



**Gulf International Bank B.S.C.**

**CONSOLIDATED FINANCIAL STATEMENTS**

**For the year ended 31<sup>st</sup> December 2014**

**CONSOLIDATED FINANCIAL STATEMENTS**For the year ended 31<sup>st</sup> December 2014**Table of contents****Independent auditors' report to the shareholders**

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## **INDEPENDENT AUDITORS' REPORT TO THE SHAREHOLDERS**

Gulf International Bank B.S.C.  
Manama, Kingdom of Bahrain

### **Report on the consolidated financial statements**

We have audited the accompanying consolidated financial statements of Gulf International Bank B.S.C. (the "Bank") and its subsidiaries (together the "Group"), which comprise the consolidated statement of financial position as at 31 December 2014, the consolidated statements of income, comprehensive income, changes in equity and cash flows for the year then ended, and notes, comprising a summary of significant accounting policies and other explanatory information.

#### *Responsibility of the board of directors for the consolidated financial statements*

The board of directors is responsible for the preparation and fair presentation of these consolidated financial statements in accordance with International Financial Reporting Standards, and for such internal control as the board of directors determines is necessary to enable the preparation of consolidated financial statements that are free from material misstatement, whether due to fraud or error.

#### *Auditors' responsibility*

Our responsibility is to express an opinion on these consolidated financial statements based on our audit. We conducted our audit in accordance with International Standards on Auditing. Those standards require that we comply with ethical requirements and plan and perform the audit to obtain reasonable assurance about whether the consolidated financial statements are free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the consolidated financial statements. The procedures selected depend on our judgment, including the assessment of the risks of material misstatement of the consolidated financial statements, whether due to fraud or error. In making those risk assessments, we consider internal control relevant to the entity's preparation and fair presentation of the consolidated financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of accounting estimates made by management, as well as evaluating the overall presentation of the consolidated financial statements.

We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinion.

#### *Opinion*

In our opinion, the consolidated financial statements present fairly, in all material respects, the consolidated financial position of the Group as at 31 December 2014, and its consolidated financial performance and its consolidated cash flows for the year then ended in accordance with International Financial Reporting Standards.

### **Report on other regulatory requirements**

As required by the Bahrain Commercial Companies Law and Volume 1 of the Central Bank of Bahrain (CBB) Rule Book, we report that:

- a) the Bank has maintained proper accounting records and the consolidated financial statements are in agreement therewith;
- b) the financial information contained in the chairman's statement is consistent with the consolidated financial statements;
- c) we are not aware of any violations during the year of the Bahrain Commercial Companies Law, the Central Bank of Bahrain and Financial Institutions Law, the CBB Rule Book (Volume 1, applicable provisions of Volume 6 and CBB directives) or the terms of the Bank's memorandum and articles of association that would have had a material adverse effect on the business of the Bank or on its financial position; and
- d) satisfactory explanations and information have been provided to us by management in response to all our requests.

KPMG Fakhro  
Partner Registration No. 83  
13 February 2015

## Consolidated statement of financial position

	<i>Note</i>	<u>31.12.14</u> US\$ millions	<u>31.12.13</u> US\$ millions
<b>ASSETS</b>			
Cash and other liquid assets	5	2,472.6	1,659.4
Securities purchased under agreements to resell	6	1,305.2	1,742.7
Placements	7	5,180.5	5,264.6
Trading securities	8	72.7	50.9
Investment securities	9	3,944.5	3,725.8
Loans and advances	10	7,931.5	8,317.2
Other assets	11	393.2	396.3
<b>Total assets</b>		<u>21,300.2</u>	<u>21,156.9</u>
<b>LIABILITIES</b>			
Deposits from banks	13	1,240.1	1,446.3
Deposits from customers	13	12,897.8	13,451.3
Securities sold under agreements to repurchase	14	618.0	785.2
Other liabilities	15	342.9	399.4
Senior term financing	16	3,372.9	2,332.9
Subordinated term financing	17	477.8	477.8
<b>Total liabilities</b>		<u>18,949.5</u>	<u>18,892.9</u>
<b>EQUITY</b>			
Share capital	18	2,500.0	2,500.0
Reserves	19	392.0	374.3
Retained earnings		(541.3)	(610.3)
<b>Total equity</b>		<u>2,350.7</u>	<u>2,264.0</u>
<b>Total liabilities &amp; equity</b>		<u>21,300.2</u>	<u>21,156.9</u>

The consolidated financial statements were approved by the Board of Directors on 13<sup>th</sup> February 2015 and signed on its behalf by:-

Jammaz bin Abdullah Al-Suhaimi  
Chairman

Abdullah bin Hassan Alabdulgader  
Chairman of Board Audit Committee

Yahya bin Abdullah Alyahya  
Chief Executive Officer

The notes on pages 6 to 45 form part of these consolidated financial statements.

## Consolidated statement of income

	<i>Note</i>	Year ended 31.12.14 US\$ millions	Year ended 31.12.13 US\$ millions
Interest income	21	308.9	305.3
Interest expense	21	150.9	142.2
Net interest income		<u>158.0</u>	163.1
Fee and commission income	22	62.9	62.0
Foreign exchange income	23	19.4	17.4
Trading income	24	2.4	9.3
Other income	25	14.9	26.5
<b>Total income</b>		<u>257.6</u>	278.3
Staff expenses		115.4	101.3
Premises expenses		15.7	13.9
Other operating expenses		33.8	36.4
<b>Total operating expenses</b>		<u>164.9</u>	151.6
<b>Net income before provisions and tax</b>		92.7	126.7
Provision release for investment securities	9	4.5	-
Provision charge for loans and advances	10	(10.3)	(4.2)
<b>Net income before tax</b>		<u>86.9</u>	122.5
Taxation charge on overseas activities		(1.3)	(1.0)
<b>Net income</b>		<u>85.6</u>	121.5
<i>Earnings per share</i>	38	<u>US\$0.03</u>	<u>US\$0.05</u>

Jammaz bin Abdullah Al-Suhaimi  
Chairman

Abdullah bin Hassan Alabdulgader  
Chairman of Board Audit Committee

Yahya bin Abdullah Alyahya  
Chief Executive Officer

## Consolidated statement of comprehensive income

	<u>Year ended</u> <u>31.12.14</u> <u>US\$ millions</u>	<u>Year ended</u> <u>31.12.13</u> <u>US\$ millions</u>
<b>Net income</b>	<b>85.6</b>	121.5
<b>Other comprehensive income:-</b>		
<b>Items that may subsequently be reclassified to consolidated statement of income:-</b>		
Cash flow hedges:-		
- net changes in fair value	(0.2)	-
- net amount transferred to consolidated statement of income	(0.1)	(1.4)
	<u>(0.3)</u>	<u>(1.4)</u>
<b>Items that will not be reclassified to consolidated statement of income:-</b>		
Net changes in fair value of equity investments classified as fair value through other comprehensive income (FVTOCI)	7.0	31.1
Remeasurement of defined benefit pension fund	(5.6)	5.1
	<u>1.4</u>	<u>36.2</u>
<b>Total other comprehensive income</b>	<u>1.1</u>	<u>34.8</u>
<b>Total comprehensive income</b>	<u>86.7</u>	<u>156.3</u>

The notes on pages 6 to 45 form part of these consolidated financial statements.

## Consolidated statement of changes in equity

	<u>Share capital</u>	<u>Reserves</u>	<u>Retained earnings</u>	<u>Total</u>
	US\$ millions	US\$ millions	US\$ millions	US\$ millions
<b>At 1<sup>st</sup> January 2014</b>	<b>2,500.0</b>	<b>374.3</b>	<b>(610.3)</b>	<b>2,264.0</b>
Net income for the year	-	-	85.6	85.6
Other comprehensive income for the year	-	2.9	(1.8)	1.1
Total comprehensive income for the year	-	2.9	83.8	86.7
Transfer from retained earnings	-	14.8	(14.8)	-
<b>At 31<sup>st</sup> December 2014</b>	<b>2,500.0</b>	<b>392.0</b>	<b>(541.3)</b>	<b>2,350.7</b>
<b>At 1<sup>st</sup> January 2013</b>	<b>2,500.0</b>	<b>328.2</b>	<b>(720.5)</b>	<b>2,107.7</b>
Net income for the year	-	-	121.5	121.5
Other comprehensive income for the year	-	26.3	8.5	34.8
Total comprehensive income for the year	-	26.3	130.0	156.3
Transfer from retained earnings	-	19.8	(19.8)	-
<b>At 31<sup>st</sup> December 2013</b>	<b>2,500.0</b>	<b>374.3</b>	<b>(610.3)</b>	<b>2,264.0</b>

The notes on pages 6 to 45 form part of these consolidated financial statements.

## Consolidated statement of cash flows

	<i>Note</i>	Year ended 31.12.14 US\$ millions	Year ended 31.12.13 US\$ millions
<b>OPERATING ACTIVITIES</b>			
Net income		85.6	121.5
Adjustments to reconcile net income to net cash inflow from operating activities:			
Provisions for investment securities		(4.5)	-
Provisions for loans and advances		10.3	4.2
Realised profits on debt investment securities		(1.4)	(1.1)
Amortisation of investment securities		13.8	19.1
Amortisation of senior term financing		0.2	0.2
Net decrease / (increase) in statutory deposits with central banks		10.6	(66.9)
Net decrease / (increase) in securities purchased under agreements to resell		437.5	(731.9)
Net decrease / (increase) in placements		84.1	(784.9)
Net (increase) / decrease in trading securities		(21.8)	49.6
Net decrease / (increase) in loans and advances		375.4	(1,211.1)
(Increase) / decrease in accrued interest receivable		(3.6)	6.2
Increase in accrued interest payable		8.3	1.7
Net increase in other net assets		(54.7)	(25.7)
Net decrease in deposits from banks		(206.2)	(776.1)
Net (decrease) / increase in deposits from customers		(553.5)	3,979.4
<b>Net cash inflow from operating activities</b>		<b>180.1</b>	<b>584.2</b>
<b>INVESTING ACTIVITIES</b>			
Purchase of investment securities		(855.9)	(804.3)
Sale and maturity of investment securities		627.0	617.7
<b>Net cash outflow from investing activities</b>		<b>(228.9)</b>	<b>(186.6)</b>
<b>FINANCING ACTIVITIES</b>			
Net (decrease) / increase in securities sold under agreements to repurchase		(167.2)	187.5
Net increase / (decrease) in senior term financing		1,039.8	(100.0)
<b>Net cash inflow from financing activities</b>		<b>872.6</b>	<b>87.5</b>
<b>Increase in cash and cash equivalents</b>		<b>823.8</b>	<b>485.1</b>
<b>Cash and cash equivalents at 1<sup>st</sup> January</b>		<b>1,515.8</b>	<b>1,030.7</b>
<b>Cash and cash equivalents at 31<sup>st</sup> December</b>	5	<b>2,339.6</b>	<b>1,515.8</b>

The notes on pages 6 to 45 form part of these consolidated financial statements.



## NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

### For the year ended 31<sup>st</sup> December 2014

#### 1. Incorporation and registration

The parent company of the Group, Gulf International Bank B.S.C. (the Bank), is a Bahraini Shareholding Company incorporated in the Kingdom of Bahrain by Amiri Decree Law No. 30 dated 24<sup>th</sup> November 1975 and is registered as 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 Bank and its subsidiaries (the Group), is principally engaged in the provision of wholesale commercial, asset management 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 930.

#### 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 (IFRS) 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, equity investment securities, and derivative financial instruments as explained in more detail in the following accounting policies. Recognised assets and liabilities that are hedged by derivative financial instruments are also stated at fair value in respect of the risk that is being hedged. The accounting policies have been consistently applied by the Bank and its subsidiaries and are consistent with those of the previous year, except for the adoption of applicable new accounting standards with effect from 1<sup>st</sup> January 2014 as referred to below.

##### **IAS 32 - Financial Instruments: Presentation**

The amendments to IAS 32 clarify the requirements relating to the offset of financial assets and financial liabilities. The amendments have been applied retrospectively and have not had a significant impact on the Group's consolidated financial statements.

##### 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, which the Bank controls. The Bank controls an entity when it is exposed to, or has rights to, variable returns from its involvement with the entity and has the ability to affect those returns through its power over the entity. The subsidiary's accounts are derecognised from the consolidated financial statements from the point when the control ceases. 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 consolidated financial statements of the Bank and its 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 Group'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.

##### 2.4 Financial assets and liabilities

Financial assets and liabilities comprise all assets and liabilities reflected in the statement of financial position, 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

The Group recognises financial assets and liabilities in the consolidated statement of financial position when, and only when, the Group becomes party to the contractual provisions of the instrument.

Financial instruments are classified at inception into one of the following categories, which then determine the subsequent measurement methodology:-

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

- financial assets at amortised cost
- financial assets at fair value through other comprehensive income (FVTOCI)
- financial assets at fair value through the profit or loss (FVTPL)

**NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS**  
For the year ended 31<sup>st</sup> December 2014

**2. Accounting policies** (continued)

**2.4 Financial assets and liabilities** (continued)

**a) Initial recognition and measurement** (continued)

Financial liabilities are classified into one of the following two categories:-

- financial liabilities at amortised cost
- financial liabilities at fair value through the profit or loss (FVTPL)

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 classified as FVTPL 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.

**b) Subsequent measurement**

Subsequent to initial measurement, financial assets and liabilities are measured at either amortised cost or fair value. The classification and the basis for measurement are subject to the Group's business model for managing the financial assets and the contractual cash flow characteristics of the financial assets, as detailed below:-

*Financial assets at amortised cost*

Financial assets are measured at amortised cost using the effective interest rate method if:-

- the assets are held within a business model whose objective is to hold assets in order to collect contractual cash flows; and
- the contractual terms of the financial assets give rise on specified dates to cash flows that are solely payments of principal and interest on the principal amount outstanding.

If either of these two criteria is not met, the financial assets are classified and measured at fair value, either through the profit or loss (FVTPL) or through other comprehensive income (FVTOCI).

Additionally, even if a financial asset meets the amortised cost criteria, the entity may choose to designate the financial asset at FVTPL. Such an election is irrevocable and applicable only if the FVTPL classification significantly reduces a measurement or recognition inconsistency.

*Financial assets at fair value through other comprehensive income (FVTOCI)*

At initial recognition, the Group can make an irrevocable election to classify an equity investment that is not held for trading as FVTOCI.

For this purpose, a financial asset is deemed to be held for trading if the equity investment meets any of the following conditions:-

- it has been acquired principally for the purpose of selling in the near term;
- on initial recognition, it is part of a portfolio of identified financial instruments that are managed together and for which there is evidence of a recent actual pattern of short-term profitability; or
- it is a derivative and not designated and effective as a hedging instrument or a financial guarantee.

The irrevocable election is on an instrument-by-instrument basis. If an equity investment is designated as FVTOCI, all gains and losses, except for dividend income, are recognised in other comprehensive income and are not subsequently included in the consolidated statement of income.

*Financial assets at fair value through the profit or loss (FVTPL)*

Financial assets not otherwise classified above are classified and measured as FVTPL.

*Financial liabilities at amortised cost*

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

## NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

### For the year ended 31<sup>st</sup> December 2014

#### 2. Accounting policies (continued)

##### 2.4 Financial assets and liabilities (continued)

##### b) Subsequent measurement (continued)

###### *Financial liabilities at fair value through the profit or loss*

Financial liabilities not otherwise classified above are classified as financial liabilities at FVTPL. This classification includes derivatives that are liabilities measured at fair value.

##### c) Derecognition of financial assets and liabilities

Financial assets are derecognised and removed from the consolidated statement of financial position 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 statement of financial position when the obligation is discharged, cancelled, or expires.

#### 2.5 Impairment of financial assets

Only financial assets that are measured at amortised cost are tested for impairment. A provision for impairment is established where there is objective evidence that the Group will not collect all amounts due, including both principal and interest, in accordance with the contractual terms of the credit facility. 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, 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.

Provisions for impairment are 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, 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 investment 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.

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.

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 on-going 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 statement of financial position 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 FVTPL 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.

## NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

### For the year ended 31<sup>st</sup> December 2014

#### 2. **Accounting policies** (continued)

##### 2.7 **Revenue recognition** (continued)

###### a) **Interest income and interest expense** (continued)

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 and foreign exchange income**

Trading and foreign exchange income arise 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 equity instruments classified as FVTPL are recognised when the right to receive the dividend is established and are included in trading income.
- dividends from equity instruments classified as FVTOCI are recognised when the right to receive the dividend is established and are included in other income.

#### 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 statement of financial position 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.

#### 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. Depreciation is calculated using the straight-line method over various periods. 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.

#### 2.10 **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 and credit markets.

## NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

### For the year ended 31<sup>st</sup> December 2014

#### 2. Accounting policies (continued)

##### 2.11 Derivative financial instruments and hedge accounting (continued)

Derivative financial instruments are recognised in the consolidated statement of financial position at fair value. Fair values are derived from prevailing market prices, discounted cash flow models or option pricing models as appropriate.

In the consolidated statement of financial position, 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 on-going 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 statement of financial position. 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 other comprehensive income. Unrealised gains or losses recognised in other comprehensive income 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. Gains and losses arising on the termination of derivatives designated as cash flow hedges are recognised in interest income or interest expense over the original tenor of the terminated hedge transaction.

Some hybrid instruments contain both a derivative and non-derivative component. In such cases, the derivative is categorised as an embedded derivative. If the host contract is accounted for under IFRS 9 then the hybrid financial instrument is holistically assessed as to whether it should be measured at amortised cost or as fair value. If the host contract is not accounted for under IFRS 9 and 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. If it is not practically possible to bifurcate the embedded derivative, the entire hybrid instrument is categorised as a financial asset at FVTPL and measured at fair value. Changes in fair value are included in trading income.

##### 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.

## NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

### For the year ended 31<sup>st</sup> December 2014

#### 2. Accounting policies (continued)

##### 2.12 Financial guarantees (continued)

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, or 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 recognised in the consolidated statement of income. In the consolidated statement of financial position, 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 expensed in the year to which they relate.

The calculation of obligations in respect of the defined benefit pension plan is performed by a qualified actuary using the projected unit credit method. The Group's net obligation is calculated by estimating the amount of future benefit that employees have earned in the current and prior periods, discounting that amount and deducting the fair value of the plan assets. When the calculation results in a potential asset for the Group, the recognised asset is limited to a ceiling so that it does not exceed the economic benefits available in the form of refunds from the plan or reductions in future contributions.

Remeasurements of the net defined benefit liability or asset, which comprises actuarial gains and losses, the return of plan assets (excluding interest) and the effect of the asset ceiling, are recognised immediately in the consolidated statement of other comprehensive income. The Group determines the net interest expense or income on the net defined benefit liability or asset for the year by applying the discount rate used to measure the defined benefit obligation at the beginning of the year to the opening net defined benefit liability or asset. Net interest expense and other expenses related to the defined benefit plan are recognised in the consolidated statement of income.

When the benefits of a plan are changed or when a plan is curtailed, the resulting change in benefit that relates to past service or the gain or loss on curtailment is recognised immediately in the consolidated statement of income. The Group recognises gains and losses on the settlement of a defined benefit plan when the settlement occurs.

##### 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

In the consolidated statement of cash flows, cash and cash equivalents comprise cash and other liquid assets, excluding statutory deposits with central banks.

##### 2.16 Segment reporting

An operating segment is a distinguishable component of the Group that is engaged in business activities from which revenues are earned and expenses are incurred, including revenues and expenses that relate to transactions with any of the Group's other operating segments. All segments have discrete financial information which is regularly reviewed by the Group's Management Committee, being the Group's chief operating decision maker, to make decisions about resources allocated to the segment and to assess its performance. The Group's Management Committee assesses the segments based on net interest income which accounts for the majority of the Group's revenues.

##### 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.



## NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

### For the year ended 31<sup>st</sup> December 2014

#### 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 Shariah compliant banking

The Group offers various Shariah compliant products to its customers. The Shariah compliant activities are conducted in accordance with Shariah principals and are subject to the supervision and approval of the Group's Shariah Supervisory Board. The disclosures set out in the consolidated financial statements in relation to these activities are prepared in accordance with Financial Accounting Standard 18 issued by the Accounting and Auditing Organisation for Islamic Financial Institutions (AAOIFI).

##### 2.20 Comparatives

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

##### 2.21 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 31<sup>st</sup> December 2014. The relevant new standards, amendments to standards, and interpretations, are as follows:-

- IAS 19 - Employee Benefits:

Further amendments to the treatment of defined benefit plans within IAS19 have been issued which clarify how an entity should account for contributions made by employees. The Group is assessing the potential impact on its consolidated financial statements resulting from the application.

- IFRS 9 (2014) - Financial Instruments:

IFRS 9 (2014) was issued as a complete standard including the requirements previously issued and adopted, and additional amendments to introduce a new expected loss impairment model, and limited changes to the classification and measurement requirements of financial assets. The Group is currently evaluating the potential impact of this standard and determining a date of initial application.

#### 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, the valuation of the Group's defined benefit pension plan, and in determining control relationships over investees, as explained in more detail below:-

##### 3.1 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.

##### 3.2 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.

##### 3.3 Retirement benefit obligations

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

**NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS**  
For the year ended 31<sup>st</sup> December 2014

**3. Accounting estimates and assumptions** (continued)

**3.4 Determination of control over investees**

The Group acts as fund manager to a number of investment funds. The determination of whether the Group controls an investment fund is based on an assessment of the aggregate economic interests of the Group in the fund and includes an assessment of any carried interests, expected management fees, and the investors' rights to remove the Group as fund manager.

Management are required to conclude whether the Group acts as an agent for the investors in the fund, or if the underlying fund is controlled by the Group.

The principal investment funds are set out in note 35.



**NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS**  
For the year ended 31<sup>st</sup> December 2014

**4. Classification of assets and liabilities**

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

	Financial assets at amortised cost	Financial assets & liabilities at FVTPL	Financial assets at FVTOCI	Financial liabilities at amortised cost	Non- financial assets & liabilities	Total
	US\$ millions	US\$ millions	US\$ millions	US\$ millions	US\$ millions	US\$ millions
<b>At 31<sup>st</sup> December 2014</b>						
Cash and other liquid assets	2,472.6	-	-	-	-	2,472.6
Securities purchased under agreements to resell	1,305.2	-	-	-	-	1,305.2
Placements	5,180.5	-	-	-	-	5,180.5
Trading securities	-	72.7	-	-	-	72.7
Investment securities	3,636.9	-	307.6	-	-	3,944.5
Loans and advances	7,931.5	-	-	-	-	7,931.5
Other assets	132.7	130.0	-	-	130.5	393.2
<b>Total assets</b>	<b>20,659.4</b>	<b>202.7</b>	<b>307.6</b>	<b>-</b>	<b>130.5</b>	<b>21,300.2</b>
Deposits from banks	-	-	-	1,240.1	-	1,240.1
Deposits from customers	-	-	-	12,897.8	-	12,897.8
Securities sold under agreements to repurchase	-	-	-	618.0	-	618.0
Other liabilities	-	131.0	-	150.0	61.9	342.9
Senior term financing	-	-	-	3,372.9	-	3,372.9
Subordinated term financing	-	-	-	477.8	-	477.8
Equity	-	-	-	-	2,350.7	2,350.7
<b>Total liabilities &amp; equity</b>	<b>-</b>	<b>131.0</b>	<b>-</b>	<b>18,756.6</b>	<b>2,412.6</b>	<b>21,300.2</b>
<b>At 31<sup>st</sup> December 2013</b>						
Cash and other liquid assets	1,659.4	-	-	-	-	1,659.4
Securities purchased under agreements to resell	1,742.7	-	-	-	-	1,742.7
Placements	5,264.6	-	-	-	-	5,264.6
Trading securities	-	50.9	-	-	-	50.9
Investment securities	3,417.4	-	308.4	-	-	3,725.8
Loans and advances	8,317.2	-	-	-	-	8,317.2
Other assets	132.9	174.9	-	-	88.5	396.3
<b>Total assets</b>	<b>20,534.2</b>	<b>225.8</b>	<b>308.4</b>	<b>-</b>	<b>88.5</b>	<b>21,156.9</b>
Deposits from banks	-	-	-	1,446.3	-	1,446.3
Deposits from customers	-	-	-	13,451.3	-	13,451.3
Securities sold under agreements to repurchase	-	-	-	785.2	-	785.2
Other liabilities	-	192.4	-	142.9	64.1	399.4
Senior term financing	-	-	-	2,332.9	-	2,332.9
Subordinated term financing	-	-	-	477.8	-	477.8
Equity	-	-	-	-	2,264.0	2,264.0
<b>Total liabilities &amp; equity</b>	<b>-</b>	<b>192.4</b>	<b>-</b>	<b>18,636.4</b>	<b>2,328.1</b>	<b>21,156.9</b>

The other assets and other liabilities classified as financial assets and liabilities at FVTPL comprise the fair values of derivatives designated as fair value and cash flow hedges.

The fair value analysis of derivative financial instruments is set out in note 31.4.

**NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS**  
For the year ended 31<sup>st</sup> December 2014

**5. Cash and other liquid assets**

	<u>31.12.14</u>	<u>31.12.13</u>
	US\$ millions	US\$ millions
Cash and balances with central banks	1,519.4	1.1
Cash and balances with banks	494.5	212.7
Certificates of deposit	51.0	51.0
Government bills	274.7	1,251.0
<b>Cash and cash equivalents</b>	<b>2,339.6</b>	<b>1,515.8</b>
Statutory deposits with central banks	133.0	143.6
<b>Cash and other liquid assets</b>	<b>2,472.6</b>	<b>1,659.4</b>

Statutory deposits with central banks are subject to local regulations which provide for restrictions on the deployment of these funds.

The increase in cash and balances with central banks and the decrease in government bills at 31<sup>st</sup> December 2014 was principally attributable to the deposit of liquid funds with central banks rather than investment in government bills.

**6. Securities purchased under agreements to resell**

The Group enters into collateralised lending transactions (reverse repurchase agreements) in the ordinary course of its operating activities. The collateral is in the form of highly rated debt securities. The collateralised lending transactions are conducted under standardised terms that are usual and customary for such transactions.

**7. Placements**

Placements at 31<sup>st</sup> December 2014 included placements with central banks amounting to US\$1,511.0 million (2013: US\$891.4 million). The placements with central banks represented the placement of surplus liquid funds.

**8. Trading securities**

	<u>31.12.14</u>	<u>31.12.13</u>
	US\$ millions	US\$ millions
Managed funds	60.6	50.9
Equity securities	12.1	-
	<b>72.7</b>	<b>50.9</b>

Equity securities comprised equities acquired in relation to investment banking activities undertaken by the Group. The equities were held with the intention of selling in the near term.

Managed funds comprised funds placed for investment with specialist managers.

**9. Investment securities**

**9.1 Composition**

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

	<u>31.12.14</u>		<u>31.12.13</u>	
	US\$ millions	%	US\$ millions	%
AAA to A- / Aaa to A3	3,298.3	90.7	3,048.9	89.2
BBB+ to BBB- / Baa1 to Baa3	338.6	9.3	368.5	10.8
Total debt securities	<b>3,636.9</b>	<b>100.0</b>	3,417.4	100.0
Equity investments	307.6		308.4	
	<b>3,944.5</b>		<b>3,725.8</b>	

Investment securities principally comprised investment-grade rated debt securities issued by major international financial institutions and government-related entities.

Debt securities are classified as investment securities at amortised cost and equity investments are classified as FVTOCI.

**NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS**  
For the year ended 31<sup>st</sup> December 2014

**9. Investment securities** (continued)

**9.2 Provisions for impairment**

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

	<u>2014</u>	<u>2013</u>
	US\$ millions	US\$ millions
<b>At 1<sup>st</sup> January</b>	7.7	7.7
Release for the year	(4.5)	-
<b>At 31<sup>st</sup> December</b>	<u>3.2</u>	<u>7.7</u>

At 31<sup>st</sup> December 2014, the provisions for the impairment of investment securities entirely comprised non-specific provisions for debt investment securities determined on a collective basis.

The provision release during the year ended 31<sup>st</sup> December 2014 arose on an adjustment to the historical loss estimate to reflect the effects of current conditions in relation to the investment-grade rated debt securities. The probabilities of default applied in the calculation of the collective provisions for impairment at 31<sup>st</sup> December 2014 nevertheless continued to reflect stressed probabilities of default and exceeded prevailing default levels.

**10. Loans and advances**

**10.1 Composition**

	<u>31.12.14</u>	<u>31.12.13</u>
	US\$ millions	US\$ millions
Gross loans and advances	8,532.6	8,908.5
Provisions for impairment	(601.1)	(591.3)
<b>Net loans and advances</b>	<u>7,931.5</u>	<u>8,317.2</u>

**10.2 Industrial classification**

	<u>31.12.14</u>	<u>31.12.13</u>
	US\$ millions	US\$ millions
Energy, oil and petrochemical	2,042.2	2,334.3
Trading and services	1,739.6	1,791.0
Financial	1,395.8	1,333.9
Transportation	1,068.8	1,048.4
Manufacturing	944.5	919.5
Construction	714.2	686.1
Communication	267.9	299.9
Real estate	143.3	275.1
Government	-	8.5
Other	216.3	211.8
	<u>8,532.6</u>	<u>8,908.5</u>
Provisions for impairment	(601.1)	(591.3)
	<u>7,931.5</u>	<u>8,317.2</u>

Gross loans at 31<sup>st</sup> December 2014 included Shariah-compliant transactions amounting to US\$2,190.1 million (2013: US\$2,407.0 million).

**NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS**  
For the year ended 31<sup>st</sup> December 2014

**10. Loans and advances** (continued)

**10.3 Provisions for impairment**

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

	<u>2014</u>			<u>2013</u>		
	<u>Specific</u>	<u>Non-specific</u>	<u>Total</u>	<u>Specific</u>	<u>Non-specific</u>	<u>Total</u>
	<u>US\$ millions</u>	<u>US\$ millions</u>	<u>US\$ millions</u>	<u>US\$ millions</u>	<u>US\$ millions</u>	<u>US\$ millions</u>
At 1 <sup>st</sup> January	423.3	168.0	591.3	436.7	189.0	625.7
Exchange rate movements	(0.5)	-	(0.5)	0.3	-	0.3
Amounts utilised	-	-	-	(38.9)	-	(38.9)
Amounts reallocated	20.0	(20.0)	-	21.0	(21.0)	-
Charge for the year	10.3	-	10.3	4.2	-	4.2
<b>At 31<sup>st</sup> December</b>	<b>453.1</b>	<b>148.0</b>	<b>601.1</b>	<b>423.3</b>	<b>168.0</b>	<b>591.3</b>

The level of non-specific loan provisions reflect the application of stressed probabilities of default in the calculation of provisions for impairment measured on a collective basis. Stressed probabilities of default are anticipated to result from the impact of the global recession on the regional economic environment.

Non-specific provisions at 31<sup>st</sup> December 2014 represented 1.8 per cent of non-specifically provisioned loans (2013: 2.0 per cent).

The gross amount of specifically provisioned loans at 31<sup>st</sup> December 2014 was US\$462.5 million (2013: US\$453.4 million). Total specific provisions at 31<sup>st</sup> December 2014 represented 98.0 per cent of loans against which a specific provision had been made (2013: 93.4 per cent).

Amounts utilised during the year ended 31<sup>st</sup> December 2013 represented provisions utilised on the settlement or sale of the related loans. No incremental losses arose on the settlement or sale of the loans.

Provision releases during the years ended 31<sup>st</sup> December 2014 and 31<sup>st</sup> December 2013 arose on the repayment of the related loans.

**10.4 Past due loans**

The gross and carrying amounts of loans for which either principal or interest was over 90 days past due were as follows:-

	<u>31.12.14</u>		<u>31.12.13</u>	
	<u>Gross</u>	<u>Carrying</u>	<u>Gross</u>	<u>Carrying</u>
	<u>US\$ millions</u>	<u>US\$ millions</u>	<u>US\$ millions</u>	<u>US\$ millions</u>
Corporates	335.1	9.4	336.4	49.7
Financial institutions	134.1	6.7	139.5	11.7
	<b>469.2</b>	<b>16.1</b>	<b>475.9</b>	<b>61.4</b>

Corporates include loans extended for investment purposes.

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

	<u>31.12.14</u>		<u>31.12.13</u>	
	<u>Past due but not impaired</u>	<u>Past due and impaired</u>	<u>Past due but not impaired</u>	<u>Past due and impaired</u>
	<u>US\$ millions</u>	<u>US\$ millions</u>	<u>US\$ millions</u>	<u>US\$ millions</u>
Less than 1 year	-	66.7	4.2	54.4
Years 2 to 5	6.7	395.8	62.7	354.6
	<b>6.7</b>	<b>462.5</b>	<b>66.9</b>	<b>409.0</b>

At 31<sup>st</sup> December 2014, interest-in-suspense on past due loans amounted to US\$181.8 million (2013: US\$135.0 million).

**NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS**  
For the year ended 31<sup>st</sup> December 2014

**10. Loans and advances** (continued)

**10.4 Past due loans** (continued)

At 31<sup>st</sup> December 2014, the past due but not impaired loan of US\$6.7 million represented a loan guaranteed by a government export credit agency.

**10.5 Restructured loans**

There were no restructured loans during the years ended 31<sup>st</sup> December 2014 and 31<sup>st</sup> December 2013. Restructured loans are loans on which the Group has agreed concessions that would not ordinarily have been accepted, due to the financial position of a customer.

**10.6 Collateral**

The Group did not take possession of any collateral during the years ended 31<sup>st</sup> December 2014 and 31<sup>st</sup> December 2013.

**11. Other assets**

	<u>31.12.14</u>	<u>31.12.13</u>
	US\$ millions	US\$ millions
Derivative financial instruments	130.0	174.9
Accrued interest, fees and commissions	93.6	90.0
Prepayments	82.4	54.0
Premises and equipment	45.4	28.3
Deferred items	2.7	3.5
Prepaid pension cost	-	2.7
Other, including accounts receivable	39.1	42.9
	<u>393.2</u>	<u>396.3</u>

Derivative financial instruments represent the positive fair values of derivative financial instruments entered into for trading purposes, or designated as fair value or cash flow hedges. An analysis of the fair value of derivative financial instruments is set out in note 31.4.

The increase in prepayments at 31<sup>st</sup> December 2014 was attributable to expenditure on new IT systems relating to the Group's new retail bank that was launched in early 2015.

The increase in premises and equipment at 31<sup>st</sup> December 2014 was principally attributable to capitalised expenditure on new premises in the Kingdom of Saudi Arabia.

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 of its employees.

The Bank maintains defined contribution pension plans for the majority of its employees. Contributions are based on a percentage of salary. The amounts to be paid as retirement benefits are determined by reference to the amounts of the contributions and investment earnings thereon. The total cost of contributions to defined contribution pension plans for the year ended 31<sup>st</sup> December 2014 amounted to US\$9.0 million (2013: US\$8.0 million).

The Bank's principal subsidiary, Gulf International Bank (UK) Limited (GIBUK), maintains a defined benefit final salary pension plan for a number of its employees. The assets of the plan are held independently of the subsidiary's assets in a separate trustee administered fund. The fund is subject to the UK regulatory framework for pensions.

The fund exposes the Group to the risk of paying unanticipated contributions in times of adverse experience. Such events could be members living for longer than expected, higher than expected inflation or salary growth, and the risk that increases in the fund's obligations are not met by a corresponding improvement in the value of the fund's assets.

**NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS**  
For the year ended 31<sup>st</sup> December 2014

**12. Post retirement benefits** (continued)

12.1 The amount recognised in the consolidated statement of financial position is analysed as follows:-

	<u>31.12.14</u>	<u>31.12.13</u>
	US\$ millions	US\$ millions
Fair value of plan assets	214.5	201.0
Present value of fund obligations	216.8	198.3
<b>Net (liability) / asset in the consolidated statement of financial position</b>	<b>(2.3)</b>	<b>2.7</b>

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

	<u>2014</u>	<u>2013</u>
	US\$ millions	US\$ millions
At 1 <sup>st</sup> January	201.0	176.8
Included in the consolidated statement of income:-		
- Interest income on the plan assets	8.8	7.9
Included in the consolidated statement of other comprehensive income:-		
- Remeasurements:-		
- Return on plan assets excluding interest income	20.3	13.3
Other movements:-		
- Exchange rate movements	(12.7)	5.0
- Contributions paid by the Group	1.4	1.4
- Benefits paid by the plan	(4.3)	(3.4)
At 31 <sup>st</sup> December	<b>214.5</b>	<b>201.0</b>

The plan assets at 31<sup>st</sup> December 2014 comprised exposure to equities, multi-asset funds, and debt and hedging funds in equal proportion and have a quoted price in an active market. The hedging funds are designed to hedge the majority of inflation and interest rate risk.

**NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS**  
For the year ended 31<sup>st</sup> December 2014

**12. Post retirement benefits** (continued)

**12.3 The movements in the present value of fund obligations were as follows:-**

	<u>2014</u>	<u>2013</u>
	US\$ millions	US\$ millions
At 1 <sup>st</sup> January	198.3	180.1
Included in the consolidated statement of income:-		
- Current service cost	0.9	0.7
- Interest cost on the fund obligations	8.6	7.9
Included in the consolidated statement of other comprehensive income:-		
- Remeasurements due to changed actuarial assumptions:-		
- Demographic assumptions	-	(7.4)
- Financial assumptions	25.9	7.2
- Experience	-	8.4
Other movements:-		
- Exchange rate movements	(12.7)	4.8
- Benefits paid by the plan	(4.3)	(3.4)
At 31 <sup>st</sup> December	<u>216.7</u>	<u>198.3</u>

**12.4 The movements in the net (liability) / asset recognised in the consolidated statement of financial position were as follows:-**

	<u>2014</u>	<u>2013</u>
	US\$ millions	US\$ millions
At 1 <sup>st</sup> January	2.7	(3.3)
Net expense included in consolidated statement of income	(0.7)	(0.7)
Remeasurement included in consolidated statement of comprehensive income	(5.6)	5.1
Contributions paid by the Group	1.4	1.4
Exchange rate movements	(0.1)	0.2
At 31 <sup>st</sup> December	<u>(2.3)</u>	<u>2.7</u>

The Group paid US\$1.4 million in contributions to the plan during 2014 and expects to pay US\$0.8 million during 2015.

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

	<u>2014</u>	<u>2013</u>
Discount rate	3.6%	4.4%
Retail price inflation	3.1%	3.4%
Consumer price inflation	2.1%	2.4%
Pension increase rate	3.1%	3.3%
Salary growth rate	3.0%	3.0%
Average life expectancy (years)	89	89

**NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS**  
For the year ended 31<sup>st</sup> December 2014

**12. Post retirement benefits** (continued)

**12.6 Sensitivity information**

The present value of the fund's obligations, which has a weighted average duration of 22 years, was calculated based on certain actuarial assumptions. Should any one of the key assumptions change by an amount that is probable whilst holding the other assumptions constant, the present value of the fund's obligations would increase or decrease as follows:-

	<u>2014</u> US\$ millions
Life expectancy increased by 1 year	0.2
Discount rate increased by 0.1%	0.2
Consumer price inflation increased by 0.1%	0.2
Retail price inflation increased by 0.1%	0.2
Salary growth rate increased by 0.1%	0.2

**13. Deposits**

The geographical composition of total deposits was as follows:-

	<u>31.12.14</u> US\$ millions	31.12.13 US\$ millions
GCC countries	9,856.0	10,224.8
Other Middle East and North Africa countries	674.8	610.1
Other countries	3,607.1	4,062.7
	<u>14,137.9</u>	<u>14,897.6</u>

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

At 31<sup>st</sup> December 2014, GCC deposits represented 69.7 per cent of total deposits (2013: 68.6 per cent).

Deposits from other countries during the year ended 31<sup>st</sup> December 2014 and 31<sup>st</sup> December 2013 reflected a high level of deposit activity by the Group's London-based subsidiary, Gulf International Bank (UK) Limited.

Total deposits at 31<sup>st</sup> December 2014 included Shariah-compliant transactions amounting to US\$3,153.7 million (2013: US\$2,897.7 million). Shariah-compliant transactions comprise murabaha contracts. The increase in Shariah-compliant deposits during the year ended 31<sup>st</sup> December 2014 reflected a generally higher funding requirement associated with higher Shariah-compliant loan volumes.

**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 investment securities portfolio. At 31<sup>st</sup> December 2014, the fair value of investment securities that had been pledged as collateral under repurchase agreements was US\$711.3 million (2013: US\$847.7 million). The collateralised borrowing transactions are conducted under standardised terms that are usual and customary for such transactions.

**15. Other liabilities**

	<u>31.12.14</u> US\$ millions	31.12.13 US\$ millions
Derivative financial instruments	131.0	192.4
Deferred items	61.9	64.1
Accrued interest	68.8	60.5
Pension liability	2.3	-
Other, including accounts payable and accrued expenses	78.9	82.4
	<u>342.9</u>	<u>399.4</u>

Derivative financial instruments represent the negative fair values of derivative financial instruments entered into for trading purposes, or designated as fair value or cash flow hedges. An analysis of the fair value of derivative financial instruments is set out in note 31.4.



**NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS**  
For the year ended 31<sup>st</sup> December 2014

**16. Senior term financing**

	<u>Maturity</u>	<u>31.12.14</u> US\$ millions	<u>31.12.13</u> US\$ millions
Murabaha term facility	2014	-	300.0
Floating rate repurchase agreements	2014	-	64.9
Floating rate note	2015	<b>932.7</b>	933.2
Floating rate repurchase agreements	2015	<b>35.4</b>	35.4
Floating rate loan	2016	<b>500.0</b>	500.0
Floating rate note	2017	<b>499.6</b>	499.4
Floating rate loans	2018	<b>605.7</b>	-
Floating rate note	2019	<b>533.0</b>	-
Floating rate loan	2019	<b>266.5</b>	-
		<b>3,372.9</b>	<b>2,332.9</b>

During the year ended 31<sup>st</sup> December 2014, the Group raised US\$1,405.2 million of new senior term finance (2013: nil).

The US\$500.0 million floating rate loan maturing in 2016 was provided by the Group's majority shareholder, the Public Investment Fund. The loan was based on market rates and standardised terms that are usual and customary for such transactions.

At 31<sup>st</sup> December 2014, the fair value of investment securities that had been pledged as collateral under term repurchase agreements was US\$50.1 million (2013: US\$137.7 million).

**17. Subordinated term financing**

	<u>Maturity</u>	<u>31.12.14</u> US\$ millions	<u>31.12.13</u> US\$ millions
Floating rate note	2015	<b>327.8</b>	327.8
Floating rate loans	2016	<b>150.0</b>	150.0
		<b>477.8</b>	<b>477.8</b>

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 31<sup>st</sup> December 2014 comprised 3.0 billion shares of US\$1 each (2013: 3.0 billion shares of US\$1 each). The issued share capital at 31<sup>st</sup> December 2014 comprised 2.5 billion shares of US\$1 each (2013: 2.5 billion shares of US\$1 each). All issued shares are fully paid.

**NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS**  
For the year ended 31<sup>st</sup> December 2014

**19. Reserves**

	Share premium	Compulsory reserve	Voluntary reserve	Cash flow hedge reserve	securities revaluation reserve	Total
	US\$ millions	US\$ millions	US\$ millions	US\$ millions	US\$ millions	US\$ millions
<b>At 1<sup>st</sup> January 2014</b>	<b>7.6</b>	<b>206.7</b>	<b>144.2</b>	<b>-</b>	<b>15.8</b>	<b>374.3</b>
Net fair value losses on cash flow hedges	-	-	-	(0.2)	-	(0.2)
Net fair value gains on equity investments classified as FVTOCI	-	-	-	-	3.2	3.2
Transfers to consolidated statement of income	-	-	-	(0.1)	-	(0.1)
Net (decrease) / increase	-	-	-	(0.3)	3.2	2.9
Transfers from retained earnings	-	7.4	7.4	-	-	14.8
<b>At 31<sup>st</sup> December 2014</b>	<b>7.6</b>	<b>214.1</b>	<b>151.6</b>	<b>(0.3)</b>	<b>19.0</b>	<b>392.0</b>
<b>At 1<sup>st</sup> January 2013</b>	<b>7.6</b>	<b>196.8</b>	<b>134.3</b>	<b>1.4</b>	<b>(11.9)</b>	<b>328.2</b>
Net fair value gains on cash flow hedges	-	-	-	-	-	-
Net fair value gains on equity investments classified as FVTOCI	-	-	-	-	27.7	27.7
Transfers to consolidated statement of income	-	-	-	(1.4)	-	(1.4)
Net (decrease) / increase	-	-	-	(1.4)	27.7	26.3
Transfers from retained earnings	-	9.9	9.9	-	-	19.8
<b>At 31<sup>st</sup> December 2013</b>	<b>7.6</b>	<b>206.7</b>	<b>144.2</b>	<b>-</b>	<b>15.8</b>	<b>374.3</b>

In accordance with the Bank's articles of association, 10 per cent of the Bank's net profit for the year is required to be transferred to each of the compulsory and voluntary reserves. Transfers to the 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.

The investment securities revaluation reserve entirely comprised unrealised fair value gains and losses on equity investments arising since the adoption of IFRS 9 on 1<sup>st</sup> January 2012.

**20. Dividends**

No dividend is proposed in respect of the financial year ended 31<sup>st</sup> December 2014.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS  
For the year ended 31<sup>st</sup> December 2014

21. Net interest income

	Year ended 31.12.14 US\$ millions	Year ended 31.12.13 US\$ millions
<b>Interest income</b>		
Placements and other liquid assets	37.7	31.8
Investment securities	55.2	58.6
Loans and advances	216.0	214.9
Total interest income	<u>308.9</u>	<u>305.3</u>
<b>Interest expense</b>		
Deposits from banks and customers	84.2	82.9
Securities sold under agreements to repurchase	3.4	3.3
Term financing	63.3	56.0
Total interest expense	<u>150.9</u>	<u>142.2</u>
<b>Net interest income</b>	<u>158.0</u>	<u>163.1</u>

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

There was no accrued interest on impaired loans included in interest income for the year ended 31<sup>st</sup> December 2014 (2013: US\$1.4 million). There was no accrued but uncollected interest included in interest income on past due loans or past due investment securities for either the year ended 31<sup>st</sup> December 2014 or 31<sup>st</sup> December 2013.

22. Fee and commission income

	Year ended 31.12.14 US\$ millions	Year ended 31.12.13 US\$ millions
<b>Fee and commission income</b>		
Commissions on letters of credit and guarantee	32.1	31.2
Investment banking and management fees	27.9	27.2
Loan commitment fees	2.0	2.5
Other fee and commission income	2.4	2.5
Total fee and commission income	<u>64.4</u>	<u>63.4</u>
<b>Fee and commission expense</b>	<u>(1.5)</u>	<u>(1.4)</u>
<b>Net fee and commission income</b>	<u>62.9</u>	<u>62.0</u>

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, initial public offerings, and mergers and acquisitions.

Investment banking and management fees for the year ended 31<sup>st</sup> December 2014 included fee income relating to the Group's fiduciary activities amounting to US\$20.8 million (2013: US\$16.0 million).

Fee and commission expense principally comprises security custody fees.

23. Foreign exchange income

Foreign exchange income principally comprises customer-initiated foreign exchange contracts which have been offset in the market with matching contracts. There is no remaining market risk associated with these offset customer-related foreign exchange contracts.

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

**NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS**  
**For the year ended 31<sup>st</sup> December 2014**

**24. Trading income**

	<b>Year ended</b> <b>31.12.14</b>	Year ended 31.12.13
	<b>US\$ millions</b>	US\$ millions
Managed funds	1.2	9.5
Equity securities	0.5	0.9
Interest rate derivatives	0.7	0.2
Debt securities	-	(1.3)
	<b>2.4</b>	<b>9.3</b>

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.

Income on managed funds for the year ended 31<sup>st</sup> December 2013 included an amount of US\$5.9 million in relation to a recovery of an underlying investment in a fund managed by the Group. The amount was written off in a previous year.

**25. Other income**

	<b>Year ended</b> <b>31.12.14</b>	Year ended 31.12.13
	<b>US\$ millions</b>	US\$ millions
Dividends on equity investments classified as FVTOCI	9.5	9.6
Recoveries on previously written off assets	3.8	15.8
Net realised profits on investment debt securities	1.4	1.1
Sundry income	0.2	-
	<b>14.9</b>	<b>26.5</b>

Recoveries on previously written off assets for the year ended 31<sup>st</sup> December 2014 principally comprised a US\$3.0 million recovery relating to a previously written off loan and a US\$0.8 million debt security recovery. Recoveries on previously written off assets for the year ended 31<sup>st</sup> December 2013 principally comprised a US\$15.3 million recovery arising on the liquidation of a structured investment vehicle that was written off in 2007.

**26. Segmental information**

Segmental information is presented in respect of the Group's business and geographical segments. The primary reporting format, business segments, reflects the manner in which financial information is evaluated by the Board of Directors and the Group Management Committee.

**26.1 Business segments**

For financial reporting purposes, the Group is organised into four main operating segments:-

- Wholesale 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, initial public offerings, 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 and trading activities and the management of the Group's balance sheet, including funding.
- Financial markets: the provision of asset and fund management services.
- Head office and support units: income arising on the investment of the Group's net free capital funds and expenses incurred by support units, including the investment in the retail banking strategy prior to the public launch of retail banking activities.

The results reported for the business segments are based on the Group's internal financial reporting systems, which report interest revenue and interest expense on a net basis. 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.

**NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS**  
For the year ended 31<sup>st</sup> December 2014

**26. Segmental information** (continued)

**26.1 Business segments** (continued)

Segment results, assets and liabilities comprise items directly attributable to the business segments. Liabilities reported for head office and support units comprise senior and subordinated term finance facilities and related accrued interest, the cost of which is recharged to the relevant operating business segments.

The business segment analysis is as follows:-

	<u>Wholesale banking</u>	<u>Treasury</u>	<u>Financial markets</u>	<u>Head office and support units</u>	<u>Total</u>
	US\$ millions	US\$ millions	US\$ millions	US\$ millions	US\$ millions
<b>2014</b>					
Net interest income	71.0	55.2	-	31.8	158.0
Total income	120.2	76.8	22.6	38.0	257.6
Segment result	67.9	66.6	16.7	(64.3)	86.9
Taxation charge on overseas activities					(1.3)
Net income after tax					85.6
Segment assets	8,086.1	12,846.2	39.0	328.9	21,300.2
Segment liabilities	-	15,014.6	10.7	3,924.2	18,949.5
Total equity					2,350.7
Total liabilities and equity					21,300.2
<b>2013</b>					
Net interest income	60.6	61.8	-	40.7	163.1
Total income	111.1	96.1	24.5	46.6	278.3
Segment result	63.7	84.4	18.6	(44.2)	122.5
Taxation charge on overseas activities					(1.0)
Net income after tax					121.5
Segment assets	8,489.9	12,367.8	40.2	259.0	21,156.9
Segment liabilities	-	15,998.3	8.1	2,886.5	18,892.9
Total equity					2,264.0
Total liabilities and equity					21,156.9

## NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

### For the year ended 31<sup>st</sup> December 2014

#### 26. Segmental information (continued)

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

	<u>2014</u>		<u>2013</u>	
	Total income	Total assets	Total income	Total assets
	US\$ millions	US\$ millions	US\$ millions	US\$ millions
GCC	206.3	15,720.6	224.5	15,651.7
Other countries	51.3	5,579.6	53.8	5,505.2
	<b>257.6</b>	<b>21,300.2</b>	<b>278.3</b>	<b>21,156.9</b>

The geographical analyses of deposits and risk assets are set out in notes 13 and 28 respectively.

#### 27. 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 Risk 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 Basel 2 Pillar 3 disclosure report in the Annual Report, and are summarised below together with additional quantitative analyses:-

##### 27.1 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.

**NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS**  
For the year ended 31<sup>st</sup> December 2014

**27. Risk management** (continued)

**27.1 Credit risk** (continued)

**a) Maximum exposure to credit risk**

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

	<u>31.12.14</u>	<u>31.12.13</u>
	US\$ millions	US\$ millions
<b>Balance sheet items:</b>		
Cash and other liquid assets	2,472.6	1,659.4
Securities purchased under agreements to resell	1,305.2	1,742.7
Placements	5,180.5	5,264.6
Trading securities	72.7	50.9
Investment securities	3,944.5	3,725.8
Loans and advances	7,931.5	8,317.2
Accrued interest receivable	93.6	90.0
<b>Total on-balance sheet credit exposure</b>	<b>21,000.6</b>	<b>20,850.6</b>
<b>Off-balance sheet items:</b>		
Credit-related contingent items	3,976.0	5,140.1
Foreign exchange-related items	195.7	290.5
Derivative-related items	40.7	48.6
Commodity contracts	3.0	-
<b>Total off-balance sheet credit exposure</b>	<b>4,215.4</b>	<b>5,479.2</b>
<b>Total gross credit exposure</b>	<b>25,216.0</b>	<b>26,329.8</b>

**b) 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. 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:-

<u>Internal rating grade</u>	<u>Internal classification</u>	<u>External rating</u>	
		<u>Fitch and Standard &amp; Poor's</u>	<u>Moody's</u>
<b>Investment grade</b>			
Rating grade 1	Standard	AAA	Aaa
Rating grade 2	Standard	AA	Aa
Rating grade 3	Standard	A	A
Rating grade 4	Standard	BBB	Baa
<b>Sub-investment grade</b>			
Rating grade 5	Standard	BB	Ba
Rating grade 6	Standard	B	B
Rating grade 7	Standard	CCC	Caa
<b>Classified</b>			
Rating grade 8	Substandard	CC	Ca
Rating grade 9	Doubtful	C	C
Rating grade 10	Loss	D	-

**NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS**  
For the year ended 31<sup>st</sup> December 2014

**27. Risk management** (continued)

**27.1 Credit risk** (continued)

**b) Credit risk profile** (continued)

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

	<u>31.12.14</u>			<u>31.12.13</u>		
	Placements, reverse repos & other liquid assets	Securities	Loans and advances	Placements, reverse repos & other liquid assets	Securities	Loans and advances
	US\$ millions	US\$ millions	US\$ millions	US\$ millions	US\$ millions	US\$ millions
<b>Neither past due nor impaired</b>						
Rating grades 1 to 4-	8,858.3	3,636.9	4,801.4	8,591.6	3,417.4	5,056.0
Rating grades 5+ to 5-	100.0	-	2,767.8	75.1	-	2,784.0
Rating grades 6+ to 6-	-	-	346.2	-	-	362.2
Equity investments	-	380.3	-	-	359.3	-
<b>Carrying amount</b>	<b>8,958.3</b>	<b>4,017.2</b>	<b>7,915.4</b>	<b>8,666.7</b>	<b>3,776.7</b>	<b>8,202.2</b>
<b>Past due but not impaired</b>						
Rating grades 1 to 7	-	-	6.7	-	-	53.5
<b>Carrying amount</b>	<b>-</b>	<b>-</b>	<b>6.7</b>	<b>-</b>	<b>-</b>	<b>53.5</b>
<b>Past due and individually impaired</b>						
Rating grade 7	-	-	-	-	-	6.8
Rating grade 8	-	-	3.8	-	-	-
Rating grade 9	-	-	5.6	-	-	19.2
<b>Carrying amount</b>	<b>-</b>	<b>-</b>	<b>9.4</b>	<b>-</b>	<b>-</b>	<b>26.0</b>
<b>Individually impaired but not past due</b>						
Rating grade 8	-	-	-	-	-	35.5
<b>Carrying amount</b>	<b>-</b>	<b>-</b>	<b>-</b>	<b>-</b>	<b>-</b>	<b>35.5</b>
	<b>8,958.3</b>	<b>4,017.2</b>	<b>7,931.5</b>	<b>8,666.7</b>	<b>3,776.7</b>	<b>8,317.2</b>

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

<b>Provisions for impairment</b>	<b>-</b>	<b>(3.2)</b>	<b>(601.1)</b>	<b>-</b>	<b>(7.7)</b>	<b>(591.3)</b>
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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.

Unimpaired financial assets are stated net of allocated non-specific provisions for impairment.

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 31<sup>st</sup> December 2014 or 31<sup>st</sup> December 2013.

An analysis of the credit risk in respect of foreign exchange and derivative financial instruments is set out in note 31 while the notional and risk-weighted exposures for off-balance sheet credit-related financial instruments are set out in note 32.



**NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS**  
For the year ended 31<sup>st</sup> December 2014

**27. Risk management** (continued)

**27.1 Credit risk** (continued)

**c) 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 10.2. The geographical distribution of risk assets is set out in note 28. An analysis of the credit risk in respect of foreign exchange and derivative financial instruments is set out in note 31.

**d) 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.

**27.2 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.

**a) 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 31.

The VaR for the Group's trading positions, as calculated in accordance with the basis set out in note 34, was as follows:-

	<b>2014</b>				<b>2013</b>			
	<b>31.12.14</b>	<b>Average</b>	<b>High</b>	<b>Low</b>	<b>31.12.13</b>	<b>Average</b>	<b>High</b>	<b>Low</b>
	<b>US\$ millions</b>	<b>US\$ millions</b>	<b>US\$ millions</b>	<b>US\$ millions</b>	<b>US\$ millions</b>	<b>US\$ millions</b>	<b>US\$ millions</b>	<b>US\$ millions</b>
Total VaR	0.4	0.1	0.4	-	1.0	1.3	2.3	0.9
Total undiversified stressed VaR	0.6	0.3	1.5	0.1	2.0	3.8	5.3	2.0

**b) 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 30. Movements in the fair value of equity investment securities are accounted for in other comprehensive income. The Group does not maintain material foreign currency exposures. 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 31.5.

**NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS**  
For the year ended 31<sup>st</sup> December 2014

**27. Risk management** (continued)

**27.2 Market risk** (continued)

**b) Non-trading market risk** (continued)

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:-

<b>Activity</b>	<b>Risk</b>	<b>Risk mitigant</b>
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

**27.3 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.

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 resources available in 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
- the maintenance of appropriate standby funding arrangements; 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 approved 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 30 day period. The liquidity limits ensure that the net cash outflows over a 30 day period do not exceed the eligible stock of available liquid resources. 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.

## NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

### For the year ended 31<sup>st</sup> December 2014

#### 27. Risk management

##### 27.3 Liquidity risk (continued)

The maturity profile of assets and liabilities is set out in note 29. An analysis of debt investment securities by rating classification is set out in note 27.1.

##### 27.4 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.

##### 27.5 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.

As referred to in more detail in note 34, the Group adopted the Basel 2 capital adequacy framework with effect from 1<sup>st</sup> January 2008, and has adopted Basel 3 from 1<sup>st</sup> January 2015 as required by the CBB. The Basel 3 framework revises the definition of regulatory capital and introduces certain new liquidity and funding ratios. The Group's current capital position is sufficient to meet the new regulatory capital requirements.

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. 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 under the standardised approach to determine the risk-weighted amounts for credit risk and specific market risk. Operational risk is calculated in accordance with the standardised approach. The regulatory capital requirement is calculated by applying the CBB's prescribed range of beta coefficients, ranging from 12 to 18 per cent, to the average gross income for the preceding three financial years for each of eight predefined business lines.

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 derivative cash flow hedging transactions and unrealised gains on equity investment securities.
- 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 equity investment securities.

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 are also 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 credit 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.

The Group complied with all externally imposed capital requirements throughout the years ended 31<sup>st</sup> December 2014 and 31<sup>st</sup> December 2013.

There have been no material changes in the Group's management of capital during the years ended 31<sup>st</sup> December 2014 and 31<sup>st</sup> December 2013.

The capital adequacy ratio calculation is set out in note 34.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS  
For the year ended 31<sup>st</sup> December 2014

28. Geographical distribution of risk assets

					<u>31.12.14</u>	<u>31.12.13</u>
	Placements, reverse repos & 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	3,765.0	1,853.6	7,430.9	3,357.0	16,406.5	17,559.1
Other Middle East & North Africa	-	5.8	15.2	25.9	46.9	67.9
Europe	3,972.1	1,315.5	338.8	336.4	5,962.8	5,330.7
North America	804.8	497.6	93.2	224.0	1,619.6	2,039.7
Asia	416.4	334.5	8.0	32.7	791.6	855.1
Latin America	-	10.2	45.4	-	55.6	48.2
	<u>8,958.3</u>	<u>4,017.2</u>	<u>7,931.5</u>	<u>3,976.0</u>	<u>24,883.0</u>	<u>25,900.7</u>

At 31<sup>st</sup> December 2014, risk exposures to customers and counterparties in the GCC represented 65.9 per cent (2013: 67.8 per cent) of total risk assets. The risk asset profile reflects the Group's strategic focus on wholesale banking activities in the GCC states.

Placements, reverse repos and other liquid assets exposure to Europe principally comprised exposure to financial institutions located in the United Kingdom, Sweden, Switzerland and the Netherlands.

An analysis of derivative and foreign exchange instruments is set out in note 31.

**NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS**  
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**29. 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 US\$ millions	4 months to 1 year US\$ millions	Years 2 and 3 US\$ millions	Years 4 and 5 US\$ millions	Over 5 years and other US\$ millions	Total US\$ millions
<b>At 31<sup>st</sup> December 2014</b>						
Cash and other liquid assets	2,300.1	172.5	-	-	-	2,472.6
Securities purchased under agreements to resell	1,257.8	47.4	-	-	-	1,305.2
Placements	4,086.2	1,094.3	-	-	-	5,180.5
Trading securities	-	-	-	-	72.7	72.7
Investment securities	433.1	528.1	1,532.8	921.3	529.2	3,944.5
Loans and advances	2,623.0	1,686.5	1,727.0	923.4	971.6	7,931.5
Other assets	115.5	54.5	17.5	-	205.7	393.2
<b>Total assets</b>	<b>10,815.7</b>	<b>3,583.3</b>	<b>3,277.3</b>	<b>1,844.7</b>	<b>1,779.2</b>	<b>21,300.2</b>
Deposits	10,605.7	3,528.0	4.2	-	-	14,137.9
Securities sold under agreements to repurchase	550.1	67.9	-	-	-	618.0
Other liabilities	144.3	45.5	16.0	-	137.1	342.9
Term financing	35.4	1,260.5	1,149.5	1,405.3	-	3,850.7
Equity	-	-	-	-	2,350.7	2,350.7
<b>Total liabilities &amp; equity</b>	<b>11,335.5</b>	<b>4,901.9</b>	<b>1,169.7</b>	<b>1,405.3</b>	<b>2,487.8</b>	<b>21,300.2</b>
<b>At 31<sup>st</sup> December 2013</b>						
Total assets	10,622.6	3,043.9	3,589.4	2,076.7	1,824.3	21,156.9
Total liabilities & equity	11,988.7	4,252.7	2,023.1	505.2	2,387.2	21,156.9

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. Formal liquidity controls are nevertheless based on contractual asset and liability maturities.

**NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS**  
For the year ended 31<sup>st</sup> December 2014

**29. Maturities of assets and liabilities** (continued)

The gross cash flows payable by the Group under financial liabilities, based on contractual maturity dates, was as follows:-

	Within 3 months US\$ millions	4 months to 1 year US\$ millions	Years 2 and 3 US\$ millions	Years 4 and 5 US\$ millions	Over 5 years and other US\$ millions
<b>At 31<sup>st</sup> December 2014</b>					
Deposits	10,619.5	3,551.4	4.5	-	-
Securities sold under agreements to repurchase	550.8	68.1	-	-	-
Term financing	44.8	1,290.0	1,209.2	1,413.6	-
Derivative financial instruments					
- contractual amounts payable	68.6	91.9	162.6	53.4	78.0
- contractual amounts receivable	(74.7)	(112.2)	(185.5)	(62.9)	(50.8)
<b>Total undiscounted financial liabilities</b>	<b>11,209.0</b>	<b>4,889.2</b>	<b>1,190.8</b>	<b>1,404.1</b>	<b>27.2</b>
<b>At 31<sup>st</sup> December 2013</b>					
Deposits	11,085.2	3,861.6	4.9	-	-
Securities sold under agreements to repurchase	787.1	-	-	-	-
Term financing	9.7	405.5	2,014.1	523.2	-
Derivative financial instruments					
- contractual amounts payable	74.4	123.6	270.3	83.3	45.1
- contractual amounts receivable	(51.2)	(105.1)	(236.9)	(80.3)	(44.4)
<b>Total undiscounted financial liabilities</b>	<b>11,905.2</b>	<b>4,285.6</b>	<b>2,052.4</b>	<b>526.2</b>	<b>0.7</b>

Information on the contractual terms for the drawdown of gross loan commitments is set out in note 32.

The figures in the table above do not agree directly to the carrying amounts in the consolidated statement of financial position 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.

A maturity analysis of derivative and foreign exchange instruments based on notional amounts is set out in note 31.3.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS  
For the year ended 31<sup>st</sup> December 2014

30. Interest rate risk

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

	Within 3 months US\$ millions	Months 4 to 6 US\$ millions	Months 7 to 12 US\$ millions	Over 1 year US\$ millions	Non-interest bearing items US\$ millions	Total US\$ millions
<b>At 31<sup>st</sup> December 2014</b>						
Cash and other liquid assets	2,300.1	172.5	-	-	-	2,472.6
Securities purchased under agreements to resell	1,257.8	47.4	-	-	-	1,305.2
Placements	5,163.4	17.1	-	-	-	5,180.5
Trading securities	-	-	-	-	72.7	72.7
Investment securities						
- Fixed rate	-	188.1	155.9	1,202.3	-	1,546.3
- Floating rate	1,545.8	548.0	-	-	(3.2)	2,090.6
- Equities	-	-	-	-	307.6	307.6
Loans and advances	6,139.0	1,839.9	100.6	-	(148.0)	7,931.5
Other assets	-	-	-	-	393.2	393.2
<b>Total assets</b>	<b>16,406.1</b>	<b>2,813.0</b>	<b>256.5</b>	<b>1,202.3</b>	<b>622.3</b>	<b>21,300.2</b>
Deposits	13,362.9	771.9	3.1	-	-	14,137.9
Securities sold under agreements to repurchase	550.1	67.9	-	-	-	618.0
Other liabilities	-	-	-	-	342.9	342.9
Term financing	3,190.0	660.7	-	-	-	3,850.7
Equity	-	-	-	-	2,350.7	2,350.7
<b>Total liabilities &amp; equity</b>	<b>17,103.0</b>	<b>1,500.5</b>	<b>3.1</b>	<b>-</b>	<b>2,693.6</b>	<b>21,300.2</b>
<b>Interest rate sensitivity gap</b>	<b>(696.9)</b>	<b>1,312.5</b>	<b>253.4</b>	<b>1,202.3</b>	<b>(2,071.3)</b>	<b>-</b>
<b>Cumulative interest rate sensitivity gap</b>	<b>(696.9)</b>	<b>615.6</b>	<b>869.0</b>	<b>2,071.3</b>	<b>-</b>	<b>-</b>
<b>At 31<sup>st</sup> December 2013</b>						
Cumulative interest rate sensitivity gap	(533.5)	1,065.1	1,139.0	2,083.5	-	-

The repricing profile is based on the remaining period to the next interest repricing date. 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 investment security and loan provisions are classified in non-interest bearing items.

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. At 31<sup>st</sup> December 2014 the modified duration of these fixed rate securities was 2.56. 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 was US\$311,000.

Based on the repricing profile at 31<sup>st</sup> December 2014, 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 an increase in net income before tax for the following year by approximately US\$0.9 million (2013: US\$1.6 million) and an increase in the Group's equity by US\$0.5 million (2013: US\$0.3 million). 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.



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**For the year ended 31<sup>st</sup> December 2014****30. Interest rate risk** (continued)

The Value-at-Risk by risk class for the Group's trading positions is set out in note 27. The market risk relating to derivative and foreign exchange instruments classified as FVTPL is set out in note 31.

**31. Derivatives 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.



**NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS**  
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**31. Derivative and foreign exchange instruments** (continued)

**31.1 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 amounts
	Trading	Hedging	Total	
	US\$ millions	US\$ millions	US\$ millions	US\$ millions
<b>At 31<sup>st</sup> December 2014</b>				
Foreign exchange contracts:-				
Unmatured spot, forward and futures contracts	3,912.4	3,341.4	7,253.8	164.1
Options purchased	1,908.4	-	1,908.4	31.6
Options written	1,908.4	-	1,908.4	-
	<b>7,729.2</b>	<b>3,341.4</b>	<b>11,070.6</b>	<b>195.7</b>
Interest rate contracts:-				
Interest rate swaps	952.2	10,732.9	11,685.1	40.7
Cross currency swaps	-	533.3	533.3	-
Options, caps and floors purchased	12.4	-	12.4	-
Options, caps and floors written	12.4	-	12.4	-
	<b>977.0</b>	<b>11,266.2</b>	<b>12,243.2</b>	<b>40.7</b>
Commodity contracts:-				
Options and swaps purchased	16.2	-	16.2	3.0
Options and swaps written	16.2	-	16.2	-
	<b>32.4</b>	<b>-</b>	<b>32.4</b>	<b>3.0</b>
	<b>8,738.6</b>	<b>14,607.6</b>	<b>23,346.2</b>	<b>239.4</b>
<b>At 31<sup>st</sup> December 2013</b>	<b>8,188.0</b>	<b>9,748.0</b>	<b>17,936.0</b>	<b>339.1</b>

There is no credit risk in respect of caps and floors written and options as they represent obligations of the Group.

At 31<sup>st</sup> December 2014, the Value-at-Risk of the foreign exchange, interest rate and credit derivative trading contracts analysed in the table above was nil, nil and nil respectively (2013: US\$0.1 million, nil and nil respectively). Value-at-Risk is a measure of market risk exposure and represents an estimate, with a 99 per cent level of confidence, of the potential loss that might arise if the positions were to be held unchanged for ten consecutive business days. The estimate is based on a twelve month historical observation period of unweighted data from the DataMetrics data set.

**31.2 Counterparty analysis**

				31.12.14	31.12.13
	Banks	Governments	Corporates	Total	Total
	US\$ millions	US\$ millions	US\$ millions	US\$ millions	US\$ millions
OECD countries	114.7	65.2	0.3	180.2	297.6
GCC countries	1.1	0.1	48.2	49.4	30.2
Other countries	0.1	-	9.7	9.8	11.3
	<b>115.9</b>	<b>65.3</b>	<b>58.2</b>	<b>239.4</b>	<b>339.1</b>

Credit risk is concentrated on major OECD-based banks and governments.

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31. Derivative and foreign exchange instruments (continued)

31.3 Maturity analysis

	Year 1	Years 2 & 3	Years 4 & 5	Over 5 years	Total
	US\$ millions	US\$ millions	US\$ millions	US\$ millions	US\$ millions
<b>At 31<sup>st</sup> December 2014</b>					
Foreign exchange contracts	9,982.4	1,088.2	-	-	11,070.6
Interest rate contracts	8,713.2	2,237.9	1,008.2	283.9	12,243.2
Commodity contracts	32.4	-	-	-	32.4
	<b>18,728.0</b>	<b>3,326.1</b>	<b>1,008.2</b>	<b>283.9</b>	<b>23,346.2</b>
<b>At 31<sup>st</sup> December 2013</b>					
	11,364.4	4,268.4	1,995.7	307.5	17,936.0

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

31.4 Fair value analysis

	Positive fair value	31.12.14 Negative fair value	Positive fair value	31.12.13 Negative fair value
	US\$ millions	US\$ millions	US\$ millions	US\$ millions
Derivatives classified as FVTPL:-				
Forward foreign exchange contracts	98.5	(82.2)	139.7	(136.1)
Interest rate swaps and swaptions	31.5	(30.1)	35.2	(33.9)
	<b>130.0</b>	<b>(112.3)</b>	<b>174.9</b>	<b>(170.0)</b>
Derivatives held as fair value hedges:-				
Interest rate swaps	-	(18.7)	-	(22.4)
<b>Amount included in other assets / (other liabilities)</b>	<b>130.0</b>	<b>(131.0)</b>	<b>174.9</b>	<b>(192.4)</b>

31.5 Significant net open positions

There were no significant derivative trading or foreign currency net open positions at either 31<sup>st</sup> December 2014 or at 31<sup>st</sup> December 2013.

31.6 Hedge effectiveness

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

	2014	2013
	US\$ millions	US\$ millions
Net (losses) / gains on derivatives fair value hedging instruments	(2.3)	28.4
Net gains / (losses) on hedged items attributable to the hedged risk	2.3	(28.4)

There were no ineffective portions of derivative fair value or cash flow hedging transactions recognised in the consolidated statement of income in either the year ended 31<sup>st</sup> December 2014 or 31<sup>st</sup> December 2013.

Certain derivative cash flow hedging transactions were unwound during the year ended 31<sup>st</sup> December 2009. The resultant realised profits are being recognised in the consolidated statement of income over the respective tenors of the original transactions for periods to 2014.

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**32. 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 CBB's Basel 2 guidelines.

	<u>31.12.14</u>		<u>31.12.13</u>	
	<u>Notional principal amount</u>	<u>Risk- weighted exposure</u>	<u>Notional principal amount</u>	<u>Risk- weighted exposure</u>
	<u>US\$ millions</u>	<u>US\$ millions</u>	<u>US\$ millions</u>	<u>US\$ millions</u>
Direct credit substitutes	528.3	470.5	522.4	478.6
Transaction-related contingent items	2,058.2	798.3	2,482.1	917.0
Short-term self-liquidating trade-related contingent items	498.4	75.0	707.0	106.1
Commitments, including undrawn loan commitments and underwriting commitments under note issuance and revolving facilities	891.1	373.3	1,428.6	452.1
	<b>3,976.0</b>	<b>1,717.1</b>	<b>5,140.1</b>	<b>1,953.8</b>

Commitments may be drawdown on demand.

Direct credit substitutes at 31<sup>st</sup> December 2014 included financial guarantees amounting to US\$467.2 million (2013: US\$432.3 million). Financial guarantees may be called on demand.

The notional principal amounts reported above are stated gross before applying credit risk mitigants, such as cash collateral, guarantees and counter-indemnities. At 31<sup>st</sup> December 2014, the Group held cash collateral, guarantees, counter-indemnities or other high quality collateral in relation to credit-related contingent items amounting to US\$526.9 million (2013: US\$985.8 million).

**33. Contingent liabilities**

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.

**34. Capital adequacy**

The CBB's Basel 2 guidelines became effective on 1<sup>st</sup> January 2008 as the common framework for the implementation of the Basel Committee on Banking Supervision's (Basel Committee) Basel 2 capital adequacy framework for banks incorporated in the Kingdom of Bahrain.

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For the year ended 31<sup>st</sup> December 2014

**34. Capital adequacy** (continued)

The risk asset ratio calculated in accordance with the CBB's Basel 2 guidelines was as follows:

	<u>31.12.14</u>		<u>31.12.13</u>
	US\$ millions		US\$ millions
<b>Regulatory capital base</b>			
Tier 1 capital:			
Total equity	2,350.7		2,264.0
Tier 1 adjustments	(39.7)		(78.2)
Tier 1 capital	<u>2,311.0</u>		<u>2,185.8</u>
Tier 2 capital:			
Subordinated term financing	30.0		125.6
Non-specific provisions (subject to 1.25% credit risk-weighted exposure limit)	151.2		152.5
Tier 2 adjustments	17.9		(23.0)
Tier 2 capital	<u>199.1</u>		<u>255.1</u>
<b>Total regulatory capital base</b>	<u>2,510.1</u>		<u>2,440.9</u>
	<b>Notional</b>	<b>Risk-</b>	<b>Notional</b>
	<b>principal</b>	<b>weighted</b>	<b>principal</b>
	<b>amount</b>	<b>exposure</b>	<b>amount</b>
	<u>US\$ millions</u>	<u>US\$ millions</u>	<u>US\$ millions</u>
<b>Risk-weighted exposure</b>			
<i>Credit risk</i>			
Balance sheet items:			
Cash and other liquid assets	2,472.6	125.9	1,659.4
Securities purchased under agreements to resell	1,305.2	10.1	1,742.7
Placements	5,180.5	968.3	5,264.6
Investment securities	3,944.5	1,329.1	3,725.8
Loans and advances	7,931.5	7,587.3	8,317.2
Other assets, excluding derivative-related items	263.2	232.7	221.4
		<u>10,253.4</u>	<u>10,109.6</u>
Off-balance sheet items:			
Credit-related contingent items	3,976.0	1,717.1	5,140.1
Foreign exchange-related items	11,070.6	103.6	8,607.1
Derivative-related items	12,243.2	33.5	9,328.9
Commodity contracts	32.4	-	-
Forward placements	60.3	12.1	51.9
Repo counterparty risk	-	37.3	-
		<u>1,903.6</u>	<u>2,093.4</u>
<b>Credit risk-weighted exposure</b>		<b>12,157.0</b>	<b>12,203.0</b>
<i>Market risk</i>			
General market risk		43.9	151.0
Specific market risk		39.8	47.2
<b>Market risk-weighted exposure</b>		<u>83.7</u>	<u>198.2</u>
<i>Operational risk</i>			
<b>Operational risk-weighted exposure</b>		<b>541.4</b>	<b>520.4</b>
<b>Total risk-weighted exposure</b>		<u>12,782.1</u>	<u>12,921.6</u>
<b>Tier 1 risk asset ratio</b>		<b>18.1%</b>	<b>16.9%</b>
<b>Total risk asset ratio</b>		<u>19.6%</u>	<u>18.9%</u>

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### For the year ended 31<sup>st</sup> December 2014

#### 34. Capital adequacy (continued)

For regulatory Basel 2 purposes, the Group has initially adopted the standardised approach for credit risk. In time and subject to approval by the CBB, the Group plans to adopt the foundation internal ratings-based (FIRB) approach for credit risk as it is more closely aligned to the Group's internal risk and capital management methodologies. For market risk, the Group uses the internal models approach. GIB applies the standardised approach for determining the capital requirement for operational risk.

In accordance with the capital adequacy guidelines of the CBB, revaluation gains and losses arising on the remeasurement to fair value of derivative cash flow hedging transactions and unrealised gains on equity investment securities are excluded from tier 1 capital. In accordance with the CBB's guidelines, gains arising on the remeasurement to fair value of equity investment securities are included in tier 2 capital, although limited to 45 per cent of the unrealised revaluation gain.

The Group's subordinated term financing facilities have been approved for inclusion in tier 2 capital by the CBB. During the last five years before maturity, a cumulative amortisation (discount) factor of 20 per cent per year is to be applied to the facilities. As at 31<sup>st</sup> December 2014, the amortisation amount excluded from tier 2 capital amounted to US\$447.8 million (2013: US\$352.2 million).

The Group calculates the regulatory capital requirement for general market risk using a Value-at-Risk model. 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 3.0 (2013: 3.0) by the CBB, representing the regulatory minimum. During 2012, the CBB implemented revisions to the market risk framework, which have become known as Basel 2.5. Consequently, the inclusion of metrics such as a 'stressed VaR' measure has been included in the calculation of the regulatory capital requirement.

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 international minimum capital ratio, to give market risk-weighted exposure on a basis consistent with credit risk-weighted exposure.

The regulatory capital requirement for operational risk is calculated by the Group in accordance with the standardised approach. The regulatory capital requirement is calculated based on a range of beta coefficients, ranging from 12 to 18 per cent, applied to the average gross income for the preceding three financial years for each of eight predefined business lines.

#### 35. Fiduciary activities

The Group conducts investment management and other fiduciary activities on behalf of clients. Assets held in trust or in a fiduciary capacity are not assets of the Group and accordingly have not been included in the consolidated financial statements. The aggregate amount of the funds concerned at 31<sup>st</sup> December 2014 was US\$12,964.5 million (2013: US\$11,152.5 million).

The Group acts as fund manager to an investment fund called the Emerging Market Opportunities Fund. In its capacity as fund manager, the Group is entitled to performance and management fees. The Group maintains an investment with the fund.

The investors are able to vote by simple majority to remove the Group as the fund manager, without cause, and the Group's aggregate economic interest is less than 20 per cent. As a result, the Group has concluded that it acts as agent for the investors in this case, and therefore has not consolidated the fund.

The maximum exposure to loss is equal to the carrying amount of the trading securities, which at 31<sup>st</sup> December 2014 amounted to US\$59.0 million (2013: US\$49.1 million).

#### 36. Related party transactions

The Group is owned by the six Gulf Cooperative Council (GCC) governments, with the Public Investment Fund holding a majority (97.2 per cent) controlling stake. The Public Investment Fund is an investment body of the Saudi Arabian Ministry of Finance. There were no individual or collectively significant transactions with the Public Investment Fund during the years ended 31<sup>st</sup> December 2014 or 31<sup>st</sup> December 2013, other than the senior term loan referred to in note 16.

The Group transacts with various entities controlled, jointly controlled or significantly influenced by the six GCC governments, these transactions are conducted in the ordinary course of the Group's business on terms comparable to those with other entities that are not government-related.

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

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**36. Related party transactions** (continued)

The compensation of key management personnel was as follows:-

	<u>2014</u>	<u>2013</u>
	US\$ millions	US\$ millions
Short-term employee benefits	8.1	8.5
Post-employment benefits	0.4	0.5
	<u>8.5</u>	<u>9.0</u>

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

Post-employment benefits principally comprise compensation paid to personnel on retirement or resignation from the services of the Group.

**37. Fair value of financial instruments**

The Group's financial instruments are accounted for under the historical cost method with the exception of trading securities, equity investment securities and derivative financial instruments, which are accounted for at fair value. The fair value represents the price that would be received to sell an asset, or paid to transfer a liability, in an orderly transaction between market participants at the measurement date. 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 (level 1 measurement) or to the pricing prevailing for similar financial instruments (level 2 measurement) and the use of unobservable inputs in estimation techniques such as discounted cash flow analysis (level 3 measurement).

The valuation methodologies applied are outlined below.

**37.1 Trading securities**

The fair values of trading securities are based on quoted prices (level 1) or valuation techniques (level 2).

**37.2 Investment securities**

The fair values of equity investment securities are based on quoted prices (level 1) or valuation techniques (level 2 or 3). The fair values of debt investment securities are based on quoted market prices (level 1) and approximate the carrying values.

**37.3 Loans and advances**

The fair values (level 2) of loans on a floating interest rate basis are principally estimated at book value. The fair values (level 3) 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. The fair values (level 2) approximate the carrying values.

**37.4 Term financing**

The fair value of term financing is based on observable market data, including quoted market prices for debt instruments issued by similarly rated financial institutions and with similar maturities, or estimated on a discounted cash flow basis utilising currently prevailing spreads for borrowings with similar maturities. The fair values (level 2) of senior term financing and subordinated term financing at 31<sup>st</sup> December 2014 approximate their respective book values.

**37.5 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.

**37.6 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.

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**37. Fair value of financial instruments** (continued)

**37.7 Valuation basis**

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

	Quoted prices (level 1) <u>US\$ millions</u>	Valuation based on observable market data (level 2) <u>US\$ millions</u>	Other valuation techniques (level 3) <u>US\$ millions</u>
<b>At 31<sup>st</sup> December 2014</b>			
Financial assets:			
Trading securities	71.1	1.6	-
Investment securities - equities	183.5	-	124.1
Derivative financial instruments	-	130.0	-
Financial liabilities:			
Derivative financial instruments	-	131.0	-
<b>At 31<sup>st</sup> December 2013</b>			
Financial assets:			
Trading securities	49.1	1.8	-
Investment securities - equities	175.8	-	132.6
Derivative financial instruments	-	174.9	-
Financial liabilities:			
Derivative financial instruments	-	192.4	-

Quoted prices include prices obtained from lead managers, brokers and dealers. Investment securities valued based on other valuation techniques comprise private equity investments that have been valued based on price / earnings and price / book ratios for similar entities, discounted cash flow techniques or other valuation methodologies.

During the year ended 31<sup>st</sup> December 2014, the value of investment securities whose measurement was determined by other valuation techniques (level 3 measurement) decreased by US\$8.5 million (2013: increase of US\$3.3 million). The decrease principally comprised changes in assigned valuations as recognised in other comprehensive income. No transfers out of, or into, the level 3 measurement classification occurred during the years ended 31<sup>st</sup> December 2014 and 31<sup>st</sup> December 2013. Similarly, no transfers between level 1 and level 2 measurement classifications were made during the years ended 31<sup>st</sup> December 2014 and 31<sup>st</sup> December 2013.

Sensitivity of the movement in the fair value of financial instruments in the level 3 category is assessed as not significant to other comprehensive income or total equity.

**38. Earnings per share**

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

	<u>2014</u>	<u>2013</u>
Net income (US\$ millions)	85.6	121.5
Weighted average number of shares in issue (millions)	2,500	2,500
<b>Basic earnings per share (US\$)</b>	<u>0.03</u>	<u>0.05</u>

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

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**39. Principal subsidiaries**

The principal subsidiary companies were as follows:-

	<u>Principal activities</u>	<u>Country of incorporation</u>
Gulf International Bank (UK) Limited	Asset management	United Kingdom
GIB Capital L.L.C.	Investment banking	Kingdom of Saudi Arabia

The Group's ownership interest in the principal subsidiary companies was 100 per cent for the years ended 31<sup>st</sup> December 2014 and 31<sup>st</sup> December 2013.

**40. Average consolidated statement of financial position**

The average consolidated statement of financial position was as follows:-

	<u>31.12.14</u>	<u>31.12.13</u>
	US\$ millions	US\$ millions
<b>ASSETS</b>		
Cash and other liquid assets	2,210.4	1,476.4
Securities purchased under agreements to resell	2,645.6	1,514.5
Placements	5,395.6	5,519.1
Trading securities	60.3	89.6
Investment securities	3,722.9	3,727.1
Loans and advances	8,205.4	7,882.0
Other assets	414.7	309.5
<b>Total assets</b>	<b>22,654.9</b>	<b>20,518.2</b>
<b>LIABILITIES</b>		
Deposits from banks	1,420.5	1,892.4
Deposits from customers	14,398.4	12,532.8
Securities sold under agreements to repurchase	729.8	691.2
Other liabilities	344.0	324.3
Senior term financing	2,960.1	2,381.1
Subordinated term financing	477.8	477.8
<b>Total liabilities</b>	<b>20,330.6</b>	<b>18,299.6</b>
<b>Total equity</b>	<b>2,324.3</b>	<b>2,218.6</b>
<b>Total liabilities &amp; equity</b>	<b>22,654.9</b>	<b>20,518.2</b>