

GULF INTERNATIONAL BANK (UK) LTD
Basel II Pillar 3 Disclosures

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1. OVERVIEW

1.1 Basel II and Pillar 3 Background

The Basel II Framework (“the framework”), as adopted by the European Union via the implementation of the Capital Requirements Directive, came into effect on 1st January 2008. This was implemented in the UK by the FSA – Gulf International Bank (UK) Ltd. (“GIBUK”) has been operating under this framework since its implementation.

The Basel II Framework is based on three pillars, consistent with the Basel II framework developed by the Basel Committee, as follows:-

- Pillar 1: the calculation of risk weighted asset amounts (RWAs) and capital requirement.
- Pillar 2: the supervisory review process, including the Internal Capital Adequacy Assessment Process (ICAAP).
- Pillar 3: the disclosure of risk management and capital adequacy information.

i) Pillar 1

Pillar 1 prescribes the basis for the calculation of the regulatory capital adequacy ratio. It sets out the definition and calculations of the RWAs, and the derivation of the regulatory capital base. The capital adequacy ratio is calculated by dividing the regulatory capital base by the total RWAs. The resultant ratio is to be maintained above a predetermined and communicated level.

With the introduction of Pillar 2, the FSA implemented a minimum ratio threshold to be determined for each institution individually, as described in more detail in the Pillar 2 section of this report. In the event that the capital adequacy ratio falls below this ratio, additional prudential reporting requirements and/or sanctions can apply, and a formal action plan setting out the measures to be taken to restore the ratio above the target level must be formulated. No separate minimum tier 1 ratio is required to be maintained under the framework. However, the maintenance of a strong tier 1 ratio is nevertheless a focus of GIBUK’s internal capital adequacy assessment process, as it represents the core capital of the bank.

Under the framework, the RWAs are calculated using more sophisticated and risk sensitive methods than under the previous Basel 1 regulations. Credit risk and market risk are two essential risk types that were included under Basel I, while operational risk has been introduced as a new risk type in the framework. The table below summarises the approaches available for calculating RWAs for each risk type in accordance with the framework:-

Approaches for determining regulatory capital requirements		
Credit Risk	Market Risk	Operational Risk
Standardised Approach	Standardised Approach	Basic Indicator Approach
Internal Ratings Based Approach: Foundation (FIRB)	Internal Models Approach	Standardised Approach
Internal Ratings Based Approach: Advanced (AIRB)		Advanced Measurement Approach

The approach applied by GIBUK for each risk type is as follows:-

a) Credit Risk

For regulatory reporting purposes, GIBUK is using the standardised approach for credit risk. The standardised approach is similar to the basis under the previous Basel 1 capital adequacy regulations, except for the use of external ratings to derive RWAs and the ability to use a wider range of financial collateral.

The RWAs are determined by multiplying the credit exposure by a risk weight factor dependent on the type of counterparty and the counterparty’s external rating, where available.

Internally, GIBUK also calculates the capital requirement under the more risk-sensitive and complex FIRB approach, although the resultant ratio is not being used for regulatory compliance purposes at present.

b) Market Risk

For the regulatory market risk capital requirement, GIBUK is using the standardised approach.

This approach involves calculating Equity, Interest rate and Foreign Exchange risks according to the rules set out in BIPRU section 7.

c) Operational Risk

For regulatory reporting purposes, GIBUK is currently using the standardised approach for calculating operational risk.

Under the standardised approach, the regulatory capital requirement is calculated based on a range of beta coefficients, ranging between 12 and 18 per cent, applied to the average gross income for the preceding three financial years for each of three predefined business lines.

ii) Pillar 2

Pillar 2 defines the process of supervisory review of an institution's risk management framework and, ultimately, its capital adequacy.

The new FSA capital adequacy framework no longer applies a flat minimum capital adequacy ratio requirement of 8 per cent as required under the previous Basel 1 framework. Under the FSA's Pillar 2 guidelines, each bank is individually assessed by the FSA and an individual minimum capital adequacy ratio is determined for each bank. The FSA has undertaken the assessment exercises, which allow their setting of minimum capital ratios in excess of 8 per cent, based on the FSA's assessment of the financial strength and risk management practices of the institution.

Pillar 2 comprises two processes:

- an Internal Capital Adequacy Assessment Process (ICAAP), and
- a supervisory review and evaluation process.

The ICAAP incorporates a review and evaluation of risk management and capital relative to the risks to which the bank is exposed. GIBUK has developed its ICAAP around its economic capital framework which is designed to ensure that the Group has sufficient capital resources available to meet regulatory and internal capital requirements, even during periods of economic or financial stress. The ICAAP addresses all components of GIBUK's risk management, from the daily management of more material risks to the strategic capital management of the Group.

The supervisory review and evaluation process represents the FSA's review of the Group's capital management and an assessment of internal controls and corporate governance. The supervisory review and evaluation process is designed to ensure that institutions identify their material risks and allocate adequate capital, and employ sufficient management processes to support such risks.

The supervisory review and evaluation process also encourages institutions to develop and apply enhanced risk management techniques for the measurement and monitoring of risks in addition to the credit, market and operational risks addressed in the core Pillar 1 framework. Other risk types which are not covered by the minimum capital requirements in Pillar 1 include liquidity risk, interest rate risk in the banking book, business risk and concentration risk. These are covered either by capital, or risk management and mitigation processes under Pillar 2.

iii) Pillar 3

In the framework, the third pillar prescribes how, when, and at what level information should be disclosed about an institution's risk management and capital adequacy practices.

The disclosures comprise detailed qualitative and quantitative information. The purpose of the Pillar 3 disclosure requirements is to complement the first two pillars and the associated supervisory review process. The disclosures are designed to enable stakeholders and market participants to assess an institution's risk appetite and risk exposures and to encourage all banks, via market pressures, to move toward more advanced forms of risk management.

Under the current regulations, full disclosure is required to coincide with the financial year-end reporting.

In this report, GIBUK disclosures have been prepared in accordance with the FSA handbook BIPRU Chapter 11. All figures within this document are as at 31/12/2008 unless stated otherwise. These disclosures are in addition to those set out in the consolidated financial statements presented in accordance with the International Financial Reporting Standards (IFRS).

1.2 Media and Location

This report will be published on the following publicly accessible website - www.pillar3.eu

2. GROUP STRUCTURE AND OVERALL RISK AND CAPITAL MANAGEMENT

2.1 Corporate Structure and Activity

GIBUK is a wholly owned subsidiary of Gulf International Bank BSC, which in turn is owned by the six member states of the Gulf Cooperation Council (consisting of Bahrain, Kuwait, Oman, Qatar, Saudi Arabia and the United Arab Emirates) and the Saudi Arabian Monetary Agency.

In the broadest sense, the role of the Bank is to generate revenues from client related services. The Bank’s business may be segmented further into 2 interrelated types of activities which are summarised below:

Client Asset Management

Client assets are managed through segregated discretionary portfolios, structured products and managed funds in both equities and fixed income. This generates fee income for the Bank.

Client Treasury Banking Services

This comprises client deposit placement and foreign exchange order execution, generating money market income and client related foreign exchange revenues. In addition to executing business as principal the Bank also generates fees through its Fiduciary Deposit services, acting as agent between customers and other banks. The Bank’s Treasury function ensures that the firm maintains a robust liquidity profile at all times.

GIBUK is regulated by the FSA, and has calculated its risk weighted assets in accordance with the FSA’s guidelines.

The principal subsidiaries and basis of consolidation for capital adequacy purposes are as follows:-

Subsidiary	Domicile	Ownership	Consolidation basis
GIB (UK) Nominees Limited	United Kingdom	100%	Full Consolidation
GIB(UK) Capital Investments Limited	United Kingdom	100%	Full Consolidation
Falcon Private Equity LP	USA	100%	Full Consolidation

There are no investments in subsidiaries that are treated as a deduction from the Group’s regulatory capital.

2.2 Risk Types

Credit Risk mainly arises from GIBUK's interbank placements. Credit risk within the proprietary trading positions has reduced considerably during 2008 due to the Bank's strategy of closing proprietary portfolios to all non GIBUK managed funds. The credit risk within the Bank's banking book has decreased due to a decrease in interbank exposure as a result of lower client deposits.

Interbank placements make up 98% of total assets and are mainly short-term placements with highly rated Western European, US or Japanese banks. The Bank retains a small exposure to the larger banks in the Middle East.

Geographically, the Bank's total credit exposure at year end is mainly to Europe, 79%; North America, 6%; and the GCC, 12%; the latter arising mainly from interbank placements. A total of \$220mn, 6% of credit exposure, relates to tri-party reverse repo transactions with the parent bank.

Market Risk exposure in GIBUK's trading, investment and derivatives portfolios is controlled through a framework of limits, encompassing both VaR and non-VaR parameters. GIBUK uses the Monte Carlo VaR calculation rather than a variance-covariance system. VaR is measured daily, using a 95% confidence level, a one-year observation period, and a one-month holding period. The one-month holding period is a more conservative assumption than most banks would normally apply, but reflects the relative illiquidity of some of the markets in which GIBUK was active up to March 2008. Back-testing supports the validity of the VaR model used.

Total diversified VaR at year-end 2008 was \$0.3mn, which is 0.2% of equity. The minimum, maximum and average VaR in 2008 was \$0.3mn, \$6.4mn and \$1.5mn respectively. The VaR mainly arises from interest rate risk from Money Markets and in strategic equity investments.

The bank has invested in the equity tranches of its own CDO structures. Typically, those tranches make up 10% of the total CDO pool, of which GIBUK takes on less than 20%. At year end 2008, the bank's equity investment in those tranches stood at zero carrying value following impairment losses during the year.

Liquidity Risk 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 the 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. Stress tests are also performed on a monthly basis.

Operational Risk is defined as the risk of loss resulting from inadequate or failed internal processes, people and systems, or from external events. GIBUK endeavours to minimise operational risk by ensuring that a strong control infrastructure is in place throughout the organisation.

GIBUK's Operational Risk Management Framework (ORMF) is in line with Basel II requirements. As part of the ORMF, a comprehensive risk assessment exercise was conducted which identified the operational risks inherent in GIBUK's activities, processes and systems. The controls in place to mitigate these risks were also reviewed. The review and challenge of the risk and control assessments is under way to ensure robustness and relevance. In addition, a database of measurable operational losses is maintained, together with a record of key risk indicators, which can provide an early warning of possible operational risks.

To embed GIBUK's operational risk objectives, each part of the business is required to continually identify, assess and manage its exposure to operational risk using a variety of approaches including:

Risk and Control Assessment

Risk and Control Assessment is a forward-looking process for identifying and assessing risks, evaluating controls, establishing thresholds for risks and controls and determining the appropriate level of risk mitigation.

Risk Event Reporting

Each part of the business is required to systematically track operational risk loss data in accordance with detailed procedures developed by the central operational risk function. These procedures are approved by the Operational Risk Management Committee.

Monitoring Key Risk Indicators

A Key Risk Indicator (KRI) is a parameter used to manage a risk event based on its severity and likelihood. Each business unit is required to monitor KRIs for operational risk in accordance with guidelines developed by the operational risk function.

External Operational Risk Data

GIBUK explores the availability, value and potential application of external operational risk loss data in relation to the business' overall approach to the management of operational risk.

GIBUK adopted the Standardised Approach to the derivation of minimum regulatory capital requirements for operational risk upon implementation of the new Basel Capital Requirements Directive in 2007 – this is explained in more detail in section 4.3 of this report.

2.3 Risk Appetite

Risk Appetite within the bank is determined by the GIBUK Board of Directors within the context of group risk parameters defined by the Board of GIB BSC in Bahrain. Senior management in London applies a framework of limits and authorities covering the investing and credit activities of the bank. Monitoring of risk on a day-to-day basis is the responsibility of the Risk Management Function.

2.4 Risk Manual

The Risk Manual documents the amount of market risk and credit risk to which GIBUK can be exposed, sets the authorities for entering into this risk and details how these exposures should be monitored and reported.

Included in the Risk Manual are:

- Delegated authorities for credit signing;
- Risk limit structures for credit, market and settlement risk and responsibility for measurement, monitoring and reporting of excesses of these limits;
- Documentation guidelines for new product approval, credit analysis and authorisation and legal and other documentation;
- Policy for analysis of credit risk, including credit rating guidelines, problem credit exposures, and methodology for the calculation of GIBUK's credit exposure.

2.5 Risk Management Function

The group has a comprehensive risk management framework in place for managing and controlling risks which is constantly evolving as the business activities change in response to credit, market, product, operational and other developments. This includes limits covering nominal transaction sizes, individual counterparty, country and concentration limits, liquidity and maturity profiles and Value at Risk (VaR), as well as policies and procedures to minimise the impact of operational risk.

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 VaR methodologies and portfolio stress testing and risk diversification.

2.6 Control

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, the internal Compliance function and regulatory authorities subject the risk management processes to additional scrutiny which help to further strengthen the risk management environment. Risk management processes have also been assessed by technical teams from the FSA who have granted model recognition for limited classes of derivative.

From a control perspective, the process of risk management is facilitated through a set of independent functions, which report directly to the Chief Financial Officer. These functions include operational risk, credit risk, market risk and financial control. This multi faceted approach aids the effective management of risk by identifying, measuring and monitoring risks from a variety of perspectives.

2.7 Committees and Reporting

The following committees are in place:

- Risk Review Committee

The Risk Review Committee (RRC) oversees the measurement, reporting and monitoring of the financial position of the firm arising from its own account activities. Its scope is to review exposures relative to regulatory and internal limits, discuss significant changes to the financial profile and to consider specific credit exposures, arising predominantly from interbank counterparties and available for sale assets. Hence, the committee carries out the functions of a Risk Management Committee, a Credit Committee and an ALCO.

Key senior and risk managers are given reports from each of the functions outlined in section 2.6 daily. On a weekly basis, these reports and any issues arising are discussed by the RRC where brief summaries of developments and market events are given by seniors from each risk management section and the trading desk.

- Operational Risk Committee

The Operational Risk Committee (ORC) oversees the development, implementation and maintenance of GIBUK's Operational Risk management framework across the business. It is responsible for the implementation of GIBUK's Business Continuity Management and Information Security procedures. It recommends Operational Risk appetite, strategies, the high-level policy and overall management framework to the Management Committee via the Chief Financial Officer and General Counsel. ORC meetings are held on a monthly basis.

- Management Committee

In accordance with the Articles of Association, the Board has delegated the authority of all day-to-day management and control to the Managing Director & CEO of GIBUK. The Management Committee is formed by the authority of the Managing Director as a general management committee. The objective of establishing the Committee is to maintain a reporting and control structure whereby all of the line operations of the Bank are accountable to individual members of the Management Committee who report to the Managing Director, who in turn reports to the Chairman of GIBUK.

Both the Risk Review and Operational Risk committees report via the Chief Financial Officer into the Management Committee of GIBUK.

2.8 Limits and Monitoring

i) Market Risk

GIBUK's market risk appetite is defined through a series of VaR limits covering all aspects of the bank's business and related risks. Limits are set for each risk category (interest rate risk including credit spread risk, equity risk, currency risk, commodity risk and implied volatility risk) and business area. Limits are also applied to the overall trading activity as well as for the bank's total activities i.e. including the banking activity.

ii) Credit Risk

GIBUK also operates portfolio and country limits for credit risk over long and short as well as net positions. Individual positions are subject to credit analysis both in the Trading Book and the Banking Book and there are clear controls to track the effectiveness of limits.

iii) Regulatory Risk

Simultaneously, levels of capital usage, concentration and liquidity are monitored and reported daily against limits.

Monthly summaries are prepared and circulated to the Management Committee as well as the attendants at the meetings in 2.7 above. Monthly reports also include the results of stress tests. In the past these have been based on six historical events using actual price movements observed at the time.

3. CAPITAL RESOURCES

3.1 Capital base

The regulatory capital base is set out in the table below:-

US\$ millions	Tier 1	Tier 2	Total
Share capital	250.0	-	250.0
Retained losses brought forward	(48.5)	-	(48.5)
Tier 1 and tier 2 capital before deductions	201.5	-	201.5
Deductions	-	-	-
Tier 1 and tier 2 capital base	201.5	-	201.5

Tier 1 capital is defined as capital of the same or close to the character of paid up capital and comprises share capital, share premium, retained earnings and eligible reserves. Retained losses, including the losses for the current year, are included in tier 1 immediately – profits for the current year are only eligible for inclusion following the external audit. Eligible reserves excludes revaluation gains and losses arising on the remeasurement to fair value of available-for-sale securities and derivative cash flow hedging transactions with the exception of unrealised gains and losses arising on the remeasurement to fair value of equity securities classified as available-for-sale.

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

There are no impediments on the transfer of funds or regulatory capital within the Group.

4. REGULATORY CAPITAL REQUIREMENTS

4.1 Capital requirements for credit risk

For regulatory reporting purposes, GIBUK calculates the capital requirements for credit risk based on the standardised approach. Under the standardised approach on- and off-balance sheet credit exposures are assigned to exposure categories based on the type of counterparty or underlying exposure. GIBUK splits counterparties into standard portfolios as shown below. The primary standard portfolios are claims on banks and corporates. Following the assignment of exposures to the relevant standard portfolios, the RWAs are derived based on prescribed risk weightings. Under the standardised approach, the risk weightings are provided by the FSA and are determined based on the counterparty's external credit rating. The external credit ratings are derived from eligible external rating agencies approved by the FSA. GIBUK uses ratings assigned by Standard & Poor's, Moody's and Fitch.

An overview of the exposures, RWAs and capital requirements for credit risk analysed by standard portfolio, as at 31st December 2008, is presented in the table below:-

US\$ millions	Rated exposure	Unrated exposure	Total exposure	Average risk weight	RWA	Credit Risk capital requirement
Banks	3,249.5	-	3,249.5	22.6%	733.1	58.6
Corporates	5.9	-	5.9	100%	5.9	0.5
Other assets	-	26.1	26.1	N/A	-	-
Total	3,255.4	26.1	3,281.5	22.5%	739.0	59.1

Exposures are stated after taking account of credit risk mitigants where applicable. The treatment of credit risk mitigation is explained in more detail in section 5.2(vii) of this report.

The definitions of each standard portfolio and the related RWA requirements are set out in section 5 of this report.

4.2 Capital requirements for market risk

GIBUK uses the standardised method to calculate the regulatory capital requirements relating to general market risk.

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 theoretical 8 per cent minimum capital ratio, to give market risk-weighted exposure on a basis consistent with credit risk-weighted exposure.

The RWAs and capital requirements for market risk are presented in the table below:-

US\$ millions	Notional RWA	Capital requirement
Equity risk	48.7	3.9
Interest rate risk	8.0	0.6
Foreign exchange risk	0.6	0.1
Total general market risk	57.3	4.6
Total specific market risk	24.4	1.9
Total	81.7	6.5

4.3 Capital requirements for operational risk

For regulatory reporting purposes, the capital requirement for operational risk is calculated according to the standardised approach. Under this approach, the Group's average gross income over the preceding three financial years is divided up into prescribed business units, and then multiplied by various fixed alpha coefficients. These alpha coefficients range from 12 to 18 per cent in the framework.

The capital requirement for operational risk at 31st December 2008 amounted to US\$7.7million.

4.4 Pillar 2 / ICAAP considerations

GIBUK's regulatory capital base exceeded the FSA's minimum requirements throughout the year ended 31st December 2008. Based on the results of capital adequacy stress testing and capital forecasting, GIBUK considers that the buffers held for regulatory capital adequacy purposes are sufficient, given its current risk profile and capital position. The Group's regulatory capital adequacy ratios set out in section 4.5 of this report significantly exceeded the minimum capital targets and are high by international comparison.

As a number of Pillar 2 risk types exist within GIBUK's economic capital framework (i.e. interest rate risk in the banking book, concentration risk and business risk), GIBUK uses its existing internal capital measurements as the basis for determining additional capital buffers. GIBUK considers the results of its capital adequacy stress testing, along with economic capital

and RWA forecasts, to determine its internal capital requirement and to ensure that the Group is adequately capitalised in stress scenarios reflecting GIBUK’s risk appetite.

4.5 Capital adequacy ratios

The Group’s policy is to maintain a strong capital base so as to preserve investor, creditor and market confidence and to sustain the future development of the business. The impact of the level of capital on shareholder’s return is also recognized 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. GIBUK manages its capital structure and makes adjustments to the structure taking account of changes in economic conditions and strategic business plans. The capital structure may be adjusted through the dividend payout, and the issue of new shares, subordinated term finance, and innovative tier 1 capital securities.

The capital adequacy ratios of GIBUK at 31st December 2008 were as follows:-

	GIBUK
Total RWAs (US\$ millions)	739.0
Capital base (US\$ millions)	201.5
Tier 1 capital (US\$ millions)	201.5
Tier 1 ratio (per cent)	27.3%
Total ratio (per cent)	27.3%

The balance of risks has been significantly reduced both in the elimination of all the proprietary trading positions but also in the pension scheme which is now fully funded and has switched to a primarily liability matching investment strategy.

GIBUK has a policy of maintaining a minimum buffer of 5% above its regulatory capital requirement. This was achieved consistently throughout the year ended 31st December 2008.

5. CREDIT RISK – PILLAR 3 DISCLOSURES

This section describes the Group's exposure to credit risk and provides detailed disclosures on credit risk in accordance with the framework in relation to Pillar 3 disclosure requirements.

5.1 Credit risk presentation under Basel II

The credit risk exposures presented in much of this report differ from the credit risk exposures reported in the consolidated financial statements. Differences arise due to the application of different methodologies, as illustrated below:-

- Under the framework, off-balance sheet exposures are converted into credit exposure equivalents by applying a credit conversion factor (CCF). The off-balance sheet exposure is multiplied by the relevant CCF applicable to the off-balance sheet exposure category. Subsequently, the exposure is treated in accordance with the standard portfolios referred to in section 4.1 of this report in the same manner as on-balance sheet exposures.
- Credit risk exposure reporting under Pillar 3 is frequently reported by standard portfolios based on the type of counterparty. The financial statement presentation is based on asset class rather than the relevant counterparty.
- Certain eligible collateral is applied to reduce exposure under the framework, whereas no such collateral netting is applicable in the consolidated financial statements.
- Based on the FSA's Basel II guidelines, certain exposures are either included in, or deducted from, regulatory capital rather than treated as an asset as in the consolidated financial statements, e.g. unrated securitisation tranches.
- Under the framework, external rating agency ratings are based on the highest rating from the lowest two ratings while for internal credit risk management purposes the Group uses the lowest rating.

5.2 Credit exposure

i) Gross credit exposure

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

US\$ millions	Gross credit exposure	Average gross credit exposure
Balance sheet items:		
Cash and other liquid assets	148.8	41.8
Due from brokers	-	23.9
Placements with banks	3,314.0	3,269.5
Investment securities	-	10.3
Loans and advances	-	0.7
Other assets, excluding derivative-related items	26.1	53.2
Total on-balance sheet credit exposure	3,488.9	3,399.4
Off-balance sheet items:		
Credit-related contingent items	4.1	5.0
Derivative and foreign exchange instruments	10.1	10.0
Total off-balance sheet credit exposure	14.2	15.0
Total credit exposure	3,503.1	3,414.4

The average gross credit exposure is based on weekly averages during the year ended 31st December 2008.

Other assets principally comprised accrued interest, fees and commissions.

The gross credit exposure for derivative and foreign exchange instruments is the replacement cost (current exposure) representing the cost of replacing the contracts at current market rates should the counterparty default prior to the settlement date. The gross credit exposure reported in the table above does not include potential future exposure. Further details on the counterparty credit risk relating to off-balance sheet exposures are set out in section 6.3(i) of this report.

ii) Credit exposure by geography

The classification of credit exposures by geography, based on the location of the counterparty, was as follows:-

US\$ millions	Placements and other liquid assets	Other Assets	Off balance sheet items	Total
Middle East	436.4	7.2	7.0	450.6
Europe	2,727.2	16.5	6.8	2,750.5
North America	207.1	2.4	-	209.5
Asia	92.1	-	0.4	92.5
Total exposure	3,462.8	26.1	14.2	3,503.1

iii) Credit exposure by industry

The classification of credit exposures by industry was as follows:-

US\$ millions	Placements and other liquid assets	Other assets	Off balance sheet items	Total
Financial services	3,462.8	5.1	8.3	3,476.2
Energy, oil and petrochemical	-	-	5.9	5.9
Government	-	4.6	-	4.6
Other	-	16.4	-	16.4
Total exposure	3,462.8	26.1	14.2	3,503.1

iv) Credit exposure by credit quality step (CQS)

The credit risk profile based on the FSA's defined credit quality steps was as follows:-

US\$ millions	Placements and other liquid assets	Other assets	Off balance sheet items	Total
Neither past due nor impaired				
CQS1	1,214.3	0.5	3.7	1,218.5
CQS2	2,248.5	11.7	10.5	2,270.7
Unrated	-	13.9	-	13.9
Total	3,462.8	26.1	14.2	3,503.1

The analysis is presented prior to the application of any credit risk mitigation techniques.

v) Credit exposure by maturity

The maturity profile of funded credit exposures based on contractual maturity dates was as follows:-

US\$ millions	Placements and other liquid assets	Other assets	Total
Within 3 months	3,341.8	26.0	3,367.8
4 months to 1 year	1.0	1.5	2.5
Over 1 year and less than 5 years	120.0	0.9	120.9
Over 20 years and other	-	11.9	11.9
Total exposure	3,462.8	40.3	3,503.1

An analysis of off balance sheet exposure is set out in section 6 of this report.

vi) Equities held in the banking book

At 31st December 2008, there were no equity investments held in the banking book.

vii) Credit risk mitigation

The credit exposure information presented in section 5.2 of this report represents gross exposures prior to the application of any credit risk mitigation techniques. Collateral items and guarantees which can be used for credit risk mitigation under the capital adequacy framework are referred to as eligible collateral. Only certain types of collateral and some issuers of guarantees are eligible for preferential risk weights for regulatory capital adequacy purposes. Furthermore, the collateral management process and the terms in the collateral agreements have to fulfil the FSA's prescribed minimum requirements (such as procedures for the monitoring of market values, insurance and legal certainty) set out in their capital adequacy regulations.

The reduction of the capital requirement attributable to credit risk mitigation is calculated as follows:-

- Adjusted exposure amount: GIBUK uses the comprehensive method for financial collateral such as cash, bonds and stocks. The exposure amount is adjusted with regard to the financial collateral. The size of the adjustment depends on the volatility of the collateral and the exposure. GIBUK uses volatility adjustments specified by the FSA, known as supervisory haircuts, to reduce the benefit of collateral and to increase the magnitude of the exposure.

Exposures secured by eligible financial collateral, guarantees and credit derivatives, presented by standard portfolio were as follows:-

US\$ millions	Exposure before credit risk mitigation	Of which secured by: Eligible collateral
Banks	221.6	221.6

Guarantees and credit derivatives

Only eligible providers of guarantees and credit derivatives may be recognised in the standardised approach for credit risk. Guarantees issued by corporate entities may only be taken into account if their rating corresponds to A- or better. The guaranteed exposures receive the risk weight of the guarantor.

Collateral and valuation principles

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 daily basis and requests are made for additional collateral in accordance with the terms of the underlying agreements. In general, lending is based on the customer’s repayment capacity and not the collateral value. However, collateral is considered the secondary alternative if the repayment capacity proves inadequate. Collateral is not usually held against securities or placements.

5.3 Impaired credit facilities and provisions for impairment

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. 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. For equity securities classified as available-for-sale, a significant or prolonged decline in fair value below cost is considered in determining whether a security is impaired.

Provisions for impairment are determined based on the difference between the net carrying amount and the recoverable amount of a financial asset. The recoverable amount is measured as the present value of expected future cash flows, including amounts recoverable from guarantees and collateral.

i) Impaired loan facilities and related provisions for impairment

There were no impaired loan facilities and related provisions for impairment as at 31st December 2008.

ii) Provisions for impairment – loans and advances

There were no movements in the provisions for the impairment of loans and advances for the year ended 31st December 2008.

iii) Impaired investment securities and related provisions for impairment

Impaired investment securities and related provisions for impairment were as follows:-

US\$ millions	Gross exposure	Impairment provisions	Net exposure
CDOs	9.7	9.7	-
Equity investments	9.0	9.0	-
Total	18.7	18.7	-

iv) Provisions for impairment – investment securities

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

US\$ millions	Specific provisions		Total provisions
	ABS and CDOs	Equities	
At 1 st January 2008	3.5	10.0	13.5
Exchange rate movements	(0.4)	-	(0.4)
Amounts utilised	-	(6.0)	(6.0)
Charge / (release) for the year	6.6	5.0	11.6
Total	9.7	9.0	18.7

5.4 Past due facilities

There were no past due facilities during the year ended 31st December 2008.

5.5 Restructured loan facilities

There were no restructured loan facilities during the year ended 31st December 2008.

5.6 Recoveries recorded directly to the income statement

2 recoveries were recorded directly to the income statement during the year ended 31st December 2008:-

- (i) A recovery of \$2.4mn from a claim on a security. The asset, held as an investment security, was sold in 2001.
- (ii) A recovery of \$0.04mn from a corporate loan.

6. OFF-BALANCE SHEET EXPOSURE AND SECURITISATIONS

Off-balance sheet exposures are divided into two exposure types in accordance with the calculation of credit risk RWAs in the framework:-

- Credit-related contingent items: Credit-related contingent items comprise guarantees, credit commitments and unutilised approved credit facilities.
- Derivative and foreign exchange instruments: Derivative and foreign exchange 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

In addition to counterparty credit risk measured within the Basel II credit risk framework, derivatives also incorporate exposure to market risk and carry a potential market risk capital requirement, as shown in section 4.2 of this report.

For the two off-balance exposure types, there are different possible values for the calculation base of the regulatory capital requirement, as commented on below:-

6.1 Credit-related contingent items

For credit-related contingent items, the nominal value is converted to an exposure at default (EAD) through the application of a credit conversion factor (CCF). The CCF factor is between 0 per cent and 100 per cent depending on the type of contingent item, and is intended to convert off-balance sheet notional amounts into an equivalent on-balance sheet exposure.

Credit commitments and unutilised approved credit facilities represent commitments that have not been drawdown or utilised at the reporting date. The nominal amount provides the calculation base to which a CCF is applied for calculating the EAD. The CCF ranges between 0 per cent and 100 per cent depending on the approach, product type and whether the unutilised amounts are unconditionally cancellable or irrevocable.

The table below summarises the notional principal amounts, RWAs and capital requirements for each credit-related contingent category:-

US\$ millions	Notional principal amount	RWA	Capital requirement
Direct credit substitutes	20.2	4.0	0.3
Transaction-related contingent items	1.0	0.1	-
Total	21.2	4.1	0.3

6.2 Derivative and foreign exchange instruments

The Group utilises derivative and foreign exchange instruments to meet the needs of its customers, and as part of its asset and liability management activity to hedge its own exposure to market risk. 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'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.

The aggregate notional and fair value amounts for derivative and foreign exchange instruments at 31st December 2008 are set out below:

US\$ millions	Notional principal amount	Fair value positive	Fair value negative
Exchange rate contracts	178.7	7.0	7.0
Total	178.7	7.0	7.0

6.3 Counterparty credit risk

Counterparty credit risk is the risk that a counterparty to a contract in the interest rate, foreign exchange, equity and credit markets defaults prior to the maturity of the contract. The counterparty credit risk for derivative and foreign exchange instruments is subject to credit limits on the same basis as other credit exposures. Counterparty credit risk arises in both the trading book and the banking book.

i) Counterparty credit risk calculation

For regulatory capital adequacy purposes, GIBUK uses the standardised approach to calculate the exposure for counterparty credit risk for derivative and foreign exchange instruments in accordance with the credit risk rules within the framework. Credit exposure comprises the sum of current exposure (replacement cost) and potential future exposure. The potential future exposure is an estimate, which reflects possible changes in the market value of the individual contract during the remaining life of the contract, and is measured as the notional principal amount multiplied by a risk weight. The size of the risk weight depends on the risk categorisation of the contract and the contract’s remaining life. Netting of potential future exposures on contracts within the same legally enforceable netting agreement is done as a function of the gross potential future exposure.

The EAD, RWAs and capital requirements for the counterparty credit risk of derivative and foreign exchange instruments analysed by standard portfolio, is presented in the table below:-

US\$ millions	Exposure at Default (EAD)			RWA	Capital requirement
	Current exposure	Future exposure	Total exposure		
Banks	7.0	1.8	8.8	3.8	0.3
Total	7.0	1.8	8.8	3.8	0.3

ii) Mitigation of counterparty risk exposure

GIBUK does not take advantage of risk mitigation techniques for derivative and foreign exchange-related exposures.

6.4 Securitisations

At 31st December 2008, GIBUK had no exposure, net of impairment provisions, to securitisation tranches.

Further information on management services:

GIBUK provides collateral management services to five collateralised debt obligations (CDOs) issued between 2002 and 2006. The CDOs are intended to extract relative value from a wide range of asset classes across a broad spectrum of credit ratings. The underlying collateral of the CDOs includes leveraged loans, residential and commercial real estate, consumer finance, lending to small and medium sized enterprises, and other receivables. In order to ensure granularity, each CDO holds between 80 and 140 individual investments providing diversification by size, asset class, industry, geography, credit rating and date of issue.

At 31st December 2008 the underlying investments in the CDOs for which GIBUK acted as collateral manager amounted to US\$1.8billion. At 31st December 2008, GIBUK did not hold any exposure to CDOs managed by the Group.

The Fitch rating agency reaffirmed the Group's CDO asset manager rating of CAM 2- in April 2009.

6.5 Other Risk Types

i) Interest rate risk in the banking book

Structural interest rate risk arises in GIBUK'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.

GIBUK does not maintain material foreign currency exposures or equity exposures in the banking book. Equities held in the banking book are commented on in more detail in section 5.2(vi) of this report.

In general, GIBUK's policy is to match financial assets and liabilities in the same currency or to mitigate currency risk through the use of currency swaps.

The repricing profile of GIBUK's financial assets and liabilities are set out in the table below:-

US\$ millions	Within 3 months	Months 4 to 6	Months 7 to 12	Non-interest		Total
				Over 1 year	bearing items	
Cash and other liquid assets	147.8	1.0	-	-	-	148.8
Placements with banks	3,194.0	-	-	120.0	-	3,314.0
Trading securities	32.4	-	-	-	-	32.4
Other assets	-	-	-	-	36.2	36.2
Total assets	3,374.2	1.0	-	120.0	36.2	3,531.4
Deposits	3,309.5	-	-	-	-	3,309.5
Other liabilities	-	-	-	-	27.5	27.5
Equity	-	-	-	194.4	-	194.4
Total liabilities & equity	3,309.5	-	-	194.4	27.5	3,531.4
Interest rate sensitivity gap	64.7	1.0	-	(74.4)	8.7	-
Cumulative interest rate sensitivity gap	64.7	65.7	65.7	(8.7)	-	-

The repricing profile is based on the remaining period to the next interest repricing date and the balance sheet categories in the consolidated financial statements.

The substantial majority of assets and liabilities reprice within three months.

Interest rate exposure beyond one year amounted to only US\$120mn or 3.4 per cent of total assets.

Based on the repricing profile at 31st December 2008, 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 (100 basis points) increase in interest rates across all maturities would result in no material impact on the Group's equity.