GULF INTERNATIONAL BANK B.S.C.

2007 CONSOLIDATED

FINANCIAL STATEMENTS

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Consolidated Balance Sheet

	Note	At 31.12.07 US$ millions	At 31.12.06 US$ millions
ASSETS			
Cash and other liquid assets	*5*	532.7	268.2
Due from brokers	*6*	243.3	950.9
Placements with banks	*7*	5,629.1	4,322.5
Trading securities	*8*	1,342.6	2,186.1
Available-for-sale securities	*9*	8,070.7	8,422.9
Loans and advances	*10*	12,601.8	8,145.0
Other assets	*11*	1,533.8	491.6
Total assets		29,954.0	24,787.2
LIABILITIES			
Deposits from banks	*13*	5,970.7	5,704.0
Deposits from customers	*13*	13,674.0	11,163.7
Securities sold under agreements to repurchase	*14*	4,141.5	2,219.6
Securities sold but not yet purchased	*6*	233.2	862.7
Other liabilities	*15*	511.5	563.5
Senior term financing	*16*	2,657.8	1,867.1
Subordinated term financing	*17*	550.0	550.0
Total liabilities		27,738.7	22,930.6
EQUITY			
Share capital	*18*	1,500.0	1,000.0
Proposed increase in share capital	*18*	1,000.0	-
Share premium		7.6	7.6
Reserves	*19*	109.6	365.9
Retained earnings		(401.9)	483.1
Total equity		2,215.3	1,856.6
Total liabilities & equity		29,954.0	24,787.2

The consolidated financial statements were approved by the Board of Directors on 20th February 2008 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 41 form part of these consolidated financial statements.

Consolidated Statement of Income

	Note	Year ended 31.12.07 US$ millions	Year ended 31.12.06 US$ millions
Interest income	*21*	1,512.7	1,235.8
Interest expense	*21*	1,207.1	978.1
Net interest income		305.6	257.7
Fee and commission income	*22*	88.1	65.8
Trading (loss) / income	*23*	(86.6)	48.2
Profits on available-for-sale securities		29.6	28.8
Other income	*24*	5.7	4.9
Total income		342.4	405.4
Staff expenses		98.3	101.9
Premises expenses		11.1	8.2
Other operating expenses		31.8	33.9
Total operating expenses		141.2	144.0
Net income before provisions and tax		201.2	261.4
Provisions for available-for-sale securities	*9*	(965.7)	1.6
Provisions for loans and advances	*10*	6.9	0.8
Net (loss) / income before tax		(757.6)	263.8
Taxation credit / (charge) on overseas activities		0.3	(8.3)
Net (loss) / income		(757.3)	255.5
Earnings per share	*37*	*(US$0.55)*	*US$0.26*

Ebrahim Bin Khalifa Al Khalifa
Chairman

Dr. Khaled M. Al-Fayez
Chief Executive Officer

The notes on pages 5 to 41 form part of these consolidated financial statements.

Consolidated Statement of Cash Flows

	Year ended 31.12.07 US$ millions	Year ended 31.12.06 US$ millions
OPERATING ACTIVITIES		
Net (loss) / income after tax	(757.3)	255.5
Adjustments to reconcile net (loss) / income to net cash inflow / (outflow) from operating activities:		
Provisions for available-for-sale securities	965.7	(1.6)
Provisions for loans and advances	(6.9)	(0.8)
Profits on available-for-sale securities	(29.6)	(28.8)
Amortisation of available-for-sale securities	2.6	2.9
Increase in accrued interest receivable	(6.4)	(66.7)
Increase in accrued interest payable	35.3	15.6
Increase in other net assets	(127.6)	(60.6)
Net decrease / (increase) in trading securities	843.5	(178.6)
Net cash inflow / (outflow) from operating activities	919.3	(63.1)
INVESTING ACTIVITIES		
Net decrease / (increase) in due from brokers	707.6	(8.7)
Net (increase) / decrease in placements with banks	(1,306.6)	757.2
Net increase in loans and advances	(4,449.9)	(1,870.5)
Purchase of available-for-sale securities	(2,653.8)	(1,730.1)
Sale and maturity of available-for-sale securities	1,815.4	1,114.4
Net cash outflow from investing activities	(5,887.3)	(1,737.7)
FINANCING ACTIVITIES		
Net increase in deposits from banks	266.8	1,612.3
Net increase in deposits from customers	2,510.3	1,792.9
Net increase / (decrease) in securities sold under agreements to repurchase	1,921.9	(1,491.9)
Net decrease in securities sold but not yet purchased	(629.5)	(10.8)
Net increase / (decrease) in senior term financing	790.7	(77.4)
Increase in share capital	500.0	-
Dividends paid	(127.7)	(101.5)
Net cash inflow from financing activities	5,232.5	1,723.6
Increase / (decrease) in cash and cash equivalents	264.5	(77.2)
Cash and cash equivalents at 1 st January	268.2	345.4
Cash and cash equivalents at 31 st December	532.7	268.2

The notes on pages 5 to 41 form part of these consolidated financial statements.

Consolidated Statement of Changes in Equity

	Share capital	Proposed increase in share capital	Share premium	Reserves	Retained earnings	Total
	US$ millions	US$ millions	US$ millions	US$ millions	US$ millions	US$ millions
At 1st January 2006	**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 statement of 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**
Arising in the year:-						
- Available-for-sale securities:						
net fair value losses	-	-	-	(248.8)	-	(248.8)
- Cash flow hedges:						
net fair value gains	-	-	-	1.3	-	1.3
Transfers in the year:-						
- Transfers to statement of income	-	-	-	(8.8)	-	(8.8)
Net losses recognised directly in equity	-	-	-	(256.3)	-	(256.3)
Increase in share capital	500.0	1,000.0	-	-	-	1,500.0
Dividend for 2006	-	-	-	-	(127.7)	(127.7)
Net loss for the year	-	-	-	-	(757.3)	(757.3)
At 31st December 2007	**1,500.0**	**1,000.0**	**7.6**	**109.6**	**(401.9)**	**2,215.3**

The notes on pages 5 to 41 form part of these consolidated financial statements.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS
for the year ended 31st December 2007

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 608.

2. ACCOUNTING POLICIES

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

2.1 Basis of preparation

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.

During the year, the Group adopted IFRS 7 - Financial Instruments: Disclosures which increased the level of disclosures in the consolidated financial statements. The adoption of IFRS 7 had no impact on the reported income and losses or the financial position of the Group. In accordance with the transitional requirements of the standard 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 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 gains and losses are included in trading income.

2.4 Financial assets and liabilities

Financial assets and liabilities comprise all assets and liabilities reflected on the balance sheet, although excluding investments in subsidiaries, associated companies and joint ventures, employee benefit plans, property and equipment, deferred taxation and taxation payable.

a) Initial recognition and measurement

Financial assets are classified at inception into one of the following three categories:-

- held-for-trading
- loans and receivables
- available-for-sale

Financial assets are initially recognised at fair value, including transaction costs that are directly attributable to the acquisition of the financial asset.

Financial liabilities are initially recognised at fair value, representing the proceeds received net of premiums, discounts and transaction costs that are directly attributable to the financial liability.

All regular way purchases and sales of financial assets and liabilities 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 or liability . All regular way purchases and sales of other financial assets and liabilities are recognised on the settlement date, i.e. the date on which the asset or liability is received from or delivered to 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. ACCOUNTING POLICIES (continued)

2.4 Financial assets and liabilities (continued)

b) Subsequent measurement

Subsequent to initial measurement, financial assets and liabilities are measured at either fair value or amortised cost, depending on their classification:-

Held-for-trading

Held-for-trading financial assets and liabilities are assets or liabilities acquired or incurred 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.

Held-for-trading financial assets and liabilities are measured at fair value. The fair value for financial assets and liabilities traded in active markets is based on quoted prices, including quotations obtained from lead managers, brokers and dealers. The bid price is used to measure financial assets and the offer price is used to measure financial liabilities. Mid-market prices are used to measure fair value only to the extent that the Group has financial assets and liabilities with offsetting risk positions.

For all other held-for-trading financial assets and liabilities not traded in an active market, fair value is determined using appropriate valuation techniques. Valuation techniques include comparison to similar instruments for which there are observable prices, discounted cash flow techniques, and option pricing models.

Realised and unrealised gains and losses, interest earned or incurred, and dividends received on held-for-trading financial assets and liabilities are included in trading income.

Loans and receivables

Loans and receivables are non-derivative financial assets with fixed or determinable payments that are not quoted in an active market, other than those classified as held-for-trading. The majority of the Group's loans and receivables are included in the loans and advances balance sheet category.

Financial assets classified as loans and receivables are stated at amortised cost using the effective interest rate method as described in note 2.7(a), less provision for impairment, with interest revenue recognised in the consolidated statement of income.

Available-for-sale financial assets

Available-for-sale financial assets are assets 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. Available-for-sale financial assets are measured at fair value. The fair value for available-for-sale financial assets in active markets is based on quoted prices, including quotations obtained from lead managers, brokers and dealers. The fair value for available-for-sale financial assets in inactive markets is determined using appropriate valuation techniques. Valuation techniques include comparison to similar instruments for which there are observable prices, and discounted cash flow techniques. 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 financial assets are recognised in a separate revaluation reserve in equity. The cumulative fair value adjustments on available-for-sale financial assets which are sold or otherwise disposed or become impaired, and which had previously been recognised in equity are transferred to the consolidated statement of income.

Non-trading financial liabilities

All financial liabilities, other than those designated as held-for-trading, are classified as non-trading financial liabilities and are measured at amortised cost using the effective interest rate method as described in note 2.7(a).

2. ACCOUNTING POLICIES (continued)

c) Derecognition of financial assets and liabilities

Financial assets are derecognised and removed from the consolidated 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 consolidated balance sheet when the obligation is discharged, cancelled, or expires.

2.5 Impairment of financial assets

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. Objective evidence that a financial asset is impaired may include a breach of contract, such as default or delinquency in interest or principal payments, the granting of a concession that, for economic or legal reasons relating to the borrower's financial difficulties, that would not otherwise be considered, indications that it is probable that the borrower will enter bankruptcy or other financial reorganisation, the disappearance of an active market, or other observable data relating to a group of assets such as adverse changes in the payment status of borrowers or issuers in the group, or economic conditions that correlate with defaults in the group. For equity securities classified as available-for-sale, a significant or prolonged decline in fair value below cost is considered in determining whether a security is impaired. Where such evidence exists, the cumulative net loss that has been previously recognised directly in equity is removed from equity and recognised in the consolidated statement of income. The amount of the cumulative loss that is removed from equity and recognised in the consolidated statement of income is the difference between the acquisition cost and current fair value, less any impairment loss on that security previously recognised in the consolidated statement of income.

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.

Provisions for impairment are recognised in the consolidated statement of income and are reflected in an allowance account against loans and advances and available-for-sale securities.

Financial assets 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.

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.

Financial assets which have been renegotiated are no longer considered to be past due and are replaced on performing status when all principal and interest payments are up to date and future payments are reasonably assured. Financial assets subject to individual impairment assessment and whose terms have been renegotiated, are subject to ongoing review to determine whether they remain impaired or should be considered past due.

2.6 Offsetting financial assets and liabilities

Financial assets and financial 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 Revenue recognition

a) Interest income and interest expense

Interest income and interest expense for all interest-bearing financial assets and liabilities 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 asset or liability 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 either 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.

2.8 Securities financing arrangements

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

2.9 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. ACCOUNTING POLICIES (continued)

2.10 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.

2.11 Derivative financial instruments and hedge accounting

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, credit 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 consolidated statement of income 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 relating to the hedged item over the life of the derivative instrument.

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

Some hybrid transactions contain both a derivative and non-derivative component. In such cases, the derivative is categorised as an embedded derivative. If the economic characteristics and risks of the embedded derivative are not closely related to those of the host contract, and the overall contract itself is not carried at fair value, the embedded derivative is bifurcated and measured at fair value. Changes in fair value are included in trading income.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS
for the year ended 31st December 2007

2. ACCOUNTING POLICIES (continued)

2.12. 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.

2.13 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.

2.14 Taxation

a) Current tax

Current taxation is the expected tax payable on the taxable income for the year, using tax rates enacted at the balance sheet date, and includes any adjustments to tax payable in respect of previous years.

b) Deferred tax

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

2.15 Cash and cash equivalents

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

2.16 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.

2.17 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.

2. ACCOUNTING POLICIES (continued)

2.18 Dividends

Dividends on issued shares are recognised as a liability and deducted from equity when they are approved by the Bank's shareholders.

2.19 Comparatives

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

2.20 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 2007. The relevant new standards, amendments to standards, and interpretations, are as follows:

- IFRIC 14 - The Limit on a Defined Benefit Asset, Minimum Funding Requirements and their Interaction. IFRIC 14 becomes effective for financial years beginning on or after 1st January 2008. This interpretation addresses issues relating to IAS 19 - Employee Benefits on the amount of a surplus in a pension plan that entities can recognise as an asset, how a minimum funding requirement affects that limit, and when a minimum funding requirement creates an obligation that should be recognised as a liability. The adoption of this interpretation is not expected to have any material impact on the consolidated financial statements.

- IAS 1 - Presentation of Financial Statements. IAS 1 becomes effective for financial years beginning on or after 1st January 2009. The adoption of this standard will result in changes in the presentation of the consolidated financial statements and is not expected to have any impact on the financial position of the Group.

- IFRS 8 - Operating Segments. IFRS 8 becomes effective for financial years beginning on or after 1st January 2009. This standard replaces IAS 14 - Segment Reporting and prescribes disclosure requirements in relation to the Group's operating segments, products, services and geographical areas in which it operates. The adoption of this standard is not expected to have any material impact on the consolidated financial statements.

3. ACCOUNTING ESTIMATES AND ASSUMPTIONS

The preparation of the consolidated financial statements requires management to make estimates and assumptions that affect the reported amounts of certain financial assets, liabilities, income and expenses.

The use of estimates and assumptions is principally limited to the determination of provisions for impairment, the valuation of financial instruments, and the valuation of the Group's defined benefit pension plan as explained in more detail below:-

Provisions for impairment

Financial assets are evaluated for impairment on the basis set out in note 2.5.

In determining provisions for impairment, judgement is required in the estimation of the amount and timing of future cash flows.

In addition to provisions for impairment against specific assets, the Group also maintains provisions that are measured and recognised on a collective basis. Key assumptions included in the measurement of the portfolio provisions include data on the probability of default and the eventual recovery amount in the event of a forced sale or write off. These assumptions are based on observed historical data and updated as considered appropriate to reflect current conditions. The accuracy of the portfolio provisions would therefore be affected by unexpected changes in these assumptions.

Equity securities classified as available-for-sale are considered to be impaired when there has been a significant or prolonged decline in fair value below cost. The determination of significant or prolonged requires judgement. In making the judgement, a number of factors are taken into account including the normal volatility in valuation, evidence of a deterioration in the financial condition of the investee, industry and sector performance, and operational and financing cash flows.

Fair value of financial assets and liabilities

Where the fair value of financial assets and liabilities cannot be derived from active markets, they are determined using a variety of valuation techniques that include the use of mathematical models. The input to these models is derived from observable markets where available, but where this is not feasible, a degree of judgement is required in determining assumptions used in the models. Changes in assumptions used in the models could affect the reported fair value of financial assets and liabilities.

Retirement benefit obligations

Management, in coordination with an independent qualified actuary, are required to make assumptions regarding the defined benefit pension plan, changes in which could affect the reported liability, service cost and expected return on pension plan assets. The principal actuarial assumptions for the defined benefit pension plan are set out in note 12 and include assumptions on the discount rate, expected return on pension plan assets, mortality, future salary increases, and inflation. Changes in the assumptions could affect the reported liability, service cost and expected return on pension plan assets.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS
for the year ended 31st December 2007

4. CLASSIFICATION OF FINANCIAL INSTRUMENTS

The classification of assets and liabilities by accounting categorisation was as follows:-

	Held-to-maturity	Loans and receivables	Held-for-trading	Available-for-sale	Financial liabilities at amortised cost	Non-financial assets & liabilities	Total
	US$ millions	US$ millions	US$ millions	US$ millions	US$ millions	US$ millions	US$ millions
At 31st December 2007							
Cash and other liquid assets	359.9	172.8	-	-	-	-	532.7
Due from brokers	-	243.3	-	-	-	-	243.3
Placements with banks	5,629.1	-	-	-	-	-	5,629.1
Trading securities	-	-	1,342.6	-	-	-	1,342.6
Available-for-sale securities	-	-	-	8,070.7	-	-	8,070.7
Loans and advances	-	12,578.6	23.2	-	-	-	12,601.8
Other assets	-	1,442.6	46.3	-	-	44.9	1,533.8
Total assets	5,989.0	14,437.3	1,412.1	8,070.7	-	44.9	29,954.0
Deposits from banks	-	-	-	-	5,970.7	-	5,970.7
Deposits from customers	-	-	-	-	13,674.0	-	13,674.0
Securities sold under agreements to repurchase	-	-	-	-	4,141.5	-	4,141.5
Securities sold but not yet purchased	-	-	233.2	-	-	-	233.2
Other liabilities	-	-	85.5	-	-	426.0	511.5
Senior term financing	-	-	-	-	2,657.8	-	2,657.8
Subordinated term financing	-	-	-	-	550.0	-	550.0
Equity	-	-	-	-	-	2,215.3	2,215.3
Total liabilities & equity	-	-	318.7	-	26,994.0	2,641.3	29,954.0
At 31st December 2006							
Cash and other liquid assets	150.6	117.6	-	-	-	-	268.2
Due from brokers	-	950.9	-	-	-	-	950.9
Placements with banks	4,322.5	-	-	-	-	-	4,322.5
Trading securities	-	-	2,186.1	-	-	-	2,186.1
Available-for-sale securities	-	-	-	8,422.9	-	-	8,422.9
Loans and advances	-	8,132.3	12.7	-	-	-	8,145.0
Other assets	-	416.6	42.5	-	-	32.5	491.6
Total assets	4,473.1	9,617.4	2,241.3	8,422.9	-	32.5	24,787.2
Deposits from banks	-	-	-	-	5,704.0	-	5,704.0
Deposits from customers	-	-	-	-	11,163.7	-	11,163.7
Securities sold under agreements to repurchase	-	-	-	-	2,219.6	-	2,219.6
Securities sold but not yet purchased	-	-	862.7	-	-	-	862.7
Other liabilities	-	-	79.7	-	-	483.8	563.5
Senior term financing	-	-	-	-	1,867.1	-	1,867.1
Subordinated term financing	-	-	-	-	550.0	-	550.0
Equity	-	-	-	-	-	1,856.6	1,856.6
Total liabilities & equity	-	-	942.4	-	21,504.4	2,340.4	24,787.2

The held-for-trading category includes the fair values of derivatives designated as fair value and cash flow hedges.

The Group did not have any financial assets or financial liabilities classified as fair value through the statement of income, other than those classified as held-for-trading, at either 31st December 2007 or 31st December 2006.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS
for the year ended 31st December 2007

5. CASH AND OTHER LIQUID ASSETS

	31.12.07 US$ millions	31.12.06 US$ millions
Cash and balances with banks	**172.8**	117.6
Certificates of deposit	**186.2**	150.0
Treasury bills	**173.7**	0.6
	532.7	268.2

6. DUE FROM BROKERS

Due from brokers represents balances held with brokers as collateral for held-for-trading liabilities (securities sold but not yet purchased) transactions.

7. PLACEMENTS WITH BANKS

Placements with banks at 31st December 2007 included placements with non-bank financial institutions amounting to US$18.3 million (2006: US$54.6 million).

8. TRADING SECURITIES

	31.12.07 US$ millions	31.12.06 US$ millions
Government bonds and bills	**278.2**	534.0
Listed debt securities	**623.0**	1,192.3
Managed funds	**421.4**	411.4
Equities	**20.0**	48.4
	1,342.6	2,186.1

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.

9. AVAILABLE-FOR-SALE SECURITIES

a) Classification of available-for-sale securities

The credit rating profile of available-for-sale securities, based on the lowest rating assigned by the major international rating agencies, was as follows:-

Rating	31.12.07		31.12.06	
	US$ millions	%	US$ millions	%
AAA / Aaa	**1,996.9**	**25.7**	1,750.4	23.0
AA- to AA+ / Aa3 to Aa1	**1,589.3**	**20.5**	1,158.2	15.2
A- to A+ / A3 to A1	**3,243.1**	**41.7**	3,860.0	50.6
BBB- to BBB+ / Baa3 to Baa1	**766.2**	**9.9**	652.2	8.6
Other debt securities	**172.2**	**2.2**	196.2	2.6
Total debt securities	**7,767.7**	**100.0**	7,617.0	100.0
Structured finance investments	**81.8**		717.6	
Equity investments	**221.2**		88.3	
Total	**8,070.7**		8,422.9	

The Group's available-for-sale securities predominantly comprise investment grade-rated debt securities. At 31st December 2007, 97.8 per cent of available-for-sale debt securities were investment grade-rated (2006: 97.4 per cent).

An analysis of the basis used for determining the fair values of available-for-sale securities is set out in note 36. At 31st December 2007 US$7,338.3 million or 90.9 per cent of available-for-sale securities were valued based on quoted prices, including quotations from lead managers, dealers and brokers (2006: US$7,914.6 million or 94.0 per cent). An additional US$246.3 million or 3.1 per cent was valued based on cost less provision for impairment (2006: US$151.1 million or 1.8 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. At 31st December 2007, the original cost and related specific provisions of the structured finance investments amounted to US$581.8 million and US$500.0 million respectively. The specific provisions therefore represented 85.9 per cent of the original cost of the investments. At 31st December 2007, the net asset values of the structured finance investments amounted to US$302.5 million, thereby exceeding the carrying value of the investments by US$220.7 million.

Equity investments principally represent investments of a private equity nature, comprising both direct investments and investments in funds managed by external specialist managers and international investment banks.

Debt securities at 31st December 2007 included GCC country government securities of US$451.3 million (2006: US$479.1 million).

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS
for the year ended 31st December 2007

a) Classification of available-for-sale securities (continued)

At 31st December 2007, the Group's unimpaired exposure to the residential mortgage sector, in the form of residential mortgage-backed securities (RMBS) and collateralised debt obligations (CDOs) containing exposure to the residential mortgage sector, was as follows:-

Residential Mortgage-Backed Securities (RMBS)

	Based on fair value		Based on ABX index	
Rating	Carrying amount	Average price	Implied value	Implied price
	US$ millions	US$	US$ millions	US$
AAA / Aaa	317.7	91	326.9	94
AA- to AA+ / Aa3 to Aa1	53.8	71	63.3	84
A- to A+ / A3 to A1	24.4	92	15.4	58
BBB- to BBB+ / Baa3 to Baa1	1.0	60	0.5	29
Total	396.9		406.1	

The ABX index implied values and prices are based on the ABX HE 2006-1 index, being the most representative ABX index for the vintages of the Group's RMBS holdings. 88.0 per cent of the Group's unimpaired RMBS were issued prior to, or in, 2006. The ABX indices represent synthetic indices reflecting the prices of series of credit default swaps based on representative selections of 20 US home equity loan asset backed securities. A new series is issued every six months based on securities issued over the preceeding period. ABX index contracts are commonly used to hedge mortgage-related asset backed security exposures. The total value of the Group's unimpaired RMBS implied by the ABX HE 2006-1 index amounted to US$406.1 million, exceeding their fair value based on quoted prices by US$9.2 million. The higher average price for the Group's A-rated RMBS security holdings compared to the ABX index was due to a security with a short remaining tenor, maturing in March 2008. US$317.7 million or 80.0 per cent of the Group's RMBS security holdings were AAA-rated.

Mortgage-Backed Collateralised Debt Obligations (CDOs)

Rating	Carrying amount	Average price
	US$ millions	US$
AAA / Aaa	105.9	60
AA- to AA+ / Aa3 to Aa1	23.5	38
A- to A+ / A3 to A1	39.0	51
BBB- to BBB+ / Baa3 to Baa1	25.9	53
Total	194.3	

US$105.9 million or 54.5 per cent of the Group's unimpaired CDOs containing exposure to the residential mortgage sector was AAA-rated while 65.2 per cent was issued prior to, or in, 2005.

The credit ratings of the Group's residential mortgage sector exposures set out above are not based on monoline insurance company guarantees or hedges.

Details of the Group's impaired securities exposures are set out in note 26(a).

b) Provisions for impairment

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

	2007	2006
	US$ millions	US$ millions
At 1st January	63.9	71.6
Exchange rate movements	0.4	1.0
Amounts utilised	(45.0)	(7.1)
Charge / (release) for the year	965.7	(1.6)
At 31st December	985.0	63.9

The provision charge for the year ended 31st December 2007 principally comprised provisions in relation to the impairment of structured finance investments and mortgage-related debt securities that were impacted by the global credit crisis witnessed during the latter months of the year.

Amounts utilised during the year ended 31st December 2007 represented provisions utilised on the exchange of structured finance investments for the underlying assets in the special purpose vehicles. The original cost of the capital notes exchanged amounted to US$117.7 million.

Provisions for the impairment of available-for-sale securities at 31st December 2007 included a US$150.0 million portfolio provision in respect of possible impairments resulting from the impact of the global credit crisis that had not been specifically identified at the balance sheet date (2006: nil).

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS
for the year ended 31st December 2007

9. AVAILABLE-FOR-SALE SECURITIES (continued)

c) Past due available-for-sale debt securities

The gross and net book value of available-for-sale debt securities for which either principal or interest was over 90 days past due were as follows:-

31.12.07		31.12.06	
Gross	Net book value	Gross	Net book value
US$ millions	US$ millions	US$ millions	US$ millions
40.7	12.2	-	-

The past due available-for-sale debt securities were past due in relation to interest only and had not yet reached their contractual maturity dates. The securities were classified as past due during the year ended 31st December 2007.

At 31st December 2007 uncollected interest-in-suspense on past due available-for-sale debt securities amounted to US$0.9 million (2006: nil).

d) Unquoted equity investments

Available-for-sale securities at 31st December 2007 included US$107.2 million (2006: US$81.4 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 represent private equity investments and 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.

10. LOANS AND ADVANCES

	31.12.07	31.12.06
	US$ millions	US$ millions
Gross loans and advances	12,677.2	8,228.0
Provisions for impairment	(75.4)	(83.0)
Net loans and advances	12,601.8	8,145.0

Gross loans and advances at 31st December 2007 included loans held for trading of US$23.2 million (2006: US$12.7 million).

a) Industrial classification

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

	31.12.07	31.12.06
	US$ millions	US$ millions
Energy, oil and petrochemical	3,418.4	2,523.4
Trading and services	2,149.5	1,547.7
Financial services	1,956.3	1,428.1
Construction	1,106.9	607.0
Manufacturing	1,012.7	594.8
Transportation	780.0	467.9
Government	686.1	299.0
Communication	616.5	321.3
Real estate	614.2	69.2
Other	336.6	369.6
	12,677.2	8,228.0
Provisions for impairment	(75.4)	(83.0)
	12,601.8	8,145.0

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.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS
for the year ended 31st December 2007

10. LOANS AND ADVANCES (continued)

b) Provisions for impairment

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

	2007	2006
	US$ millions	US$ millions
At 1st January	83.0	104.9
Exchange rate movements	(0.2)	0.3
Amounts utilised	(0.5)	(21.4)
Release for the year	(6.9)	(0.8)
At 31st December	75.4	83.0

Total specific provisions at 31st December 2007 represented 80.0 per cent (2006: 70.7 per cent) of loans against which a specific provision had been made. Total provisions at 31st December 2007 exceeded the gross book value of past due loans by US$58.4 million (2006: US$64.3 million).

Amounts utilised during the year ended 31st December 2007 of US$0.5 million (2006: US$21.4 million) represented provisions utilised on the sale, settlement or write off of the related loans.

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:-

	31.12.07		31.12.06	
	Gross	Net book value	Gross	Net book value
	US$ millions	US$ millions	US$ millions	US$ millions
Corporates	11.8	-	8.4	0.3
Financial Institutions	5.2	2.6	10.3	-
	17.0	2.6	18.7	0.3

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

	31.12.07	31.12.06
	US$ millions	US$ millions
Less than 1 year	4.0	-
2 to 5 years	13.0	18.7
	17.0	18.7

At 31st December 2007 uncollected interest-in-suspense on past due loans amounted to US$2.3 million (2006: US$1.4 million).

d) Renegotiated loans

There were no renegotiated loans during either the year ended 31st December 2007 or 31st December 2006.

e) Collateral

The Group did not take possession of any collateral as a result of a loan default during either the year ended 31st December 2007 or 31st December 2006.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS
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11. OTHER ASSETS

	31.12.07 US$ millions	31.12.06 US$ millions
Amounts receivable in respect of increase in share capital	1,000.0	-
Accrued interest, fees and commissions	345.0	338.7
Derivative financial instruments	46.3	42.5
Premises and equipment	44.9	32.5
Prepaid pension cost	14.6	-
Deferred items	9.6	7.7
Prepayments	6.5	10.5
Outstanding security settlements	1.0	30.0
Other, including accounts receivable	65.9	29.7
	1,533.8	491.6

The increase in share capital is commented on in more detail in note 18.

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 30(d).

An analysis of the prepaid pension cost is set out in note 12.

12. 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 2007 amounted to US$5.8 million (2006: US$5.5 million).

The Bank's principal subsidiary, Gulf International Bank (UK) Limited (GIBUK), maintains a defined benefit pension plan for the majority of 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 2007.

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

	31.12.07 US$ millions	31.12.06 US$ millions
Fair value of plan assets	169.9	132.5
Present value of fund obligations	162.5	161.7
Plan surplus / (deficit)	7.4	(29.2)
Unrecognised actuarial loss	7.2	21.9
Net asset / (liability) in the consolidated balance sheet	14.6	(7.3)

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

	2007 US$ millions	2006 US$ millions
At 1st January	132.5	105.9
Expected return on plan assets	9.2	7.4
Contributions paid by the Group	23.5	2.4
Benefits paid by the plan	(2.3)	(2.3)
Actuarial gains	3.4	3.1
Exchange rate movements	3.6	16.0
At 31st December	169.9	132.5

The plan assets at 31st December 2007 comprise equity and debt securities in the ratio of 35 per cent and 65 per cent respectively (2006: 85 per cent and 15 per cent respectively).

The expected and actual returns on the plan assets for the year ended 31st December 2007 were US$9.2 million and US$12.6 million respectively (2006: US$7.4 million and US$10.2 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.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS
for the year ended 31st December 2007

12. POST RETIREMENT BENEFITS (continued)

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

	2007 US$ millions	2006 US$ millions
At 1st January	161.7	138.1
Current service cost	2.8	3.8
Interest cost	8.4	7.0
Actuarial gains	(11.5)	(4.7)
Benefits paid by the plan	(2.3)	(2.3)
Exchange rate movements	3.4	19.8
At 31st December	162.5	161.7

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

	2007 US$ millions	2006 US$ millions
At 1st January	(7.3)	(1.5)
Net expense included in staff expenses	(2.8)	(5.5)
Contributions paid by the Group	23.5	2.4
Exchange rate movements	1.2	(2.7)
At 31st December	14.6	(7.3)

The Group paid US$23.5 million in contributions to the plan during 2007 and expects to pay US$1.3 million during 2008.

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

	2007 US$ millions	2006 US$ millions
Current service cost	2.8	3.8
Interest cost	8.4	7.0
Expected return on plan assets	(9.2)	(7.4)
Amortisation of actuarial loss	0.8	2.1
Net expense included in staff expenses	2.8	5.5

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

	2007	2006
Discount rate	5.8%	5.1%
Expected return on plan assets - equities	8.0%	7.4%
Expected return on plan assets - bonds	5.8%	4.9%
Future salary increases	4.5%	3.9%
Future increases to pensions in payment	2.4%	2.8%

g) Historical information

	2007 US$ millions	2006 US$ millions	2005 US$ millions	2004 US$ millions	2003 US$ millions
Fair value of plan assets	169.9	132.5	105.9	100.0	80.2
Present value of fund obligations	162.5	161.7	138.1	134.4	94.1
Plan surplus / (deficit)	7.4	(29.2)	(32.2)	(34.4)	(13.9)
Experience gains on plan assets	4.2	3.5	10.4	11.0	12.8
Experience (losses) / gains on plan liabilities	(1.2)	0.3	5.0	(3.0)	(0.4)

13. DEPOSITS

Deposits from customers include deposits from central banks.

The geographical composition of total deposits was as follows:-

	31.12.07	31.12.06
	US$ millions	US$ millions
GCC countries	**12,636.7**	11,484.3
Other Middle East and North Africa countries	**4,931.7**	3,603.7
Other countries	**2,076.3**	1,779.7
	19,644.7	16,867.7

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

GCC deposits at 31st December 2007 represented 64.3 per cent (2006: 68.1 per cent) of total deposits.

Total deposits at 31st December 2007 included Islamic-related transactions amounting to US$2,463.7 million (2006: US$2,744.9 million). Islamic-related transactions comprised murabaha contracts.

14. 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 portfolios. At 31st December 2007, the fair value of available-for-sale and trading securities that had been pledged as collateral under repurchase agreements was US$4,033.5 million and US$28.3 million respectively (2006: US$2,128.2 million and US$161.1 million respectively). The fair value of the securities that had been pledged as collateral as reported in the consolidated financial statements may be different to, and potentially lower than, the value applied to the securities by the counterparties to the repurchase agreements. The collateralised borrowing transactions are conducted under standardised terms that are usual and customary for such transactions.

At 31st December 2007, the fair value of available-for-sale securities that had been pledged as collateral under the term repo facility referred to in note 16 was US$344.4 million (2006: US$574.2 million). This was in addition to the available-for-sale securities pledged as collateral under repurchase agreements referred to in the paragraph above.

The increase in the volume of repurchase agreements during the year ended 31st December 2007 was largely due to repurchase agreements related to securities acquired in exchange for the capital notes of structured finance investments as explained in more detail in note 9(b).

15. OTHER LIABILITIES

	31.12.07	31.12.06
	US$ millions	US$ millions
Accrued interest	**260.3**	224.9
Derivative financial instruments	**85.5**	79.7
Deferred items	**80.4**	70.4
Minority interests	**11.0**	25.2
Outstanding security settlements	**-**	62.0
Pension plan liability	**-**	7.3
Other, including accounts payable and accrued expenses	**74.3**	94.0
	511.5	563.5

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 30(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 12.

16. SENIOR TERM FINANCING

	Maturity	**31.12.07**	31.12.06
		US$ millions	US$ millions
Islamic murabaha term facility	2008	**6.1**	6.1
Floating rate repo	2007-2009	**300.0**	500.0
Floating rate loans	2009	**175.0**	50.0
Islamic murabaha term facilities	2009	**29.0**	29.0
Floating rate loan	2010	**800.0**	800.0
Islamic murabaha term facility	2010	**14.6**	14.6
Floating rate loan	2011	**60.0**	60.0
Floating rate loans	2012	**1,273.1**	-
Floating rate note	2007	**-**	350.0
Islamic murabaha term facilities	2007	**-**	57.4
		2,657.8	1,867.1

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17. SUBORDINATED TERM FINANCING

	Maturity	31.12.07	31.12.06
		US$ millions	US$ millions
Floating rate note	2015	400.0	400.0
Floating rate loans	2016	150.0	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.

18. SHARE CAPITAL

The authorised share capital at 31st December 2007 comprised 3.0 billion shares of US$1 each (2006: 3.0 billion shares of US$1 each). The issued share capital at 31st December 2007 comprised of US$1.5 billion shares of US$1 each (2006: 1.0 billion shares of US$1 each). All issued shares are fully paid.

At an Extraordinary General Assembly meeting held on 20th February 2008, the shareholders ratified an earlier commitment in 2007 to increase the issued share capital of the bank by US$1.0 billion to US$2.5 billion. The capital increase has been approved by the Group's lead regulator, the Central Bank of Bahrain, and will be transferred to issued share capital after the relevant legal formalities have been completed. The proceeds of the capital increase were receivable immediately following the Extraordinary General Assembly meeting.

19. 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 2006	**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 statement of 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**
Arising in the year:-					
- Available-for-sale securities: net fair value losses	-	-	-	(248.8)	(248.8)
- Cash flow hedges: net fair value gains	-	-	1.3	-	1.3
Transfers in the year:-					
- Transfers to statement of income	-	-	1.0	(9.8)	(8.8)
Net gains / (losses) recognised directly in equity	-	-	2.3	(258.6)	(256.3)
At 31st December 2007	**169.2**	**106.7**	**1.1**	**(167.4)**	**109.6**

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. No transfer was made to either the compulsory or voluntary reserve for the year ended 31st December 2007.

20. DIVIDENDS

No dividend is proposed in respect of the financial year ended 31st December 2007.

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21. NET INTEREST INCOME

	2007 US$ millions	2006 US$ millions
Interest income		
Placements and other liquid assets	**306.9**	283.2
Due from brokers	**29.3**	36.5
Available-for-sale securities	**494.1**	441.6
Loans and advances	**682.4**	474.5
Total interest income	**1,512.7**	1,235.8
Interest expense		
Deposits from banks and customers	**911.9**	722.8
Securities sold under agreements to repurchase	**127.9**	120.6
Term financing	**167.3**	134.7
Total interest expense	**1,207.1**	978.1
Net interest income	**305.6**	257.7

Interest income on available-for-sale securities includes dividends from structured finance investments.

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

Accrued but uncollected interest on impaired available-for-sale debt securities included in interest income for the year ended 31st December 2007 amounted to US$4.2 million (2006: US$1.7 million). There was no accrued but uncollected interest included in interest income on past due available-for-sale debt securities, or impaired or past due loans for either the year ended 31st December 2007 or 31st December 2006.

22. FEE AND COMMISSION INCOME

	2007 US$ millions	2006 US$ millions
Fee and commission income		
Investment banking and management fees	**61.2**	44.2
Commissions on letters of credit and guarantee	**20.8**	15.7
Loan commitment fees	**5.0**	4.4
Other fee and commission income	**3.5**	3.7
Total fee and commission income	**90.5**	68.0
Fee and commission expense	**(2.4)**	(2.2)
Net fee and commission income	**88.1**	65.8

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.

Investment banking and management fees for the year ended 31st December 2007 included fee income relating to the Group's fiduciary activities amounting to US$35.3 million (2006: US$26.1 million).

Fee and commission expense principally comprises security custody fees.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS
for the year ended 31st December 2007

23. TRADING (LOSS) / INCOME

	2007	2006
	US$ millions	US$ millions
Foreign exchange	9.7	8.3
Interest rate derivatives	1.4	0.3
Loans held for trading	0.1	0.4
Equity securities	(2.0)	2.8
Managed funds	(4.3)	11.0
Debt securities	(91.5)	25.4
	(86.6)	48.2

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.

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

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

The trading loss on debt securities for the year ended 31st December 2007 principally comprised revaluation losses on asset backed securities arising as a result of the global credit crisis.

An analysis of the basis used for determining the fair values of held-for-trading financial assets and liabilities is set out in note 36.

24. OTHER INCOME

Other income principally comprises dividends on available-for-sale equity investments.

25. 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 these consolidated financial statements and are 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
for the year ended 31st December 2007

25. 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
2007					
Total income	173.8	118.1	(58.8)	109.3	342.4
Segment result	168.0	(857.9)	(77.1)	103.3	(663.7)
Unallocated overhead					(93.9)
Taxation credit on overseas activities					0.3
Net loss after tax					(757.3)
Segment assets	13,065.0	14,558.7	1,235.7	1,094.6	29,954.0
Segment liabilities	14.2	24,727.8	35.1	2,961.6	27,738.7
Total equity					2,215.3
Total liabilities and equity					29,954.0
2006					
Total income	131.8	146.5	54.0	73.1	405.4
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

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:-

	2007	2006
	US$ millions	US$ millions
GCC countries	359.9	297.9
Other countries	(17.5)	107.5
	342.4	405.4

The geographical analyses of deposits and risk assets are set out in notes 13 and 27 respectively.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS
for the year ended 31st December 2007

26. 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 described in detail in the Risk Management Review section of the Annual Report and are summarised below together with additional quantitative analysis:-

a) 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.

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

The Group also mitigates its credit exposures on foreign exchange and derivative financial instruments through the use of master netting agreements and collateral arrangements.

Maximum exposure to credit risk

The gross maximum exposure to credit risk before applying collateral, guarantees and other credit enhancements was as follows:-

	At 31.12.07 US$ millions	At 31.12.06 US$ millions
Balance sheet items:		
Cash and other liquid assets	532.7	268.2
Due from brokers	243.3	950.9
Placements with banks	5,629.1	4,322.5
Trading securities	1,342.6	2,186.1
Available-for-sale securities	8,070.7	8,422.9
Loans and advances	12,601.8	8,145.0
Other assets, excluding derivative-related items	1,345.0	338.7
Total on-balance sheet credit exposure	29,765.2	24,634.3
Off-balance sheet items:		
Credit-related contingent items	7,261.9	3,896.4
Foreign exchange-related items	60.2	24.7
Derivative-related items	46.1	42.8
Total off-balance sheet credit exposure	7,368.2	3,963.9
Total gross credit exposure	37,133.4	28,598.2

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS
for the year ended 31st December 2007

26. RISK MANAGEMENT (continued)

a) Credit risk (continued)

Credit Risk Profile

The Group monitors, manages and controls credit risk exposures based on an internal credit rating system that rates individual obligors based on a rating scale from 1 to 10, subject to positive (+) and negative (-) modifiers for rating grades 2 to 6. The internal credit rating is a measure of the credit-worthiness of a single obligor, based on an assessment of the credit risk relating to senior unsecured, medium term, foreign currency credit exposure. The primary objectives of the internal credit rating system are the maintenance of a single uniform standard for credit quality measurement, and to serve as the primary basis for Board-approved risk parameters and delegated credit authority limits. The internal credit rating system also serves as a key input into the Group's risk-adjusted return on capital (RAROC) performance measurement system and equips the Group to meet the more advanced regulatory requirements under the new Basel 2 capital adequacy regime which is to be implemented in 2008. Ratings are assigned to obligors, rather than facilities, and reflect a medium term time horizon, thereby rating through an economic cycle. The internal ratings map directly to the rating grades used by the international credit rating agencies as follows:-

Internal rating grade	Internal classification	Historical default rate range %	External Rating: Fitch and Standard & Poor's	External Rating: Moody's
Investment grade				
Rating grade 1	Standard	0.00 - 0.00	AAA	Aaa
Rating grade 2		0.00 - 0.02	AA	Aa
Rating grade 3	Standard	0.05 - 0.07	A	A
Rating grade 4	Standard	0.16 - 0.33	BBB	Baa
Sub-investment grade				
Rating grade 5	Standard	0.57 - 1.54	BB	Ba
Rating grade 6	Standard	2.70 - 10.11	B	B
Rating grade 7	Standard	26.29	CCC	Caa
Classified				
Rating grade 8	Substandard	26.29	CC	Ca
Rating grade 9	Doubtful	26.29	C	C
Rating grade 10	Loss	-	D	-

The historical default rates represent the range of probability of defaults between the positive and negative modifiers for each rating grade based on Standard & Poor's one year default rates for the 25 years from 1981 to 2006 for senior unsecured obligations. The default rates represent the averages over the 25 year period and therefore reflect the full range of economic conditions over that period.

The credit risk profile, based on internal credit ratings, was as follows:-

	31.12.07			31.12.06		
	Placements, due from brokers & other liquid assets	Securities	Loans and advances	Placements, due from brokers & other liquid assets	Securities	Loans and advances
	US$ millions	US$ millions	US$ millions	US$ millions	US$ millions	US$ millions
Neither past due nor impaired						
Rating grades 1 to 4-	6,370.1	8,084.7	9,086.9	5,520.7	8,533.1	5,395.6
Rating grades 5+ to 5-	35.0	299.4	3,105.7	20.0	425.2	2,563.6
Rating grades 6+ to 6-	-	113.3	397.5	0.9	300.8	171.3
Rating grade 7	-	26.3	9.1	-	69.1	5.0
Equity investments	-	619.5	-	-	1,180.7	-
Carrying amount	6,405.1	9,143.2	12,599.2	5,541.6	10,508.9	8,135.5
Past due or individually impaired						
Rating grades 1 to 7	-	171.9	-	-	97.8	9.2
Rating grade 8	-	6.3	-	-	-	-
Rating grade 9	-	7.8	-	-	-	0.3
Rating grade 10	-	2.0	2.6	-	-	-
Equity investments	-	82.1	-	-	2.3	-
Carrying amount	-	270.1	2.6	-	100.1	9.5
Total	6,405.1	9,413.3	12,601.8	5,541.6	10,609.0	8,145.0

The above analysis is reported net of the following provisions for impairment:-

Provisions for impairment	-	(985.0)	(75.4)	-	(63.9)	(83.0)

Impaired equity investments principally comprise structured finance investments.

26. RISK MANAGEMENT (continued)

Individually impaired financial assets represent assets for which 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 obligation.

At 31st December 2007 there were no past due but not impaired financial assets (2006: nil).

The Group holds collateral against loans and advances in the form of physical assets, cash deposits, securities and guarantees. The amount and type of collateral is dependent upon the assessment of the credit risk of the counterparty. The market / fair value of the collateral is actively monitored on a regular basis and requests are made for additional collateral in accordance with the terms of the underlying agreements. Collateral is not usually held against securities or placements and no such collateral was held at either 31st December 2007 or 31st December 2006.

An analysis of the credit risk in respect of foreign exchange and derivative financial instruments is set out in note 30 while the notional and risk-weighted exposures for off-balance sheet credit-related financial instruments are set out in note 31.

Credit risk concentration

The Group monitors concentrations of credit risk by sector and by geographic location. The industrial classification of loans and advances is set out in note 10. The geographical distribution of risk assets is set out in note 27. An analysis of the credit risk in respect of foreign exchange and derivative financial instruments is set out in note 30.

Settlement risk

Settlement risk is the risk of loss due to the failure of a counterparty to honour its obligations to deliver cash, securities, or other assets as contractually agreed.

For certain types of transactions, the Group mitigates this risk by conducting settlements through a settlement or clearing agent to ensure that a trade is settled only when both parties have fulfilled their contractual settlement obligations. Settlement limits form part of the credit approval and limit monitoring process.

b) 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, credit 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 8. An analysis of derivative financial instruments, including the VaR of foreign exchange and derivative trading contracts, is set out in note 30.

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26. 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 33, was as follows:-

	2007				2006			
	31.12.07	Average	High	Low	31.12.06	Average	High	Low
	US$ millions	US$ millions	US$ millions	US$ millions	US$ millions	US$ millions	US$ millions	US$ millions
Interest rate risk	3.2	4.1	6.8	3.0	6.7	4.7	7.1	3.6
Foreign exchange risk	0.2	0.8	2.8	0.2	0.9	1.4	2.2	0.5
Equity risk	7.0	5.8	7.8	3.8	5.4	4.4	5.6	2.9
Total diversified risk	9.3	8.0	10.8	6.0	9.9	7.3	9.9	5.6

- **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 are set out in note 29. The Group is exposed to the impact of changes in credit spreads on the fair value of available-for-sale debt securities. Movements in the fair value of available-for-sale securities are accounted for in equity. Credit spread risk is managed within VaR limits and through the use of models to evaluate the sensitivitiy of changes in equity to movements in credit spreads. Based on the available-for-sale debt securities held at 31st December 2007, a 1 b.p. increase in credit spreads would result in a US$3.1 million decrease in fair value (2006: US$3.1 million). The Group does not maintain material non-trading equity or foreign currency exposures. Details of available-for-sale equity investments are set out in note 9. In general, the Group's policy is to match financial 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 30(e).

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

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

c) Liquidity risk

Liquidity risk is the risk that sufficient funds are not available to meet the Group's financial obligations on a punctual basis as they fall due.

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.

The management of liquidity and funding is primarily conducted in the Group's individual geographic entities within limits set and approved by the Board of Directors. The limits take account of the depth and liquidity of the market in which the entity operates. It is the Group's general policy that each geographic entity should be self-sufficient in relation to funding its own operations.

26. RISK MANAGEMENT (continued)

The Group's liquidity management policies include the following:-

- the monitoring of (i) future contractual cash flows against approved limits, and (ii) the level of liquid assets available in the event of a stress event
- the monitoring of balance sheet liquidity ratios
- the monitoring of the sources of funding in order to ensure that funding is derived from a diversified range of sources
- the monitoring of depositor concentrations in order to avoid undue reliance on individual depositors
- the maintenance of a satisfactory level of term financing; and
- the maintenance of liquidity and funding contingency plans. These plans identify early indicators of stress conditions and prescribe the actions to be taken in the event of systemic or other crisis, while minimising adverse long term implications for the Group's business activities.

The Group has established limits which restrict the volume of liabilities maturing in the short term. An independent risk management function monitors the future cash flow maturity profile against approved limits on a daily basis. The cash flows are monitored against limits applying to both daily and cumulative cash flows occurring over a 14 day period. The cash flow analysis is also monitored on a weekly basis by the Assets and Liabilities Committee (ALCO).

Customer deposits form a significant part of the Group's funding. The Group places considerable importance on maintaining the stability of both its customer and interbank deposits. The stability of deposits depends on maintaining confidence in the Group's financial strength and financial transparency.

The maturity profile of assets and liabilities is set out in note 28. An analysis of available-for-sale debt securities by rating classification is set out in note 9 (a).

d) 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.

e) 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.

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26. RISK MANAGEMENT (continued)

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 complied with all externally imposed capital requirements throughout the years ended 31st December 2007 and 31st December 2006.

There have been no material changes in the Group's management of capital during the years ended 31st December 2007 and 31st December 2006.

The capital adequacy ratio calculated in accordance with the guidelines of the Basel Committee is set out in note 33.

The Group is adopting the Basel 2 capital adequacy framework with effect from 1st January 2008 in accordance with the guidelines of the CBB. At 31st December 2007, the Group had completed its preparations for the implementation of the CBB's Basel 2 Pillar One guidelines.

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for the year ended 31st December 2007

27. GEOGRAPHICAL DISTRIBUTION OF RISK ASSETS

	31.12.07					31.12.06
	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	1,846.9	1,740.7	11,779.6	6,433.5	21,800.7	13,002.1
Other Middle East & North Africa	-	54.1	381.2	182.5	617.8	560.2
Europe	3,701.7	2,949.4	413.1	462.3	7,526.5	7,701.8
North America	555.1	4,238.3	3.0	183.6	4,980.0	6,099.2
Asia	301.4	256.6	24.9	-	582.9	565.4
Latin America	-	174.2	-	-	174.2	263.3
	6,405.1	9,413.3	12,601.8	7,261.9	35,682.1	28,192.0

An analysis of derivative and foreign exchange instruments is set out in note 30.

28. MATURITIES OF ASSETS AND LIABILITIES

The maturity profile of the carrying amount of assets and liabilities, based on the 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 2007						
Cash and other liquid assets	421.5	111.2	-	-	-	532.7
Due from brokers	243.3	-	-	-	-	243.3
Placements with banks	5,614.1	15.0	-	-	-	5,629.1
Trading securities	1,342.6	-	-	-	-	1,342.6
Available-for-sale securities	96.5	247.8	1,676.8	1,331.9	4,717.7	8,070.7
Loans and advances	3,624.6	2,265.7	2,671.8	1,619.3	2,420.4	12,601.8
Other assets	1,373.0	84.1	13.8	7.2	55.7	1,533.8
Total assets	12,715.6	2,723.8	4,362.4	2,958.4	7,193.8	29,954.0
Deposits	17,080.6	2,558.7	-	5.4	-	19,644.7
Securities sold under agreements to repurchase	1,148.7	2,992.8	-	-	-	4,141.5
Securities sold but not yet purchased	233.2	-	-	-	-	233.2
Other liabilities	326.1	68.9	27.8	17.1	71.6	511.5
Term financing	-	206.1	1,118.7	1,333.0	550.0	3,207.8
Equity	-	-	-	-	2,215.3	2,215.3
Total liabilities & equity	18,788.6	5,826.5	1,146.5	1,355.5	2,836.9	29,954.0
At 31st December 2006						
Total assets	9,879.3	2,366.8	2,930.9	2,706.4	6,903.8	24,787.2
Total liabilities & equity	18,655.5	2,163.0	591.6	885.2	2,491.9	24,787.2

28. MATURITIES OF ASSETS AND LIABILITIES (continued)

The asset and liability maturities presented in the table above 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 2007 for counterparties with individual deposits of US$10.0 million and above at 31st December 2007 amounted to US$17,002.8 million (2006: US$13,542.0 million). Formal liquidity controls are nevertheless based on contractual asset and liability maturities.

The gross cash flows payable by the Group under financial liabilities, based on 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
	US$ millions	US$ millions	US$ millions	US$ millions	US$ millions
At 31st December 2007					
Deposits	17,227.8	2,617.9	0.6	6.0	-
Securities sold under agreements to repurchase	1,188.3	3,095.1	-	-	-
Term financing	46.2	333.4	1,398.8	1,529.0	652.4
Derivative financial instruments:					
- contractual amounts payable	91.8	147.9	239.4	98.2	59.3
- contractual amounts receivable	(73.8)	(157.5)	(219.8)	(97.7)	(55.4)
Total undiscounted financial liabilities	18,480.3	6,036.8	1,419.0	1,535.5	656.3
At 31st December 2006					
Deposits	15,729.4	1,360.3	-	-	-
Securities sold under agreements to repurchase	1,779.9	485.8	-	-	-
Term financing	82.7	434.3	780.9	967.7	690.9
Derivative financial instruments:					
- contractual amounts payable	83.8	114.2	230.0	127.5	81.5
- contractual amounts receivable	(69.0)	(140.5)	(206.4)	(105.0)	(78.6)
Total undiscounted financial liabilities	17,606.8	2,254.1	804.5	990.2	693.8

Information on the contractual terms for the drawdown of gross loan commitments is set out in note 31.

The figures in the table above do not agree directly to the carrying amounts in the consolidated balance sheet as they incorporate all cash flows, on an undiscounted basis, related to both principal as well as those associated with future coupon and interest payments. Coupons and interest payments for periods for which the interest rate has not yet been determined have been calculated based on the relevant forward rates of interest prevailing at the balance sheet date.

Held-for-trading liabilities (securities sold but not yet purchased) have not been included in the table above as they are typically held for short periods of time.

A maturity analysis of derivative and foreign exchange instruments based on notional amounts is set out in note 30(c).

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29. INTEREST RATE RISK

The repricing profile of assets and liabilities categories were as follows:-

	Within 3 months	Months 4 to 6	Months 7 to 12	Over 1 year	Non-interest bearing items	Total
	US$ millions	US$ millions	US$ millions	US$ millions	US$ millions	US$ millions
At 31st December 2007						
Cash and other liquid assets	421.5	91.2	20.0	-	-	532.7
Due from brokers	243.3	-	-	-	-	243.3
Placements with banks	5,364.1	140.0	50.0	75.0	-	5,629.1
Trading securities	901.1	-	-	-	441.5	1,342.6
Available-for-sale securities:-						
- Fixed rate	1.0	39.5	37.3	363.9	-	441.7
- Floating rate	6,848.8	456.6	20.6	-	-	7,326.0
- Equities & equity funds	-	-	-	-	303.0	303.0
Loans and advances	8,923.5	3,488.5	249.1	5.8	(65.1)	12,601.8
Other assets	-	-	-	-	1,533.8	1,533.8
Total assets	22,703.3	4,215.8	377.0	444.7	2,213.2	29,954.0
Deposits	17,486.6	1,505.3	652.8	-	-	19,644.7
Securities sold under agreements to repurchase	2,523.8	1,273.9	343.8	-	-	4,141.5
Securities sold but not yet purchased	233.2	-	-	-	-	233.2
Other liabilities	-	-	-	-	511.5	511.5
Term financing	3,207.8	-	-	-	-	3,207.8
Equity	-	-	-	-	2,215.3	2,215.3
Total liabilities & equity	23,451.4	2,779.2	996.6	-	2,726.8	29,954.0
Interest rate sensitivity gap	(748.1)	1,436.6	(619.6)	444.7	(513.6)	-
Cumulative interest rate sensitivity gap	(748.1)	688.5	68.9	513.6	-	-
At 31st December 2006						
Cumulative interest rate sensitivity gap	(1,966.4)	(89.1)	271.8	708.3	-	-

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 2007 the modified duration of these fixed rate securities and interest rate swaps was 4.99. 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$221,000.

Based on the repricing profile at 31st December 2007, 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$7.7 million and US$7.5 million respectively (2006: US$8.4 million and US$11.2 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 26. The market risk relating to foreign exchange and derivative trading instruments is set out in note 30.

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30. 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, credit 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 and sold by the Group are classified as derivative financial instruments.

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

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30. 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, credit and equity-related derivative contracts.

	Notional amounts			Credit risk
	Trading	Hedging	Total	amounts
	US$ millions	US$ millions	US$ millions	US$ millions
At 31st December 2007				
Foreign exchange contracts:-				
Unmatured spot, forward and futures contracts	1,445.6	3,747.9	5,193.5	58.9
Options purchased	27.3	55.3	82.6	1.3
Options written	27.3	-	27.3	-
	1,500.2	3,803.2	5,303.4	60.2
Interest rate contracts:-				
Futures	162.4	-	162.4	-
Interest rate swaps and swaptions	1,861.2	4,990.1	6,851.3	45.2
Options, caps and floors purchased	24.3	-	24.3	0.2
Options, caps and floors written	1,255.8	-	1,255.8	-
	3,303.7	4,990.1	8,293.8	45.4
Credit contracts:-				
Protection bought	125.8	-	125.8	0.7
Protection sold	203.4	-	203.4	-
	329.2	-	329.2	0.7
Equity contracts:-				
Contracts for differences	2.4	-	2.4	-
Total	5,135.5	8,793.3	13,928.8	106.3
At 31st December 2006				
Total	18,298.9	8,097.4	26,396.3	67.5

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, and protection sold on credit contracts as they represent obligations of the Group.

At 31st December 2007 the Value-at-Risk of the foreign exchange, interest rate, credit, and equity derivative trading contracts analysed in the table above, as calculated in accordance with the basis set out in note 33, was US$0.2 million, US$0.2 million, nil and US$1.1 million respectively (2006: US$0.5 million, US$0.5 million, nil and US$0.6 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

	31.12.07			31.12.06
Credit risk amounts	Banks	Other	Total	Total
	US$ millions	US$ millions	US$ millions	US$ millions
OECD countries	71.0	-	71.0	43.9
GCC countries	3.5	31.3	34.8	22.2
Other countries	0.5	-	0.5	1.4
	75.0	31.3	106.3	67.5

Credit risk is concentrated on major OECD-based banks.

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30. 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 2007					
Foreign exchange contracts	5,174.0	129.4	-	-	5,303.4
Interest rate contracts	4,196.2	1,491.6	1,101.5	1,504.5	8,293.8
Credit contracts	47.9	92.4	30.0	158.9	329.2
Equity contracts	-	-	-	2.4	2.4
Total	**9,418.1**	**1,713.4**	**1,131.5**	**1,665.8**	**13,928.8**
At 31st December 2006					
Total	20,030.9	2,928.0	1,327.8	2,109.6	26,396.3

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

	31.12.07		31.12.06	
	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	6.5	(6.9)	0.6	(0.5)
Foreign exchange options	0.6	(0.6)	8.4	(8.5)
Interest rate futures	0.1	-	1.5	-
Interest rate swaps and swaptions	30.2	(28.1)	19.4	(16.4)
Interest rate options, caps and floors	-	-	-	-
Credit default swaps	0.7	(2.1)	1.4	(2.0)
Equities - contracts for differences	1.3	-	1.2	-
	39.4	(37.7)	32.5	(27.4)
Derivatives held as fair value hedges:- Interest rate swaps	4.7	(47.8)	10.0	(51.1)
Derivatives held as cash flow hedges:- Interest rate swaps	2.2	-	-	(1.2)
Amount included in other assets / (other liabilities)	46.3	(85.5)	42.5	(79.7)

e) Significant net open positions

There were no significant derivative trading or foreign currency net open positions at either 31st December 2007 or at 31st December 2006.

f) Hedge effectiveness

Gains and losses recognised in the consolidated statement of income relating to fair value hedging relationships were as follows:-

	2007	2006
	US$ millions	US$ millions
Net (losses) / gains on derivative hedging instruments	(13.1)	42.5
Net gains / (losses) on hedged items attributable to the hedged risk	13.1	(42.5)

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 2007 or 31st December 2006. The maximum period over which the Group was hedging its exposure to the variability in future cash flows for forecasted transactions was 18 months (2006: 19 months).

31. 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.

	31.12.07		31.12.06	
	Notional principal amount	**Risk-weighted exposure**	Notional principal amount	Risk-weighted exposure
	US$ millions	US$ millions	US$ millions	US$ millions
Direct credit substitutes	**2,269.2**	**595.2**	200.6	187.9
Transaction-related contingent items	**1,505.1**	**700.0**	969.5	455.5
Short-term self-liquidating trade-related contingent items	**588.9**	**99.7**	409.2	75.5
Commitments, including undrawn loan commitments and underwriting commitments under note issuance and revolving facilities	**2,898.7**	**1,180.5**	2,317.1	988.7
	7,261.9	**2,575.4**	3,896.4	1,707.6

Commitments may be drawdown on demand.

Credit-related financial instruments are reported gross before applying credit risk mitigants, such as cash collateral, guarantees and counter-indemnities. At 31st December 2007 the Group held cash collateral, guarantees, counter-indemnities or other high quality collateral in relation to credit-related financial instruments amounting to US$2,041.3 million (2006: US$157.7 million).

Direct credit substitutes at 31st December 2007 included a US$2.0 billion credit facility for which the Group was acting on behalf of a syndicate of banks. The credit facility was largely collateralised by cash or counter-indemnified by the syndicate of banks. The Group's net exposure under this credit facility amounted to US$262.1 million.

32. 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.

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33. CAPITAL ADEQUACY

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

		31.12.07 US$ millions	31.12.06 US$ millions
Regulatory capital base			
Tier 1 capital:			
Total equity		2,215.3	1,856.6
Adjustment to exclude net fair value losses / (gains)		166.3	(90.0)
Tier 1 capital		2,381.6	1,766.6
Tier 2 capital:			
Subordinated term financing		550.0	550.0
Non-specific loan provision		65.0	60.0
Tier 2 capital		615.0	610.0
Total regulatory capital base	*(a)*	2,996.6	2,376.6

Risk-weighted exposure

		31.12.07 Notional principal amount US$ millions	31.12.07 Risk-weighted exposure US$ millions	31.12.06 Notional principal amount US$ millions	31.12.06 Risk-weighted exposure US$ millions
Credit risk					
Balance sheet items:					
Cash and other liquid assets		532.7	127.6	268.2	52.1
Due from brokers		243.3	-	950.9	-
Placements		5,629.1	1,006.4	4,322.5	900.1
Available-for-sale-securities		8,070.7	7,215.7	8,422.9	7,618.7
Loans and advances		12,601.8	11,384.8	8,145.0	7,318.4
Other assets		1,533.8	993.9	491.6	319.8
			20,728.4		16,209.1
Off-balance sheet items:					
Credit-related contingent items		7,261.9	2,575.4	3,896.4	1,707.6
Forward asset purchases		-	-	214.7	42.9
Foreign exchange-related items		5,303.4	17.6	5,551.2	9.3
Derivative-related items		8,625.4	10.8	20,845.1	175.5
			2,603.8		1,935.3
Credit risk-weighted exposure			23,332.2		18,144.4
Market risk					
General market risk			416.4		491.5
Specific market risk			1,193.2		1,782.6
Market risk-weighted exposure			1,609.6		2,274.1
Total risk-weighted exposure	*(b)*		24,941.8		20,418.5
Risk asset ratio [(a)/(b) x 100]			12.0%		11.6%

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33. 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 2007 or at 31st December 2006.

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 (2006: 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.

34. 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 2007 was US$24,089.7 million (2006: US$21,689.5 million).

35. 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:-

	2007	2006
	US$ millions	US$ millions
Short term employee benefits	9.7	11.1
Post-employment benefits	0.7	0.7
	10.4	11.8

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.

36. 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 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.

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36. FAIR VALUE OF FINANCIAL INSTRUMENTS (continued)

a) Securities

The fair values of securities are based on quoted prices or valuation techniques with the exception of investments in unquoted equity investments for which fair values cannot be reliably measured, the fair values of which are based on their carrying amounts.

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 techniques or option pricing models as appropriate. The fair values of all other on-balance sheet financial assets and liabilities 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.

The valuation basis for financial assets and financial liabilities carried at fair value was as follows:-

	Quoted prices	Valuation based on observable market data	Other valuation techniques or amortised cost	Total
	US$ millions	US$ millions	US$ millions	US$ millions
At 31st December 2007				
Financial assets:				
Trading securities	1,342.6	-	-	1,342.6
Available-for-sale securities	7,338.3	454.8	277.6	8,070.7
Derivative financial instruments	2.2	43.5	0.6	46.3
Financial liabilities:				
Securities sold but not yet purchased	233.2	-	-	233.2
Derivative financial instruments	2.1	83.1	0.3	85.5
At 31st December 2006				
Financial assets:				
Trading securities	2,166.4	19.7	-	2,186.1
Available-for-sale securities	7,914.6	234.1	274.2	8,422.9
Derivative financial instruments	4.5	29.6	8.4	42.5
Financial liabilities:				
Securities sold but not yet purchased	862.7	-	-	862.7
Derivative financial instruments	1.9	69.3	8.5	79.7

Quoted prices include prices obtained from lead managers, brokers and dealers. The majority of the Group's financial assets and liabilities that are carried at fair value are valued based on quoted market prices. At 31st December 2007 only 8.2 per cent of financial assets carried at fair value were valued based on valuation techniques or amortised cost (2006: 5.3 per cent). This included US$139.1 million of impaired available-for-sale securities and US$107.2 million of unquoted equity investments (2006: US$69.7 million and US$81.4 million respectively), for which the carrying value was determined based on cost less provision for impairment.

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37. EARNINGS PER SHARE

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

	2007	2006
Net (loss) / income after tax (US$ millions)	(757.3)	255.5
Weighted average number of shares in issue (millions)	1,385	1,000
Basic earnings per share	(US$0.55)	US$0.26

The diluted earnings per share is equivalent to the basic earnings per share set out above.

38. PRINCIPAL SUBSIDIARIES

The principal subsidiary companies were as follows:-

	Country of incorporation	Ownership interest 31.12.07	31.12.06
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%

39. AVERAGE CONSOLIDATED BALANCE SHEET

The average consolidated balance sheet was as follows:-

	At 31.12.07 US$ millions	At 31.12.06 US$ millions
Assets		
Cash and other liquid assets	314.0	462.0
Due from brokers	628.2	1,080.2
Placements with banks	5,512.8	5,338.6
Trading securities	1,798.7	2,132.1
Available-for-sale securities	8,290.9	8,032.4
Loans and advances	10,407.9	7,585.7
Other assets	529.6	581.8
Total assets	27,482.1	25,212.8
Liabilities		
Deposits from banks	5,885.1	5,140.9
Deposits from customers	13,050.7	11,383.1
Securities sold under agreements to repurchase	2,466.5	2,844.2
Securities sold but not yet purchased	554.9	925.8
Other liabilities	598.5	729.7
Senior term financing	2,303.5	1,883.1
Subordinated term financing	539.4	546.2
Total liabilities	25,398.6	23,453.0
Total equity	2,083.5	1,759.8
Total liabilities & equity	27,482.1	25,212.8

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40. PARENT COMPANY

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

a) Condensed balance sheet

	At 31.12.07 US$ millions	At 31.12.06 US$ millions
Assets		
Cash and other liquid assets	505.5	178.3
Placements with banks	2,191.2	2,445.3
Trading securities	398.4	377.1
Available-for-sale securities	8,058.1	8,402.4
Investment in GIBUK	250.6	346.6
Loans and advances	12,533.3	8,144.9
Other assets	1,452.9	397.2
Total assets	25,390.0	20,291.8
Liabilities		
Deposits from banks	5,924.2	5,611.4
Deposits from customers	9,473.5	7,928.1
Securities sold under agreements to repurchase	4,112.8	2,056.1
Other liabilities	456.4	422.3
Senior term financing	2,657.8	1,867.1
Subordinated term financing	550.0	550.0
Total liabilities	23,174.7	18,435.0
Total equity	2,215.3	1,856.8
Total liabilities & equity	25,390.0	20,291.8

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 31.12.07 US$ millions	Year ended 31.12.06 US$ millions
Net interest income	278.4	235.3
Fee and commission income	52.9	39.5
Trading income	1.8	17.1
Profits on available-for-sale securities	29.6	28.7
Dividend received from GIBUK	14.1	6.4
Other income	5.5	2.9
Total income	382.3	329.9
Operating expenses	86.7	86.8
Net income before provisions and tax	295.6	243.1
Provisions for securities	(962.3)	-
Provisions for loans and advances	6.9	0.8
Net (loss) / income before tax	(659.8)	243.9
Taxation charge on overseas activities	(5.7)	(8.3)
Net (loss) / income	(665.5)	235.6