquidating trade-related contingent items	**409.2**	**75.5**	234.3	40.0
Commitments, including undrawn loan commitments and underwriting commitments under note issuance and revolving facilities	**2,317.1**	**988.7**	1,541.4	681.2
	4,094.5	**1,870.3**	2,949.6	1,381.1

29. 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
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30. CAPITAL ADEQUACY

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

		31.12.06 US$ millions	31.12.05 US$ millions
Regulatory capital base			
Tier 1 capital:			
Total equity		1,856.6	1,718.3
Adjustment to exclude net fair value gains		(90.0)	(105.7)
Tier 1 capital		1,766.6	1,612.6
Tier 2 capital:			
Subordinated term financing		550.0	550.0
Non-specific loan provision		60.0	50.0
Tier 2 capital		610.0	600.0
Total regulatory capital base	*(a)*	2,376.6	2,212.6

Risk-weighted exposure

	31.12.06 Notional principal amount US$ millions	31.12.06 Risk-weighted exposure US$ millions	31.12.05 Notional principal amount US$ millions	31.12.05 Risk-weighted exposure US$ millions
Credit risk				
Balance sheet items:				
Cash and other liquid assets	268.2	52.1	345.4	68.2
Due from brokers	950.9	-	942.2	-
Placements	4,322.5	900.1	5,079.7	1,152.5
Securities	10,609.0	7,618.7	9,847.1	7,003.2
Loans and advances	8,145.0	7,318.4	6,273.7	5,907.5
Other assets	491.6	319.8	368.5	229.7
	24,787.2	16,209.1	22,856.6	14,361.1
Off-balance sheet items:				
Credit-related contingent items	4,094.5	1,870.3	2,949.6	1,381.1
Forward asset purchases	214.7	42.9	120.2	24.0
Foreign exchange-related items	5,551.2	9.3	4,040.5	13.3
Derivative-related items	20,455.0	12.8	17,838.5	11.5
	30,315.4	1,935.3	24,948.8	1,429.9
Credit risk-weighted exposure		18,144.4		15,791.0
Market risk				
General market risk		491.5		353.3
Specific market risk		1,782.6		1,332.4
Market risk-weighted exposure		2,274.1		1,685.7
Total risk-weighted exposure	*(b)*	20,418.5		17,476.7
Risk asset ratio [(a)/(b) x 100]		11.6%		12.7%

30. CAPITAL ADEQUACY (continued)

In accordance with the capital adequacy guidelines of the Bank's regulator, the Central Bank of Bahrain (CBB), 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 1 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 CBB's guidelines, gains arising on the remeasurement to fair value of marketable equity securities classified as available for sale are included in tier 2 capital. There were no fair value gains or losses in relation to marketable equity securities classified as available for sale at either 31st December 2006 or at 31st December 2005.

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 CBB. 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 (2005: 3.0) by the CBB.

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.

31. 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 31st December 2006 was US$21,689.5 million (2005: US$17,918.7 million).

32. RELATED PARTY TRANSACTIONS

The Group's related party transactions are limited to the compensation of its directors and executive officers.

The compensation of key management personnel was as follows:-

	2006	2005
	US$ millions	US$ millions
Short term employee benefits	10.2	9.0
Post-employment benefits	0.7	0.6
	10.9	9.6

Key management personnel comprise members of the Board of Directors, the Group Chief Executive Officer, the Chief Operating Officer and the Managing Directors of the Group.

There were no other related party transactions.

33. FAIR VALUE OF FINANCIAL INSTRUMENTS

The Group's financial instruments are accounted for under the historical cost method with the exception of trading securities, available-for-sale securities, securities sold but not yet purchased and derivative financial instruments. 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.

Based on the valuation methodologies outlined below, the fair values of all on- and off-balance sheet financial instruments were not significantly different to their net book values.

a) Securities

The fair values of securities are based on quoted market prices with the exception of investments in unquoted equity investments, the fair values of which are based on their book values.

b) Loans and advances

The fair values of loans held for trading are based on quoted market prices. The fair values of other loans on a floating interest rate basis are principally estimated at book value less provisions for impairment. The fair values of troubled sovereign debt are based on market bid prices. The fair values of impaired loans are 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 values of fixed rate loans are 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.

c) Term financing

The fair value of term financing is 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.

d) Other on-balance sheet items

The fair values of foreign exchange and derivative financial instruments are based on market prices, discounted cash flow models or option pricing models as appropriate. The fair values of all other on-balance sheet items approximate 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 made in respect of individual transactions where a potential for loss has been identified are included in provisions for the impairment of loans and advances.

34. 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.

	2006	2005
Net income after tax (US$ millions)	**255.5**	203.0
Weighted average number of shares in issue (millions)	**1,000.0**	1,000.0
Basic earnings per share	US$0.26	US$0.20

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS
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35. PRINCIPAL SUBSIDIARIES

The principal subsidiary companies were as follows:-

	Country of incorporation	Ownership interest 31.12.06	31.12.05
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%

36. AVERAGE CONSOLIDATED BALANCE SHEET

The average consolidated balance sheet was as follows:-

	At 31.12.06 US$ millions	At 31.12.05 US$ millions
Assets		
Cash and other liquid assets	462.0	189.1
Due from brokers	1,080.2	759.2
Placements with banks	5,338.6	4,588.4
Trading securities	2,132.1	1,751.8
Available-for-sale securities	8,032.4	7,906.0
Loans and advances	7,585.7	5,411.2
Other assets	581.8	423.7
Total assets	25,212.8	21,029.4
Liabilities		
Deposits from banks	5,140.9	4,664.4
Deposits from customers	11,383.1	7,707.9
Securities sold under agreements to repurchase	2,844.2	3,487.8
Securities sold but not yet purchased	925.8	691.7
Other liabilities	729.7	678.7
Senior term financing	1,883.1	1,918.0
Subordinated term financing	546.2	257.8
Total liabilities	23,453.0	19,406.3
Total equity	1,759.8	1,623.1
Total liabilities & equity	25,212.8	21,029.4

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS
for the year ended 31st December 2006

37. PARENT COMPANY

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

a) Condensed balance sheet

	At 31.12.06 US$ millions	At 31.12.05 US$ millions
Assets		
Cash and other liquid assets	178.3	286.4
Placements with banks	2,445.3	3,065.4
Trading securities	377.1	256.2
Available-for-sale securities	8,402.4	7,789.7
Investment in GIBUK	346.6	330.2
Loans and advances	8,144.9	6,233.9
Other assets	397.2	305.4
Total assets	20,291.8	18,267.2
Liabilities		
Deposits from banks	5,611.4	3,994.6
Deposits from customers	7,928.1	6,272.6
Securities sold under agreements to repurchase	2,056.1	3,352.5
Other liabilities	422.3	434.7
Senior term financing	1,867.1	1,944.5
Subordinated term financing	550.0	550.0
Total liabilities	18,435.0	16,548.9
Total equity	1,856.8	1,718.3
Total liabilities & equity	20,291.8	18,267.2

The investment in GIBUK is accounted for at fair value. Gains and losses arising from changes in the fair value of the investment are accounted for in equity.

b) Condensed income statement

	Year ended 31.12.06 US$ millions	Year ended 31.12.05 US$ millions
Net interest income	235.3	188.4
Provisions for securities	-	14.3
Provisions for loans and advances	(0.8)	(9.4)
Net interest income after provisions	236.1	183.5
Fee and commission income	39.5	25.5
Profits on available-for-sale securities	28.7	45.4
Trading income	17.1	25.3
Dividend received from GIBUK	6.4	13.3
Other income	2.9	2.4
Total income	330.7	295.4
Operating expenses	86.8	85.8
Net income before tax	243.9	209.6
Taxation charge on overseas activities	8.3	4.1
Net income after tax	235.6	205.5