

**GULF INTERNATIONAL BANK (UK) LTD**

**Basel II Pillar 3 Disclosures**

**31 December 2015**

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## **1. INTRODUCTION**

Gulf International Bank (UK) Limited (“GIBUK”) is authorised and regulated by the Financial Services Authority (“PRA”). This document sets out the Pillar 3 disclosures required by BIPRU Chapter 11 of the PRA’s Handbook.

All financial information in this document is as at 31<sup>st</sup> December 2015 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).

The document will be published on the publically accessible website [www.pillar3.eu](http://www.pillar3.eu).

## 2. GROUP STRUCTURE AND OVERALL RISK AND CAPITAL MANAGEMENT

### 2.1 Corporate Structure

GIBUK is a 100% owned subsidiary of Gulf International Bank BSC (GIB) (registered in Bahrain), which is owned by the Public Investment Fund of Saudi Arabia (97.2%) and the governments of Kuwait (0.7%), UAE (0.4%), Qatar (0.7%), Bahrain (0.4%) and Oman (0.4%).

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.

The above consolidation is on the same basis as the accounting treatment.

### 2.2 Business Activities

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:

**i) 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.

**ii) 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.

## 2.3 Risk Types

### i) Credit Risk

Credit risk represents the potential loss to the Group when a counterparty fails to meet its obligations. The Group is exposed to credit risk from its Treasury lending activities in addition to other transactions involving both on and off balance sheet financial instruments and from the non-performance of counterparties and issuers. 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.

The Credit Risk Management Function is responsible for monitoring and controlling credit risk within the parameters determined by management. Formal credit limits are applied at the individual counterparty, country and portfolio levels. The limit setting and monitoring processes involve an analysis of financial and other information about the counterparty, including credit ratings, collateral, if any, to be provided in the transaction and the duration of the transaction. The Group mitigates its credit exposures on foreign exchange and derivative financial instruments through the use of master netting agreements and collateral arrangements.

Interbank placements make up 68% (2014: 68%) of total assets and are mainly short-term placements with highly rated Western European, US or Japanese banks. The Bank retains some exposure to the larger banks in the Middle East. The Bank placed \$3,521mn with Central Banks at 31 December 2015 (2014: \$1,355) and held no Government bills (2014:\$91mn).

Geographically, the Bank's total credit exposure at year end is to Europe, 80% (2014: 64%); North America, nil (2014: 6%); Asia, nil (2014: 7%), and the GCC 20% (2014: 23%); the latter arising mainly from interbank placements. A total of \$334mn, 4% of credit exposure, relates to tri-party reverse repo transactions with GIB BSC (2014: \$53mn, 1% of credit exposure) and a further \$1,835mn, 24% of credit exposure, relates to tri-party reverse repo transactions with other banking counterparties (2014:\$1,305mn, 24%). The net exposure after credit mitigation on all of the tri-party reverse repo transactions amounted to \$14mn of which \$0.1mn was with GIB BSC.

### ii) Market Risk

Market Risk exposure in GIBUK's trading and investment portfolios is controlled through a framework of limits, encompassing both VaR and non-VaR parameters. VaR is measured daily, using the Monte Carlo method; with a 95% confidence level, a one-year observation period, and a one-month holding period.

Total diversified VaR at year-end 2015 was \$0.4mn, which is 0.1% of equity (2014: \$0.7mn, 0.3% of equity). The minimum, maximum and average VaR in 2015 were \$0.3mn, \$1.1mn and \$0.5mn respectively (2014: \$0.3mn, \$0.7mn and \$0.4mn). The VaR mainly arises from interest rate risk from money markets and in strategic equity investments in funds managed by GIBUK.

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 2015, the Bank's equity investment in those tranches stood at nil carrying value following impairment losses during 2008.

### **iii) 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. Whilst 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. The internal audit function makes regular independent appraisals of the control environment in all identified risk areas. Tested contingency arrangements are also in place to support operations in the event of a range of possible disaster scenarios.

GIBUK's Operational Risk Management Framework (ORMF) is in line with Basel II requirements. As part of the ORMF, a comprehensive risk assessment process identifies the operational risks inherent in GIBUK's activities, processes and systems. The controls in place to mitigate these risks are also reviewed and assessed for their effectiveness. 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.

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 2008 – this is explained in more detail in section 4.3 of this report.

### **iv) Liquidity Risk**

Liquidity risk 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 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.

GIBUK controls its liquidity risk by keeping much of its asset base in short-term interbank placements and with balances at the bank of England. At 31 December 2015 this amounted to \$7.2bn (2014: \$5.0bn) which equated to 95% (2014: 89%) of assets.

## **2.4 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 relevant risk management function.

## **2.5 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.

## **2.6 Risk Management Functions**

The group has a comprehensive risk management framework in place for managing and controlling these risks which is constantly evolving as the business activities change in response to credit, market, product 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 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.

## 2.7 Control

Risks are managed through 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 control processes are performed through a set of independent control and risk functions, which report directly to the Chief Financial Officer. These functions include operational risk, credit risk, market risk and financial control.

## 2.8 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 monthly 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. ORC meetings are held on a monthly basis.

- Management Committee / Leadership Team

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.

## 2.9 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 counterparty 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 attendees at the meetings in 2.8 above. Monthly reports also include the results of liquidity 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:-

<b>US\$ millions</b>	<b>Tier 1</b>	<b>Tier 2</b>	<b>Total</b>
Share capital	250	-	250
Retained Profits	57	-	57
<b>Tier 1 and tier 2 capital before deductions</b>	<b>307</b>	<b>-</b>	<b>307</b>
Deductions	-	-	-
<b>Tier 1 and tier 2 capital base</b>	<b>307</b>	<b>-</b>	<b>307</b>

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.

## **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 classes based on the type of counterparty or underlying exposure. Following the assignment of exposures to the relevant standard classes, the RWAs are derived based on prescribed risk weightings. Under the standardised approach, the risk weightings are provided by the PRA and are determined based on the counterparty's external credit rating. The external credit ratings are derived from eligible External Credit Assessment Institutions (ECAI's) approved by the PRA.

GIBUK uses ratings assigned by the following three PRA approved ECAI's; Standard & Poor's Rating Group, Moody's Investors Services and Fitch Group.

GIBUK uses the ECAI's risk assessments for the following classes of exposures; Central governments, Multilateral development banks, Institutions, Corporates, and Other assets

An overview of the exposures, RWAs and capital requirements for credit risk analysed by standard portfolio, as at 31<sup>st</sup> December 2015, is presented in the table below:-

<b>US\$ millions</b>	<b>Rated exposure</b>	<b>Unrated exposure</b>	<b>Total exposure</b>	<b>Average risk weight</b>	<b>RWA</b>	<b>Credit Risk capital requirement</b>
Central governments	3,525	-	3,525	0%	-	-
Multilateral development banks	33	-	33	0%	-	-
Institutions	1,833	-	1,833	34%	616	49
Corporates	-	-	-	-	-	-
Other assets	-	19	19	100%	19	1
<b>Total</b>	<b>5,391</b>	<b>19</b>	<b>5,409</b>	<b>12%</b>	<b>634</b>	<b>50</b>

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 standard rules method to calculate the regulatory capital requirements relating to market risk.

The 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:-

<b>US\$ millions</b>	<b>Notional RWA</b>	<b>Capital requirement</b>
Equity risk	55	4
Interest rate risk	16	1
Foreign exchange risk	1	0
<b>Total</b>	<b>73</b>	<b>5</b>

## 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 allocated to prescribed business units, and then multiplied by various fixed alpha coefficients as prescribed in the PRA rules. These alpha coefficients range from 12 to 18 per cent in the framework.

The capital requirement for operational risk at 31<sup>st</sup> December 2015 amounted to US\$8million.

**4.4 Pillar 2 / ICAAP considerations**

GIBUK’s regulatory capital base exceeded the PRA’s minimum requirements throughout the year ended 31<sup>st</sup> December 2015. 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 are set out in section 4.5 of this report.

As a number of Pillar 2 risk types exist within GIBUK’s economic capital framework (e.g. 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 Risk Weighted Assets (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.

The capital adequacy ratios of GIBUK at 31<sup>st</sup> December 2015 were as follows:-

	<b>GIBUK</b>
Total RWAs (US\$ millions)	831
Capital base (US\$ millions)	307
Tier 1 capital (US\$ millions)	307
<b>Tier 1 ratio</b>	<b>37%</b>
<b>Total ratio</b>	<b>37%</b>

**5. CREDIT RISK**

This section describes the Group’s exposure to credit risk and provides detailed disclosures on credit risk in accordance with the 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:-

- 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.
- 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.
- 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
<b>Balance sheet items:</b>		
Cash and other liquid assets	3,711	3,031
Placements with banks	3,802	4,233
Loans and advances	33	0
Other assets, excluding derivative-related items	19	78
<b>Total on-balance sheet credit exposure</b>	<b>7,565</b>	<b>7,342</b>
<b>Off-balance sheet items:</b>		
Credit-related contingent items	1	7
Derivative and foreign exchange instruments	58	96
<b>Total off-balance sheet credit exposure</b>	<b>59</b>	<b>103</b>
<b>Total credit exposure</b>	<b>7,624</b>	<b>7,445</b>

The average gross credit exposure is based on weekly averages during the year ended 31<sup>st</sup> December 2015.

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, loans and other liquid assets	Other Assets	Off balance sheet items	Total
Middle East	1,801	-	1	1,802
Africa	-	-	-	-
Europe	5,664	19	51	5,734
North America	78	-	1	79
Asia	3	-	6	9
<b>Total exposure</b>	<b>7,546</b>	<b>19</b>	<b>59</b>	<b>7,623</b>

## iii) Credit exposure by industry

The classification of credit exposures by industrial sector was as follows:-

US\$ millions	Placements, Loans and other liquid assets	Other assets	Off balance sheet items	Total
Financial services	4,021	-	24	4,045
Government	3,525	-	35	3,560
Other	-	19	-	19
<b>Total exposure</b>	<b>7,546</b>	<b>19</b>	<b>59</b>	<b>5,506</b>

## iv) Credit exposure by credit quality step (CQS)

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

US\$ millions	Placements, Loans and other liquid assets	Other assets	Off balance sheet items	Total
<b>Neither past due nor Impaired</b>				
CQS1	3,558	-	55	3,613
CQS2	3,938	-	3	3,941

CQS3	50	-	-	50
Unrated	-	19	-	19
<b>Total exposure</b>	<b>7,546</b>	<b>19</b>	<b>59</b>	<b>7,623</b>

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:-

<b>US\$ millions</b>	<b>Placements, Loans and other liquid assets</b>	<b>Other assets</b>	<b>Total</b>
Within 3 months	5,673	19	5,692
4 months to 1 year	1,822	-	1,822
2 to 4 years	51	-	51
Over 5 years and other	-	-	-
<b>Total exposure</b>	<b>7,546</b>	<b>19</b>	<b>7,565</b>

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

**vi) Equities held in the banking book**

At 31<sup>st</sup> December 2015, 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 PRA'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 PRA, 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:-

<b>US\$ millions</b>	<b>Exposure before credit risk mitigation</b>	<b>Of which secured by: Eligible collateral</b>
Financial Institutions	2,169	2,155

#### **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 31<sup>st</sup> December 2015.

**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 31<sup>st</sup> December 2015.

**iii) Impaired investment securities and related provisions for impairment**

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

<b>US\$ millions</b>	<b>Gross exposure</b>	<b>Impairment provisions</b>	<b>Net exposure</b>
CDOs	9	9	-
Equity investments	6	6	-
<b>Total</b>	<b>15</b>	<b>15</b>	<b>-</b>

**iv) Provisions for impairment – investment securities**

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

<b>US\$ millions</b>	<b>Specific provisions</b>		<b>Total provisions</b>
	<b>CDOs</b>	<b>Equities</b>	
At 1 <sup>st</sup> January 2015	9	6	15
Amount utilised	-	-	-
Exchange rate movements	-	-	-
<b>Total</b>	<b>9</b>	<b>6</b>	<b>15</b>

## **5.4 Past due facilities**

There were no past due facilities during the year ended 31<sup>st</sup> December 2015.

## **5.5 Restructured loan facilities**

There were no restructured loan facilities during the year ended 31<sup>st</sup> December 2015.

## **5.6 Recoveries recorded directly to the income statement**

Other operating income included the recovery of \$13k from a number of old investment positions held at zero value.

## 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:-

<b>US\$ millions</b>	<b>Notional principal amount</b>	<b>RWA</b>	<b>Capital requirement</b>
Direct credit substitutes	1	-	-
Transaction-related contingent items	0	-	-
<b>Total</b>	<b>1</b>	<b>-</b>	<b>-</b>

## 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 31<sup>st</sup> December 2015 are set out below:

<b>US\$ millions</b>	<b>Notional principal amount</b>	<b>Fair value positive</b>	<b>Fair value negative</b>
Exchange rate contracts	3,476	58	51
Interest rate contracts	3,400	-	-
<b>Total</b>	<b>6,876</b>	<b>58</b>	<b>51</b>

## 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 mark to market method to calculate the exposure for counterparty credit risk for derivative and foreign exchange instruments, the exposure values are used to determine the capital requirement under the standardised credit

risk approach.. 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		
Financial Institutions	23	30	52	16	1
Governments	35	10	45	-	-
<b>Total</b>	<b>58</b>	<b>40</b>	<b>97</b>	<b>16</b>	<b>1</b>

**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 31<sup>st</sup> December 2015, 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. Each CDO holds up to 65 individual investments.

At 31<sup>st</sup> December 2015 the underlying investments in the CDOs for which GIBUK acted as collateral manager amounted to US\$0.5 billion. At 31<sup>st</sup> December 2015, GIBUK did not hold any exposure to CDOs managed by GIBUK.

**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.

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	2 to 3 years	Non-interest bearing items	Total
Cash and other liquid assets	3,688	-	-	-	-	3,688
Placements with banks	1,945	1,494	324	50	-	3,813
Loans and advances	-	-	-	-	-	-
Other assets	-	-	-	-	41	41
<b>Total assets</b>	<b>5,633</b>	<b>1,494</b>	<b>324</b>	<b>50</b>	<b>41</b>	<b>7,542</b>
Deposits	6,666	582	-	-	-	7,248
Other liabilities	-	-	-	-	10	10
Equity	-	-	-	-	314	314
<b>Total liabilities</b>	<b>6,666</b>	<b>582</b>	<b>-</b>	<b>-</b>	<b>324</b>	<b>7,572</b>
<b>On Balance sheet Gap</b>	<b>(1,033)</b>	<b>912</b>	<b>324</b>	<b>50</b>	<b>(283)</b>	
Derivatives held for risk management	1,681	(1,321)	(310)	(50)	-	
<b>Interest rate sensitivity gap</b>	<b>648</b>	<b>(409)</b>	<b>14</b>	<b>-</b>	<b>(283)</b>	
<b>Cumulative interest rate sensitivity gap</b>	<b>648</b>	<b>239</b>	<b>253</b>	<b>253</b>	<b>(30)</b>	

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.

Based on the repricing profile at 31<sup>st</sup> December 2015, 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.

## **7. REMUNERATION**

Under the proportionality guidance in place as at 31 December 2015, GIBUK falls into Tier 3.

### **7.1 Decision making process**

GIB UK has a Remuneration Committee which is a sub-committee of the Board. Its terms of reference are as follows:

#### **i) Membership**

The Committee shall consist of not less than three non-executive directors appointed by the Board, one of whom shall be appointed Chairman by the Board. Executive Directors of GIB UK are not eligible to be members of the Committee.

#### **ii) Duties**

The Committee shall be responsible for:

- Reviewing, updating and approving GIB (UK)'s Remuneration Policy on at least an annual basis and recommending it for adoption by the Board
- Setting the remuneration of the executive members of the Board, including bonuses
- Reviewing, considering and approving aggregate salaries and bonuses and all other aspects of compensation terms, including any incentive plans, applicable to the bank's personnel.
- Ensuring that staff salary and bonus awards are determined in a manner which is consistent with the Remuneration Policy.

#### **iii) Meetings**

The Committee will meet at least once a year. Two members shall constitute a quorum. The Committee shall keep minutes of its proceedings. In addition to the members, and as agreed by them, other directors and managers may attend the meetings if invited.

### **7.2 Link between pay and performance**

All staff receive a fixed and a variable component to their remuneration. The variable component is based on the performance of the individual and the firm as a whole and it is entirely discretionary.

### 7.3 Design Characteristics

The variable component of an individual's remuneration is designed to reward members of staff for good performance and to incentivise continued good performance in the future. In determining the quantum of the variable component, various factors are taken into consideration which depend on the nature of the individual's role in the firm. Individuals engaged in business lines will be assessed on their net profit contribution to the firm, however the risk taken in achieving that performance will be factored into the assessment along with the transparency and certainty of the profits arising. They are also assessed on their overall contribution to the firm. Individuals engaged in risk, control and support functions are assessed through an appraisal process which is based on the achievement of objectives and meeting key performance criteria. Taking into account the risk of the firm's business activities, it was not considered necessary to defer any part of any individual's variable remuneration in 2015.

### 7.4 Aggregate remuneration information

<b>Business Area</b>	<b>No. of Staff</b>	<b>Fixed Remuneration (including pension &amp; other benefits)</b>	<b>Variable Remuneration</b>
Senior Management	12	£1,610,751	£620,000
Treasury Division	6	£659,417	£442,500
Asset Management Division	19	£1,877,398	£1,241,500
Other staff	30	£1,883,100	£242,500
<b>TOTAL</b>	<b>67</b>	<b>£6,030,666</b>	<b>£2,546,500</b>