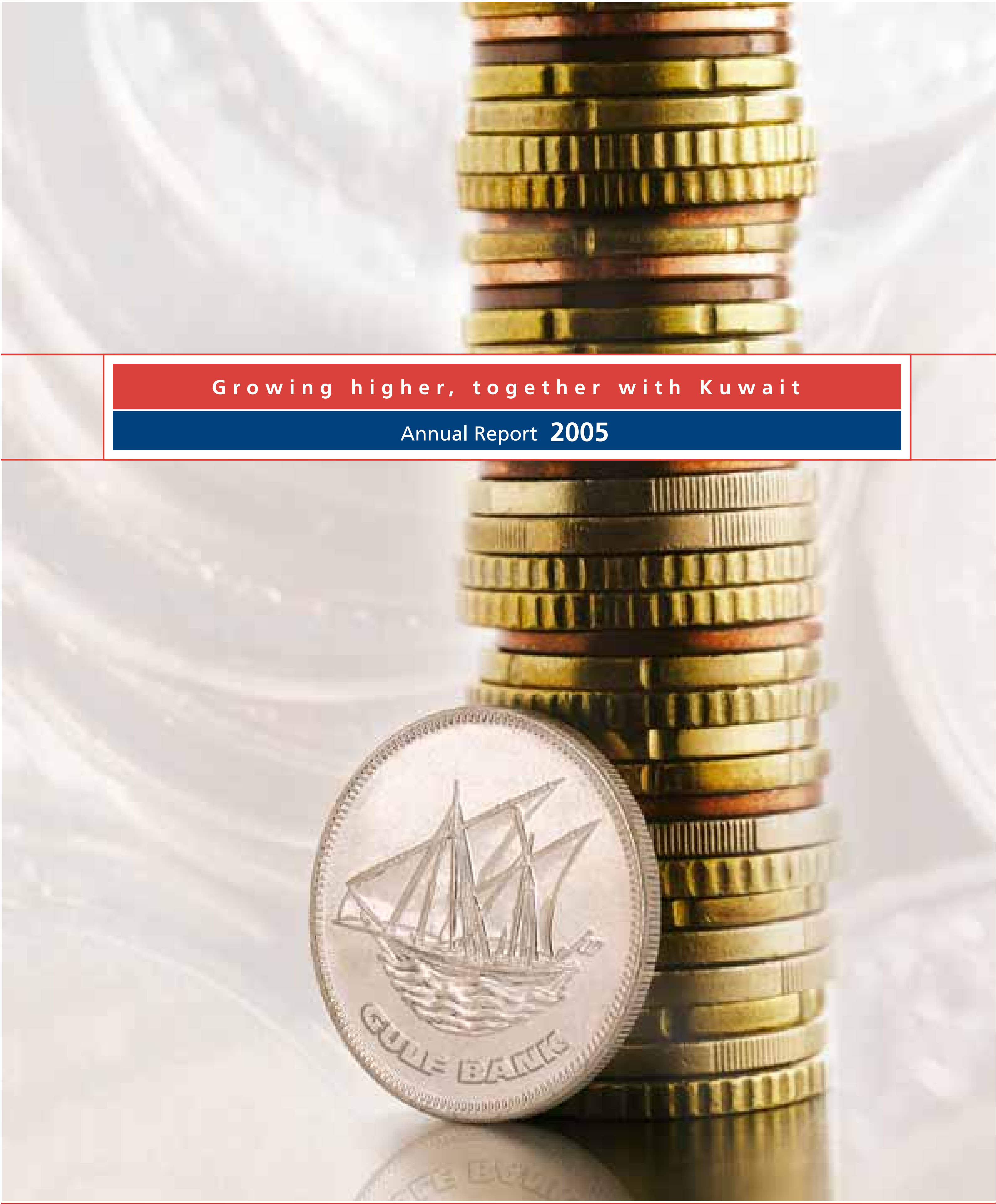
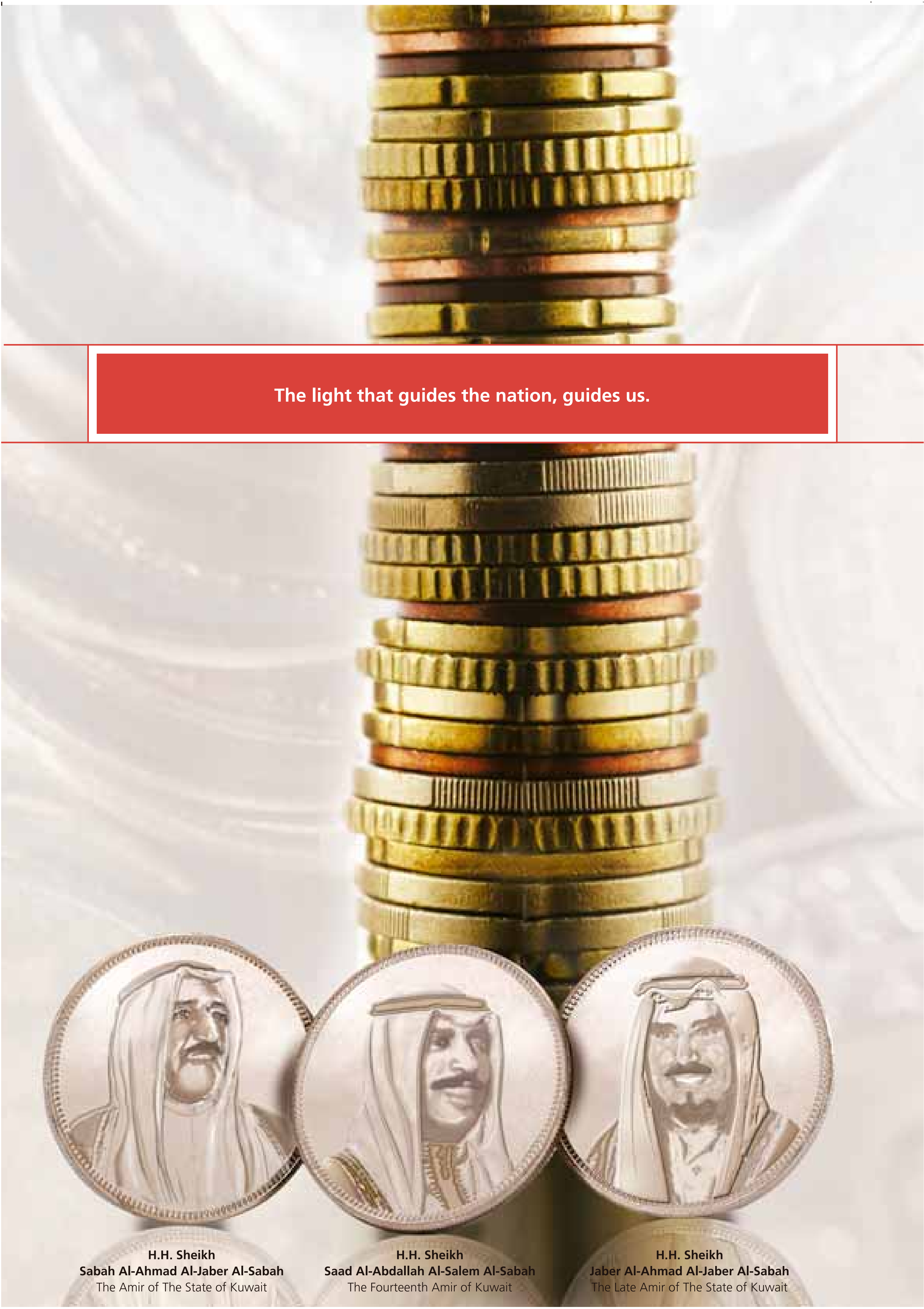


Growing higher, together with Kuwait

Annual Report 2005

بنك الخليج
GULF BANK

ALWAYS MORE



The light that guides the nation, guides us.

H.H. Sheikh
Sabah Al-Ahmad Al-Jaber Al-Sabah
The Amir of The State of Kuwait

H.H. Sheikh
Saad Al-Abdallah Al-Salem Al-Sabah
The Fourteenth Amir of Kuwait

H.H. Sheikh
Jaber Al-Ahmad Al-Jaber Al-Sabah
The Late Amir of The State of Kuwait

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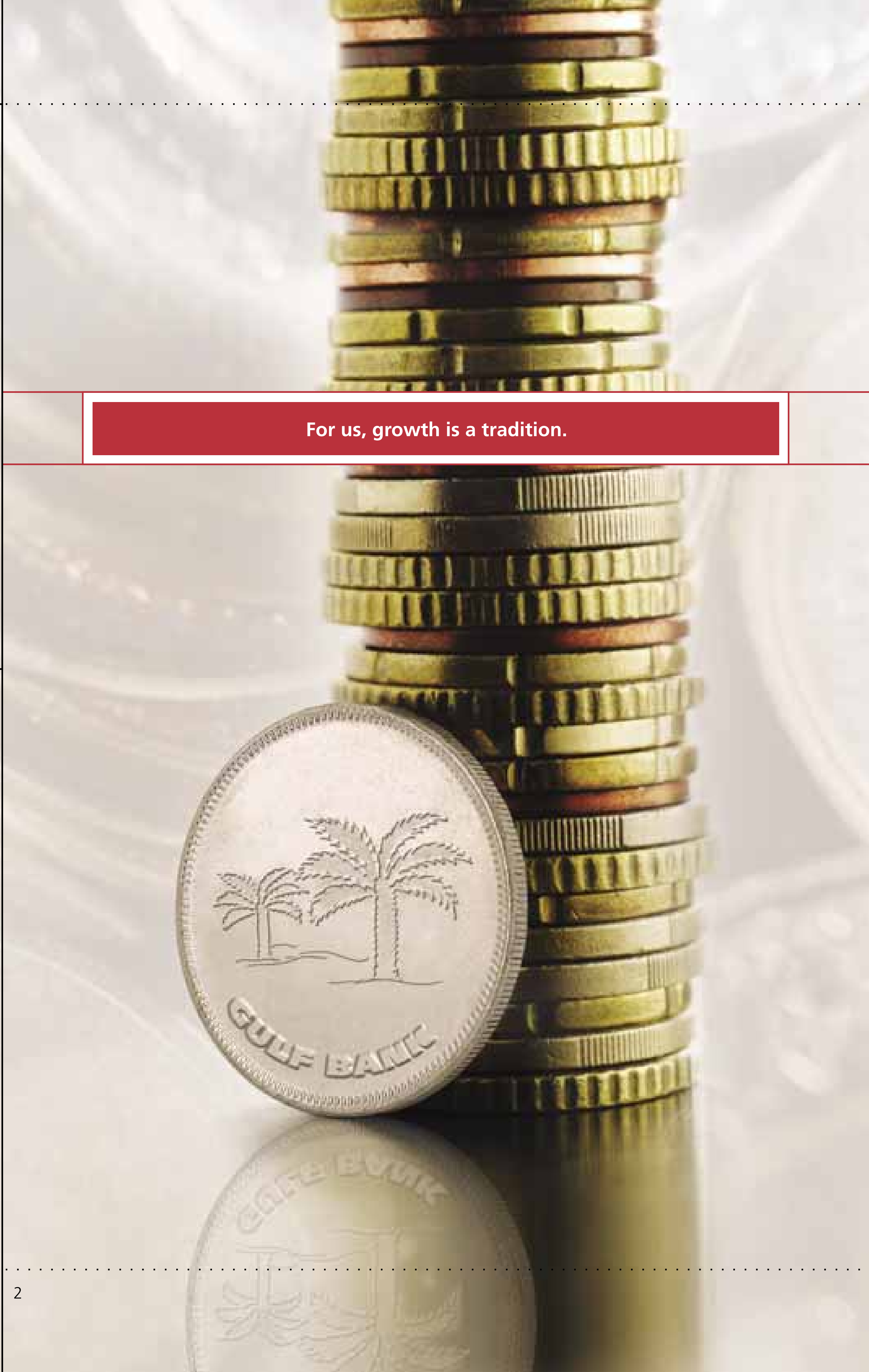
Board of Directors

Bassam Yusuf Ahmed Alghanim	Chairman and Managing Director
Salah Khaled Fulaij Al-Ali Al-Fulaij	Deputy Chairman
Adel Mohammed Rida Yousef Behbehani	Board Member
Abdul Aziz Abdul Rahman Abdul Aziz Al-Shaya	Board Member
Abdulkareem Abdulla Abdulkareem Al-Saeed	Board Member
Hussain Ahmed Qabazard	Board Member
Khaled Saoud Al-Hasan	Board Member
Naser Yousef Naser Bourisli	Board Member
Mahdi Mahmoud Hajji Haidar	Board Member

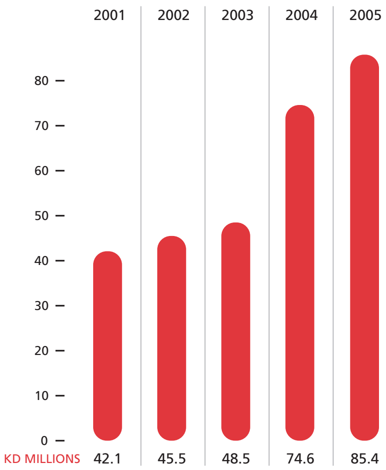
Dr. Yousef A. Al-Awadi KBE	Chief General Manager & Chief Executive Officer



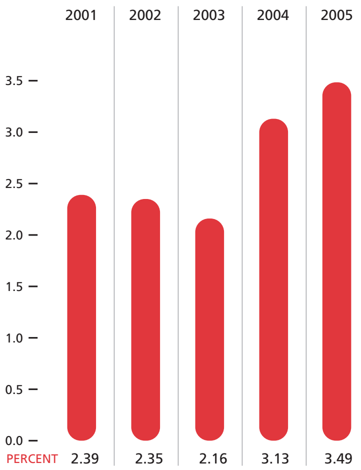
For us, growth is a tradition.

Financial Highlights

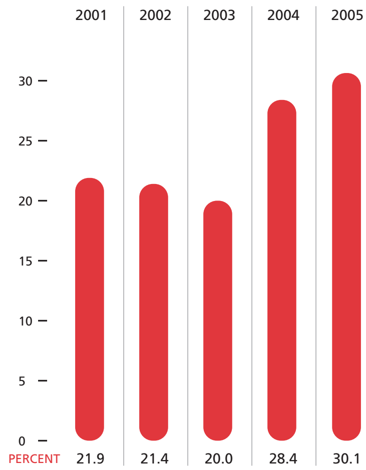
PROFITS FOR THE YEAR



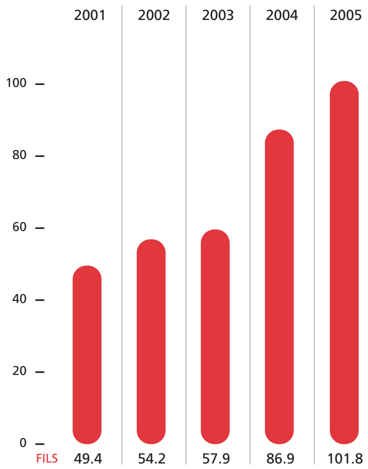
RETURN ON AVERAGE ASSETS



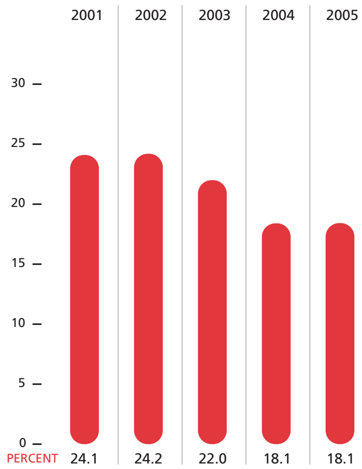
RETURN ON AVERAGE SHAREHOLDERS' FUNDS

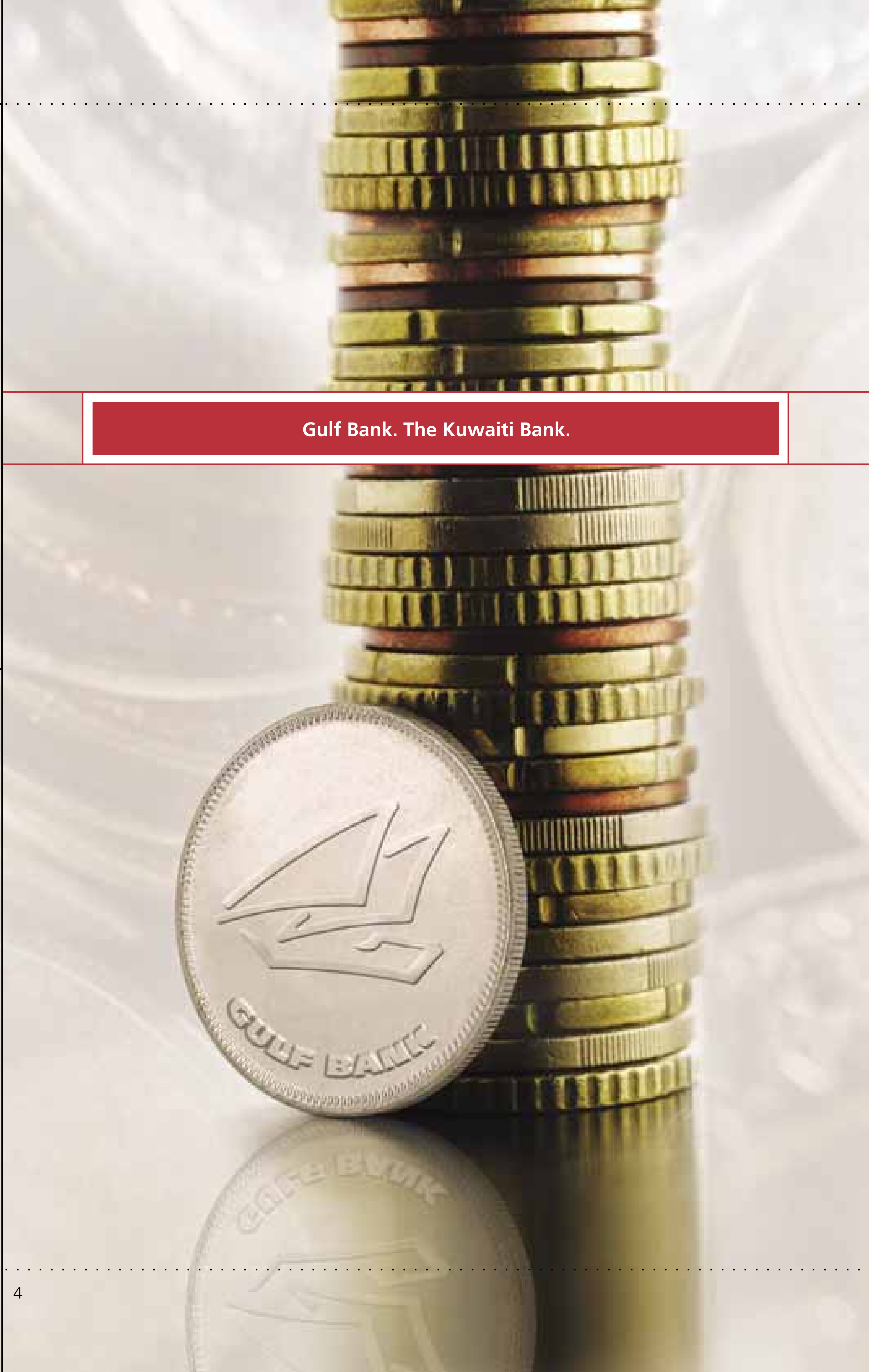


EARNINGS PER SHARE



COST TO INCOME RATIO





Gulf Bank. The Kuwaiti Bank.

Chairman's Message

"2005, Six Consecutive Years of Record Growth."

2005 marked the 6th consecutive year of unparalleled growth and profit for Gulf Bank, the true test of success of our Transformation Strategy that began in 1999 and the Actualization Strategy that commenced in 2003. Gulf Bank takes pride in its achievements and the strong financial results in 2005 validates that Gulf Bank will continue to successfully stand the test of time in a highly competitive market environment.

The winning of two prestigious awards in 2005 comes in recognition of the Bank's progressively increasing leadership position, bringing accolades for our innovative and dynamic banking programs and services under the leadership of a professional and innovative management and rolled out by our talented high caliber staff. The prestigious Banker Middle East magazine awarded Gulf Bank the "Best Retail Bank in the Middle East" in 2005. The GCC Council of Ministers for Social Affairs and Labour recognized Gulf Bank with an award for achieving the highest percentage of Kuwaiti nationals in employment in the private sector in Kuwait.

Gulf Bank has delivered very strong financial results in 2005. The total annual Net Profit increased by 14% to KD85.4 million (USD292.4 million), reflecting strong core earnings growth in all business areas.

We also delivered major improvements in the Bank's key profitability and shareholder return measures. Return on Assets rose to 3.49% and Return on Equity increased to 30.1% – both returns are exceptionally high by international banking standards. Net Interest Income increased by 21%, Net Fees and Commissions grew by 45%.

As one of the most efficient financial institutions in the world, Gulf Bank continues to maintain its industry-beating cost to income operational efficency ratio at 18.1%, while still investing heavily in its business.

Gulf Bank's asset quality is good and non-performing loans are well covered by loan loss provisions. Non-Performing loans to advances has fallen from 2.99% in 2004 to 2.25% in 2005. Provisions cover has similarly improved from 144.7% to 197.4% in 2005. Gulf Bank's funding base is supported by its strong position in the retail savings market.

Gulf Bank also delivered impressive record earnings per share of 101.8 fils for the year ended 2005.

Gulf Bank has a balanced strategy that consistently delivers strong results in changing economic environments. We are very much focused on ensuring that our business groups create sustainable earnings within the regulatory framework of the Central Bank of Kuwait by focusing on innovation and superior customer service.

I would like to take this opportunity to highlight some of the key successes and strategic initiatives in each of our business groups in 2005.

“Giving more to the Consumer”

The Retail Banking Group is focused on being the preferred retailer of financial services in Kuwait. The Retail Banking Group had an extremely successful year with a dramatic increase in customer acquisition in all key segments resulting in continued growth in Gulf Bank’s market share of targeted salary consumer segments. Gulf Bank is the only bank that has seen such a significant increase in its market share since the change in ownership control in 1999. An important milestone was reached when Gulf Bank was selected by the Kuwait Oil Company (KOC) as the preferred Retail Bank for its employees. The Retail Banking Group plans to build many more such strategic alliances to leverage its role as the preferred Retail Bank for other strategic customers.

The loan book grew exceptionally and the Bank’s loan market share increased significantly as well. Deposits also increased significantly providing a better mix of funding. The Al Danah account has built up substantial brand equity of its own and it will continue to set the standard for draw accounts in Kuwait. Credit cards continue to provide a significant income stream and the Retail Banking Group succeeded in significantly increasing penetration of cards in the key target markets.

Gulf Bank continues to lead the market in terms of innovation based on solid consumer insight effectively demonstrated by the success of Red, Gulf Bank’s unique package offer to university students. Gulf Bank was recently identified as the preferred bank by over 30% of Kuwaiti students, a leading indicator of future salary market share.

We have made significant investment in Telebanking to build it into a world class, highly innovative, responsive system that will continue to offer our customers the best Telebanking service in Kuwait. In addition, our Online Banking channel is experiencing strong growth as well and the Bank continues to invest in this channel to bring more and more benefits to our customers.

Gulf Bank has the largest share of off-site ATMs in Kuwait among any financial institution giving consumers ready access to their money through strategic positioning in key consumer outlets.

For the banking convenience of our customers, the Bank is continually expanding its network of branches to strategic locations across Kuwait. Gulf Bank has set a new standard in banking in Kuwait with its contemporary architectural brand format rolled out in the newly designed branches. Set against the ambiance of true Kuwaiti heritage intrinsically woven into the architectural style and decor, Gulf Bank’s new branches have become the benchmark in the country for providing customers the best in banking services in a contemporary yet technologically advanced banking environment. More than 60% of the branches are now based on the new Gulf Bank architectural brand format.

The Retail Banking Group continues to identify opportunities to provide superior satisfaction by using the latest proven technology that has been tried and tested by international banks around the world to eliminate human error and allow our employees to focus on serving the customer in the most efficient manner.

The Retail Banking Group will continue to offer a wider range of products and services through a wider distribution channel mix that includes an ever expanding branch and ATM network, the most comprehensive e-Banking suite of products and services that offer the latest in banking technology, and through the 24/7 self-service areas that continue to provide the majority of services of any branch bank.

The Corporate Banking Group prides itself on being the bank of choice for businessmen in Kuwait, for its deep routed culture of establishing a long strategic partnership with customers, rather than opportunistic activities. As a result, the organic growth of the Corporate Banking Group has been strong.

In 2005, the Corporate Banking Group completed the full transformation to industry based business divisions, in order to offer the best available resources to our customers as well as minimizing risks inherent in every industry based on its unique characteristics. This market leading segmentation provides a strong foundation for future growth.

Significant financing programs in 2005 by the Corporate Banking Group include arranging the financial needs for the foreign and local contractors on the Engineering, Procurement and Construction (EPC) contract for a 1500 MW Gas-Turbine Power Plant. The Corporate Banking Group also provided the working capital finance and bond requirements to the contractor awarded the construction of one of the largest hypermarkets in Kuwait, The Avenues Mall. Another significant financing deal clinched by the Corporate Banking Group in 2005 was to provide contractor finance for the Fifth Ring Road project.

International Banking has remained focused on its key areas of competitive advantage in 2005 by supporting commercial trade and seeking high quality international credits. This has led to another year of solid performance. In addition, it has been able to diversify Gulf Bank's earnings by generating revenue from its activities outside Kuwait. In the international arena, it has been proactively expanding its business in the Middle East and in emerging markets, particularly the Far East, through a proactive policy on international lending. On the domestic front, International Banking continues to provide active support to the Bank's domestic client base in their activities outside of Kuwait. In addition, the Multinational unit of the International Banking Group continues to play a key role in catering to the financial requirements of projects for international companies both in Kuwait and elsewhere.

The Treasury Group had another excellent year with income from financial transactions increasing substantially over the previous year. Significant strides were made in 2005 with the introduction of innovative structured products and the offering of risk mitigation solutions to Gulf Bank's corporate clients. The proprietary trading desk had a good year within tightly controlled risk parameters and enhanced its pricing capabilities with a shift towards internet based pricing platforms.

The Investment Group spearheaded the launch of two retail investment products in 2005 offering an excellent opportunity for investors to enhance their returns and become part of the surging growth of the region's capital markets. The Capital Guaranteed Fund in alliance with JP Morgan offers investors the opportunity to participate in a capital protected structure that benefits from the positive performance of a basket of equity indices with a minimum return at maturity. As the exclusive placement agent, the Bank's Investment Group announced the launch of Al Basha'er GCC Equity Fund, an Islamic equity fund, in partnership with the region's leading financial institutions. Al Basha'er GCC Equity Fund reflects the Bank's pioneering spirit to offer innovative investment products to global and regional investors. The launch of this fund comes at a time when the region's equity markets are upbeat supported by the changing economic landscape across the GCC countries. In addition, during the latter part of 2005, the Investment Group launched its Custody

Services providing a new level of service and support to existing and new customers, both institutional and retail.

Gulf Bank remains one of the top rated banks in the region with an 'A' rating from Capital Intelligence, one of the top emerging market rating agencies in the world and strong ratings from the world's top international rating agencies, namely: 'A-' (Fitch), 'A2' (Moody's) and 'A-' (Standard & Poor's). The positive ratings reflect the Bank's sound profitability, good asset quality, stable retail deposit funding and adequate capitalization. These ratings are also a reflection of Gulf Bank's strong financial performance and solid market position that makes Gulf Bank one of the strongest commercial banks in Kuwait.

As you are aware, this is the first annual report under the new Basel II Accord and Gulf Bank is pleased that the Central Bank of Kuwait has taken a leadership role in being the first country not only in the GCC but also to a large extent in the world to implement it fully. Gulf Bank has prided itself on providing significant information to shareholders in excess of the regulatory requirements and we believe Basel II will demonstrate the strengths of our business model.

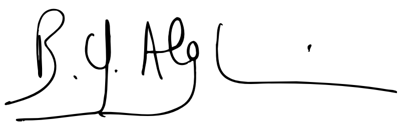
The financial services market in Kuwait continues to evolve as customers become more and more demanding. Gulf Bank continues to invest in its current industry-leading management team and staff to ensure we remain at the forefront of the industry.

Gulf Bank has a proven track record of success and we will continue to lead the industry in 2006. Our customer-driven strategy is delivering significant benefits for customers and shareholders. Superior customer service and superior return on investments guide our decision-making. To this end, the Board of Directors is pleased to recommend a cash dividend of 60 fils and a bonus issue of 10% per share for 2005.

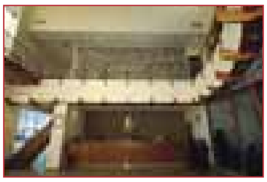
On behalf of the Board of Directors, I would like to express our sincere gratitude and appreciation to His Highness, The Amir Sheikh Sabah Al Ahmed Al Jaber Al Sabah. Our appreciation would not be complete if we did not include a note of gratitude for the many long years of support and encouragement from our late Amir Sheikh Jaber Al-Ahmad Al-Jaber Al-Sabah and we extend our deepest condolences to his family.

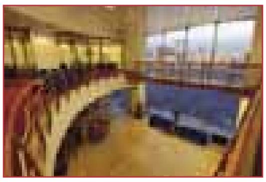
We also thank the Central Bank of Kuwait for its prudent management and strong support.

It gives me great pleasure, on behalf of Gulf Bank, to thank our loyal customers and shareholders for their continued support and patronage. The past twelve months have been the most exciting period in the Bank's history and we look forward to many more shared successes in the future.

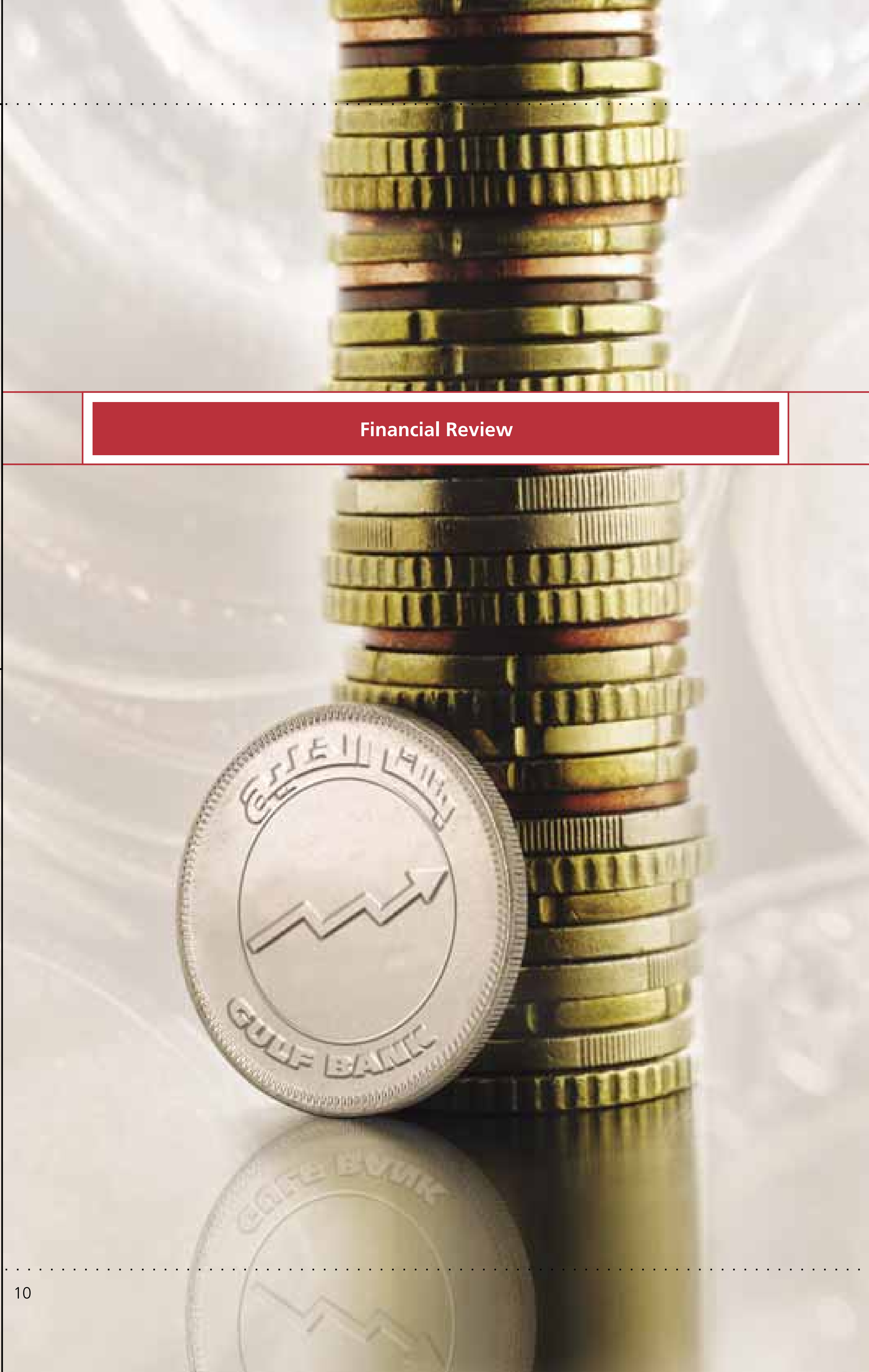


Bassam Yusuf Alghanim
Chairman and Managing Director





Financial Review



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Summary of Financial Performance

(KD millions)	**2005**	2004
Net interest income	**81.54**	67.65
Other operating income	**51.61**	35.57
Operating income	**133.15**	103.22
Operating expenses	**(24.10)**	(18.67)
Operating profit before provisions	**109.05**	84.55
Provisions	**(20.73)**	(7.31)
Operating profit	**88.32**	77.24
Directors' emoluments	**(0.11)**	(0.11)
KFAS/National Labour Support Tax	**(2.84)**	(2.48)
Net profit	**85.37**	74.65

Gulf Bank produced another record set of results in 2005, further building upon the new heightened level of profitability that produced 2004's record results. The 2005 performance marks 6 years of uninterrupted profit growth since the Bank's change of ownership in late 1999. Operating and net profit, shareholder returns, operating efficiency and profitability ratios reached all time highs in 2005 and the Bank met all of its key 2005 business plan targets.

The record net profit of KD85.37 million (USD292.36 million) was KD10.72 million or 14% higher than 2004. Operating profit before provisions grew by KD24.50 million (29%) to KD109.05 million, reflecting strong core earnings growth in all business areas. The strong growth in operating income (up KD29.93 million or 29%) was even more remarkable since it was achieved against the backdrop of the new Central Bank of Kuwait ('CBK') '80:20' loan/deposit ratio that restricts customer lending to 80% of customer deposits. This ratio severely curtailed the pace of new loan growth in the latter part of 2004 and the early part of 2005. The '80:20' restrictions not only slowed the year-on-year growth in net interest income but also reduced the growth in the fee and foreign exchange income associated with credit growth.

Despite the constraints of the '80:20' ratio, net interest income increased by KD13.89 million (21%) as a result of higher customer deposit balances, strong retail loan growth and improved corporate loan spreads.

Other operating income grew by KD16.04 million (45%), driven by strong growth in fee income (up 45%) and foreign exchange earnings (up 14%), and higher investment disposal income.

Operating expenses increased by KD5.43 million (29%) due to continuing investment in branches, people and systems. Staff costs were up KD2.02 million (17%) and non-staff costs were up KD3.41 million (49%). The Bank's industry-beating cost:income ratio was maintained at 18.1% because the cost growth was offset by the corresponding 29% growth in operating income. Gulf Bank's cost:income ratio has almost halved since 1999 as a result of substantial productivity improvements and the measures taken to enhance sales performance. Revenue growth has consistently outpaced the growth in operating expenses as the Bank has expanded its business and network over the last six years.

The provisions charge of KD20.73 million was

KD13.42 million (183%) higher than 2004. Specific provisions were KD2.31 million higher at KD4.45 million and general provisions were KD11.11 million higher at KD16.28 million. The general provisions mainly arise from the CBK conservative regulatory requirement to provide a minimum 2% general provision against credit facilities (both on and off-balance-sheet).

The record results delivered major improvements in the Bank's key profitability and shareholder return measures. Return on assets and return on equity reached all time highs of 3.49% and 30.1%, respectively. These returns are exceptionally high by international banking standards. Earnings per share similarly grew by 17%, from 86.9 fils to 101.8 fils.

Net Interest Income

	2005	2004
Net interest income *(KD millions)*	**81.54**	67.65
Average interest-earning assets *(KD millions)*	**2,380.1**	2,336.7
Net interest spread *(Per cent)*	**3.08%**	2.65%
Net interest margin *(Per cent)*	**3.43%**	2.90%
Average KD Discount Rate *(Per cent)*	**5.40%**	3.70%

Net interest income increased by KD13.89 million (21%) in 2005, with strong growth in both Retail and Corporate Banking. Average retail lending grew by 29% and average retail deposits grew by 14% as the Bank further enhanced its product range, opened more new branches and continued to increase its retail market share. Average corporate loan balances were 6% lower because corporate credit facilities were reduced in the latter part of 2004 and the early part of 2005 in order to meet the '80:20' ratio (net corporate loan growth resumed from April 2005 onwards, funded by the substantial growth in customer deposits). Corporate Banking's net interest income was still 28% above 2004 because the benefits of higher loan spreads and strong deposit growth offset the impact of the decline in average loan volumes.

The impact of the introduction of the '80:20' ratio in July 2004 led to a fairly modest growth in average interest-earning assets in 2005: up KD43.4 million (1.9%) to KD2.38 billion. Net interest income was boosted, however, by the strong improvement in interest margins. The overall net interest spread was 43 basis points higher (at 3.08%), due to increased corporate loan spreads, substantial growth in higher yield retail lending and an improved funding mix. The net interest margin was 53 basis points higher, at 3.43%, due to the added benefit of higher interest rates on the Bank's net free funds. The KD Discount Rate rose steadily during 2005 (from 4.75% to 6.00%), as CBK generally followed the upward trend in US interest rates. The average rate was consequently 170 basis points, or 46 per cent, higher in 2005, at 5.40%.

Other Operating Income

(KD millions)	**2005**	2004
Net fees and commissions	**25.32**	17.47
Foreign exchange and derivatives income	**5.45**	4.78
Dividend income	**1.86**	1.62
Other income	**0.15**	0.26
Income from disposal of investment securities	**18.83**	11.44
Total other operating income	**51.61**	35.57

Other operating income grew by KD16.04 million or 45% in 2005. Net fees and commissions increased by KD7.85 million (45%), with strong business volume growth in all business areas across all products and services (apart from loan fees). The growth in letters of credit and guarantee commissions and retail loan protection insurance income was particularly strong.

Foreign exchange earnings were up KD0.67 million (14%), reflecting increased customer business volumes. Proprietary trading income was broadly unchanged year-on-year.

Dividend income was KD0.24 million (14%) higher in 2005, at KD1.86 million. Other income was KD0.11 million (42%) lower at KD0.15 million.

Income from the disposal of investment securities was KD7.39 million (65%) higher at KD18.83 million. The 2005 gains were almost entirely due to the disposal of the remaining fixed income securities originally purchased in 2001 when interest rates were declining, and the disposal of the Bank's holdings in Kuwait Clearing Company and the Bahrain-based Bank of Bahrain and Kuwait. These were long-term investments that were sold in response to changes in market conditions. The Bank continues to apply rigorous investment performance criteria when considering equity investments, due to concerns over potential equity market volatility, and the main focus is to generate sustainable core earnings rather than seek windfall gains from investment securities.

Operating Expenses

(KD millions)	**2005**	2004
Staff costs	**13.75**	11.73
Occupancy costs	**1.20**	1.12
Depreciation	**1.15**	0.87
Other expenses	**8.00**	4.95
Total operating expenses	**24.10**	18.67

Cost:income ratio *(Per cent)*	**18.1%**	18.1%
Period end headcount	**914**	809

Operating expenses increased by KD5.43 million (29%) in 2005. Staff costs grew by KD2.02 million (17%), mainly due to higher performance-related incentive payments and headcount growth. Year-end headcount was up 105 (13%), primarily reflecting headcount growth to support the growth in retail business and the expansion of the branch network.

Occupancy costs were 7.5% higher due to the opening of two new branches in 2005. Depreciation costs were KD0.28 million (32%) higher due to the significant investment in new branches and systems during the Bank's transformation strategy.

Other expenses were KD3.05 million (62%) higher in 2005, entirely due to higher marketing costs (KD0.9 million increase) and provisions for two long-outstanding litigation claims (KD2.2 million). The sharp increase in marketing costs reflects substantial marketing and promotional activity throughout 2005 to support the retail customer acquisition programme.

The cost:income ratio remained unchanged at 18.1%. Gulf Bank continues to maintain one of the best operating efficiency ratios of any bank in the world, despite significant and continuous business-led cost growth. This demonstrates the Bank's ability to grow its business and increase its market share so that revenue growth exceeds the costs of investing in branches, people, new products and systems.

Provisions

(KD millions)	**2005**	2004
Specific provisions	**4.45**	2.14
General provisions	**16.28**	5.17
Total provisions	**20.73**	7.31

Non-performing to total loans *(Per cent)*	**2.25%**	2.99%
Specific provisions cover *(Per cent)*	**50.7%**	56.2%
Total provisions cover *(Per cent)*	**197.4%**	144.7%

The provisions charge of KD20.73 million was KD13.42 million (183%) higher than 2004. Specific provisions were KD2.31 million (108%) higher at KD4.45 million. The increase occurred in commercial lending, mostly due to a KD1.99 million provision for a performance guarantee granted to a customer who was unable to fulfill a Kuwaiti government contract. Improved collections meant that retail specific provisions were broadly unchanged, despite the significant growth in personal lending in recent years. The general provisions charge of KD16.28 million was KD11.11 million (215%) higher than 2004. Most of the increase related to the CBK requirement to make a minimum 2% general provision against the growth in year-end credit facilities (on and off-balance-sheet).

Asset quality remains good, reflecting the Bank's prudent lending strategies and its strict and comprehensive credit policies and procedures. Non-performing loans (NPLs) declined by KD6.8 million (15%) to KD38.4 million at 31 December 2005, helped by write-offs of KD11.0 million. As a consequence, the proportion of NPLs to total loans fell from 2.99% to 2.25%. Specific provisions cover declined from 56.2% of NPLs in 2004 to 50.7% of NPLs at 31 December 2005, since the loans written off were fully provided for; but total provisions cover (including general provisions), improved from 144.7% to 197.4%.

Balance Sheet Analysis

Selected balance sheet data (KD millions)	**31 Dec 2005**	31 Dec 2004
Cash & short term funds: balances with CBK	**125.4**	31.6
Loans and advances to banks	**63.5**	116.3
Loans and advances to customers	**1,578.6**	1,338.3
Deposits with banks and OFIs	**17.4**	-
Investment securities	**105.9**	87.6
Total assets	**2,608.2**	2,286.1
Due to banks	**65.8**	108.2
Medium term loans from banks	**-**	154.2
Floating rate notes	**58.4**	58.9
Subordinated loans	**43.8**	44.2
Deposits from OFIs	**205.8**	168.0
Customer deposits	**1,829.0**	1,393.7
Shareholders' funds	**303.6**	264.3
Key ratios *(Per cent)*		
Return on average assets	**3.49%**	3.13%
Return on average equity	**30.1%**	28.4%
Loan/deposit ('80:20') ratio	**76.9%**	85.1%

Total assets increased by KD322.1 million or 14.1% to KD2.61 billion (USD8.93 billion) at 31 December 2005. The significant growth in customer loans and advances (up KD240.3 million or 18%) was made possible by the KD435.3 million (31%) growth in customer deposits. Approximately 60.5% of the balance sheet was deployed in customer loans and advances at 31 December 2005, compared with approximately 58.5% at 31 December 2004.

Balances with CBK increased by KD93.8 million due to excess KD liquidity in the market (partly due to the impact of the '80:20' ratio).

Loans and advances to banks declined by KD52.8 million (45%) to KD63.5 million, mostly reflecting the early pre-payment of facilities granted to Turkish banks and reduced lending to another Kuwaiti bank.

Loans and advances to customers increased by KD240.3 million (18%), mainly reflecting the strong, but prudent and strictly controlled growth in personal lending: up KD148.2 million (33%) to KD595.1 million. As a consequence, the proportion of personal lending increased from 32.1% to 36.3% of gross loans and advances to customers.

Deposits with banks and other financial institutions ('OFIs') increased by KD17.4 million (100%), mainly due to excess KD liquidity in the market.

Investment securities increased by KD18.3 million (21%) since new investments in local market equity and money market funds and international hedge funds offset the significant 2005 disposals. Debt securities fell by KD14.0 million (81%), from KD17.3 million to KD3.3 million, due to the sale of the remaining fixed income securities originally purchased in 2001 when interest rates were declining. Equity securities increased by KD32.3 million (46%), from KD70.3 million to KD102.6 million, and increased as a portion of total investment securities from 80.3% at 31 December 2004 to 96.9% at end 2005. The 2005 sales and purchases led to a significant change in the geographical mix of the investment securities portfolio. Kuwaiti securities increased from 26.1% of the portfolio at end 2004 to 41.2% at end 2005. Other Middle East securities declined from 41.3% at end 2004 to 0.2% at end 2005 due to the sale of the bulk of the Bank's shareholding in the Bahrain-based Bank of Bahrain and Kuwait.

The introduction of the '80:20' loan/deposit ratio in July 2004 led to significant changes in the funding mix of Gulf Bank. The 'deposit' component of the ratio includes customer deposits and deposits from non-bank financial institutions, but excludes deposits from banks and longer term funding such as medium term loans from banks, subordinated loans and bonds. The movements in liabilities in 2005 consequently reflect the Bank's success in raising '80:20' deposits in order to support further loan growth. By contrast, other funding was reduced in 2005.

'80:20' deposits increased by KD473.1 million (30%) in 2005, from KD1.56 billion to KD2.03 billion. Deposits from non-bank financial institutions ('OFIs') grew by KD37.8 million (22.5%) to KD205.8 million reflecting strong growth in current accounts and demand deposits. Customer deposits were increased by KD435.3 million (31%) to KD1.83 billion. Lower cost deposits were KD72.0 million (14%) higher, at KD589.7 million. Current account balances grew by KD70.2 million (22%) and savings account balances grew by 1%, despite the significant rise in interest rates during 2005. Time deposits grew by KD363.3 million (41%) as the Bank successfully increased customer deposits to meet the '80:20' ratio and support further loan growth.

By contrast, other funding declined by KD197.5 million (54%) in 2005, from KD365.5 million to KD168.0 million. Due to banks (mostly time deposits) was reduced by KD42.4 million (39%), from KD108.2 million to KD65.8 million. Medium term loans from banks (KD154.2 million at end 2004) were eliminated, as two of the loans were pre-paid and the third was repaid upon maturity. Long-term funding remained unchanged, comprising the 5 year USD200 million floating rate note Eurobond (due October 2008) issued by Gulf Bank in October 2003 and the two 10 year subordinated loans obtained in 2004: USD50 million due June 2014 and USD100 million due December 2014. The year-on-year decline in the KD-equivalent values of the long-term funding was due solely to exchange rate movements.

Shareholders' funds increased by KD39.3 million (15%) from KD264.3 million to KD303.6 million. The benefit of the proposed 10% bonus share issue (KD8.6 million), the growth in retained earnings (up KD17.4 million), statutory reserves (up KD8.8 million) and other reserves (up KD3.4 million), and the reduction in treasury shares held by the Bank (KD9.5 million) offset the net decline in the fair value reserve (down KD8.4 million). The Bank had unrealised gains on its 'available for sale' financial assets of KD17.1 million at 31 December 2005 (2004: KD25.5 million).

The return on average assets rose by 36 basis points (11.5 per cent), from 3.13% in 2004 to 3.49% in 2005. The return on average equity similarly increased by 170 basis points (6 per cent), from 28.4% to 30.1%. The major improvements reflect the sharp growth in profitability in 2005.

The '80:20' ratio was reduced from 85.1% at end 2004 to 76.9% at end 2005. The Bank met the required 80% ratio by February 2005 (well ahead of the July 2005 deadline given by CBK). Total '80:20' deposits increased KD682 million (50%), from KD1.35 billion to KD2.03 billion, in the 18 month period between the ratio's introduction in July 2004 and year-end 2005.

Bank Ratings

Long-term foreign currency ratings	**2005**	2004
Fitch Ratings	**A-**	A-
Moody's Investors Service	**A2**	A2
Standard & Poor's	**A-**	BBB+
Capital Intelligence	**A**	A

Gulf Bank maintains its position as the second highest rated bank in Kuwait and one of the highest rated banks in the Middle East. The strong ratings reflect the Bank's financial strength, prudent risk management and good asset quality, strong and consistent profit growth and well focused and effective business strategy. Gulf Bank views its strong ratings as a source of competitive advantage and the Bank continues to increase its market share and build on its position as Kuwait's second largest commercial bank, despite the increasing competition in the market. In January 2006, Standard & Poor's raised the Bank's long-term credit rating from 'BBB+' to 'A-'. The rating on the Bank's 5 year USD200 million floating rate note Eurobond (due October 2008) was similarly raised from 'BBB+' to 'A-'.

CAPITAL MANAGEMENT AND ALLOCATION

Capital measurement and allocation

Gulf Bank K.S.C. is a public shareholding company incorporated in Kuwait and registered as a bank with the Central Bank of Kuwait ('CBK'). The Bank is a domestic Kuwaiti commercial bank (with no overseas offices). It has no subsidiaries or significant minority equity investments.

Gulf Bank is required to comply with the regulatory capital adequacy guidelines promulgated by CBK. These guidelines are based on the standards established by the Basel Committee on Banking Supervision ('the Basel Committee') of the Bank for International Settlements ('BIS'). The BIS/CBK guidelines require banks to maintain adequate levels of regulatory capital against risk-bearing assets and off-balance-sheet exposure. Capital is also set aside for operational risk and for the market risk associated with trading activities. In accordance with the CBK guidelines, the Kuwaiti banks (including Gulf Bank) must maintain a minimum capital adequacy ratio of 12% (compared with the internationally agreed minimum of 8%).

Gulf Bank's capital is divided into two tiers: Tier 1, comprising paid-up share capital and reserves (less treasury shares); and Tier 2, comprising subordinated debt and a proportion of property revaluation reserves, fair value reserves and general provisions. The Bank does not have any Tier 3 capital (which is used solely to cover market risk) since the level of Gulf Bank's market risk exposure is minimal and is expected to remain so for the foreseeable future.

Risk-weighted assets comprise credit risk-weighted assets and market risk-weighted assets. Credit risk-weighted assets are measured by means of a hierarchy of risk weightings classified according to the nature of each asset (on and off-balance-sheet) and counterparty, taking account of any eligible collateral or guarantees. Market risk-weighted assets are determined by taking into account market-related risks such as foreign exchange, interest rate and equity position risks, and counterparty risk. Capital is also required to cover operational risk-weighted exposure.

Recent developments

In June 2004, the Basel Committee issued a new capital adequacy framework (the 'International Convergence of Capital Measurement and Capital Standards: a Revised Framework') to replace the original Basel Capital Accord of 1988. The fundamental objective of the new capital adequacy framework (commonly known as 'Basel II') is to further strengthen the soundness and stability of the international banking system while maintaining sufficient consistency to ensure that capital adequacy regulation is not a significant source of competitive inequality among internationally active banks. Basel II constitutes a more comprehensive approach to addressing risks and is intended to promote the adoption of stronger risk management practices by the banking industry.

The Central Bank Governors and Heads of Banking Supervision for the Group of Ten ('G10') countries endorsed the Basel II guidelines on 26 June 2004, with the intention that the new framework be available for implementation at year-end 2006 (with the most advanced approaches being delayed until year-end 2007). Supervisory authorities in the non-G10 countries were encouraged to adopt the Basel II framework to a timetable that was consistent with their broader supervisory priorities. The Basel II guidelines are still subject to modification and recalibration and a revised version was issued in November 2005.

The Basel II framework incorporates three equally important and mutually reinforcing pillars: Pillar 1 (minimum capital requirements), Pillar 2 (supervisory review process) and Pillar 3 (market discipline). The combination of the new minimum capital requirements (for both credit and operational risks), strong risk-based supervisory review and increased disclosure and transparency in public reporting is intended to encourage improvements in risk management. Banks and their supervisors are required to comply with all three pillars of the new accord.

The new Basel II framework retains three key elements of the 1988 Basel I accord: the 8% minimum capital adequacy ratio requirement; the definition of eligible regulatory capital; and the basic treatment of market risk introduced in the 1996 Market Risk Amendment to Basel I.

The Basel II framework is significantly more risk sensitive than the 'one size fits all' approach of the 1988 Accord. It aims to distinguish between the relative degrees of creditworthiness among individual borrowers and to align capital requirements more closely with the risks actually faced by banks. Pillar 1 therefore provides three approaches (of increasing sophistication) to the calculation of the regulatory capital requirement for credit risk: the standardised approach and two more sophisticated internal ratings-based ('IRB') approaches. The standardised approach uses external credit ratings to determine the risk weightings to be applied to rated counterparties and groups non-rated counterparties into broad categories and applies standardised risk weightings to these categories. The foundation IRB approach allows banks to calculate their credit risk regulatory capital requirement based on their own internal assessment of the probability that the counterparty will default. The advanced IRB approach allows banks to use their own internal assessments of the probability of default, the exposure at default and the loss suffered in the event of default.

The Basel II framework also introduces a capital requirement for operational risk, i.e. the risk of losses resulting from operational failures such as inadequate or failed internal processes, human behaviour and systems or from external events. As for credit risk, Pillar 1 provides three approaches (of increasing sophistication) to the calculation of the regulatory capital requirement for operational risk. The basic indicator approach uses a simple percentage (15%) of gross revenues to determine the capital requirement for operational risk. The standardised approach divides a bank's activities into eight business lines and uses one of three different percentages (12%, 15% or 18%) for the gross revenues of each of these business lines to determine the capital requirement. The advanced measurement approach uses the risk measures generated by the bank's own internal operational risk measurement system to determine the operational risk regulatory capital requirement.

The range of options offered by Basel II for determining the capital requirements for credit risk and operational risk allow banks and supervisors to select the approaches that are most appropriate to their operations and the local market conditions. To this end, CBK has decided that the banks in Kuwait will initially use the standardised approaches for calculating the regulatory capital requirements for both credit risk and operational risk.

Pillar 2 recognises the necessity of exercising effective supervisory review to ensure that banks have comprehensive risk management and control structures in place and are exercising sound judgement in evaluating the risk profiles of their activities and are setting aside adequate capital to cover these risks. Supervisors are required to intervene at an early stage to prevent capital falling below the minimum levels required to support the risk characteristics of the bank.

Pillar 3 leverages the ability of market discipline to motivate prudent management by enhancing the degree of transparency in banks' public reporting. It defines minimum public disclosure requirements to enable the market to understand a bank's activities and the risks inherent in those activities, and to assess the effectiveness of the controls that the bank has in place to manage its exposures. This will enable the market to recognise those banks that manage their risks prudently.

CBK is implementing all three pillars of the Basel II framework with effect from 31 December 2005 (much earlier than Basel II is being implemented in other jurisdictions).

Capital structure

The following table details the regulatory capital resources for Gulf Bank as at 31 December 2005 and 31 December 2004. The figures are not directly comparable since the 2004 data is on a Basel I basis while the 2005 data is on a Basel II basis. Although the Basel II definition of regulatory capital is unchanged from Basel I, the banks in Kuwait (including Gulf Bank) benefit under Basel II from CBK's decision to permit the minimum 2% regulatory general provision to be included in Tier 2 capital (subject to a maximum of 1.25% of credit risk-weighted assets). CBK did not permit this under Basel I.

(KD millions)	31 Dec 2005	31 Dec 2004
Composition of capital		
Tier 1 capital		
Paid-up share capital (incl. proposed bonus shares)	**94.8**	86.2
Reserves	**125.9**	113.9
Retained earnings	**69.5**	52.1
Less: Treasury shares	**(11.4)**	(20.9)
Total qualifying Tier 1 capital	**278.8**	231.3
Tier 2 capital		
Property revaluation reserve (45%)	**3.5**	3.4
Fair value reserve (45%)	**7.7**	11.5
General provisions (1.25% of credit RWAs)	**19.7**	-
Subordinated debt	**43.8**	44.2
Total qualifying Tier 2 capital	**74.7**	59.1
Total eligible regulatory capital	**353.5**	290.4

Regulatory capital increased by KD63.1 million (22%) in 2005, from KD290.4 million to KD353.5 million. Qualifying Tier 1 capital increased by KD47.5 million (21%) to KD278.8 million, reflecting the increase in paid-up share capital arising from the proposed 10% bonus share issue (KD8.6 million), the growth in reserves (KD12.0 million) and retained earnings (KD17.4 million), and the reduction in treasury shares held by the Bank (KD9.5 million).

Qualifying Tier 2 capital increased by KD15.6 million (26%) to KD74.7 million, since the inclusion of a portion of general provisions offset the year-on-year declines in subordinated debt and fair value reserves. Under Basel II, general provisions are included in Tier 2 capital subject to a maximum of 1.25% of credit risk-weighted assets, i.e. KD19.7 million at end 2005.

Tier 2 capital includes subordinated debt, comprising two 10 year US dollar subordinated loans obtained from financial institutions outside of Kuwait in 2004: USD50 million due June 2014 and USD100 million due December 2014. Both loans are repayable at maturity, with an option for early pre-payment (subject to prior CBK approval). Interest is variable and related to interbank offered rates ('LIBOR'), with the following terms: USD50 million (due June 2014) – LIBOR plus 1.25% for the first five years and LIBOR plus 1.75% thereafter, with a management fee of 1%; USD100 million (due December 2014) – LIBOR plus 1.4% for the first five years and LIBOR plus 1.9% thereafter, with a management fee of 1.25%. Exchange rate movements reduced the KD-equivalent value of the subordinated debt by KD0.4 million (1%) in 2005.

Tier 2 capital also includes 45% of the property revaluation reserve and this component increased by KD0.1 million (2%) in 2005. Tier 2 capital further includes 45% of the fair value reserve for 'available for sale' investment securities. The net decline of KD3.8 million (33%) in this component of Tier 2 capital, from KD11.5 million to KD7.7 million, reflected the investment disposals made during 2005 (principally the sale of the bulk of the Bank's shareholding in the Bahrain-based Bank of Bahrain and Kuwait), partly offset by the fair value increase in the Bank's remaining 'available for sale' investment securities.

Capital management

Gulf Bank's capital adequacy policy is to maintain a strong capital base to support the development and growth of the business. Current and future capital requirements are determined on the basis of loan growth expectations for each business group, expected growth in off-balance-sheet facilities and trading (i.e. market risk) activities, future sources and uses of funds, and the Bank's future dividend policy. Attention is also paid to the capital levels of other banks in Kuwait and the region and the capital adequacy expectations and views of the international rating agencies. Capital is allocated to different business groups and stress testing is used to ensure that the Bank's internal capital targets are consistent with the risk profile of the Bank.

The Bank seeks to maintain a prudent balance between the different components of its capital, particularly the relative mix of Tier 1 and Tier 2 capital. It also recognises the impact on shareholder returns of the level of capital employed and therefore seeks to maintain a prudent balance between the advantages and flexibility afforded by a strong capital position and the higher returns on equity made possible by greater leverage. In the current environment, the Bank aims to maintain a minimum total capital adequacy ratio of around 15% and a minimum Tier 1 ratio of around 14%.

The following table details the risk-weighted assets, regulatory capital requirements and regulatory capital ratios for Gulf Bank as at 31 December 2005. The figures are based on the Basel II standardised approach for credit/operational risk. Under the standardised approach, credit risk exposures are assigned to one of twelve standard portfolios: cash items; claims on sovereigns; claims on international organisations; claims on public sector entities; claims on multilateral development banks; claims on banks; claims on corporates; regulatory retail exposures; qualifying residential housing loans; past due exposures; other assets; and securitised exposures. Gulf Bank's credit risk exposures are assigned to eight of the twelve standard portfolios.

(KD millions)	**31 Dec 2005**
Risk-weighted assets	
Credit risk-weighted assets	**1,579.2**
Less: excess general provisions	**(36.5)**
Net credit risk-weighted exposure	**1,542.7**
Market risk-weighted assets	**11.7**
Operational risk-weighted exposure	**113.7**
Total risk-weighted exposure	**1,668.1**

(KD millions)	31 Dec 2005
Capital requirements	
Credit risk	
Cash items	-
Claims on sovereigns	**7.0**
Claims on public sector entities	**0.1**
Claims on banks	**13.7**
Claims on corporates	**89.7**
Regulatory retail exposures	**44.5**
Past due exposures	**2.3**
Other assets	**32.2**
Credit risk capital requirement	**189.5**
Less: excess general provisions (12%)	**(4.4)**
Net credit risk capital requirement	**185.1**
Market risk	
Interest rate position risk	**0.1**
Foreign exchange risk	**1.3**
Capital requirement for market risk	**1.4**
Capital requirement for operational risk	**13.7**
Total capital requirement	**200.2**
Capital adequacy ratios *(Per cent)*	
Tier 1 ratio	**16.72%**
Total capital adequacy ratio	**21.19%**

Basel II has a major beneficial impact on Gulf Bank's capital adequacy since it reduces the amount of credit risk-weighted assets (as well as increasing the amount of Tier 2 capital, as discussed under 'capital structure' above). The calculation of credit risk-weighted assets under the standardised approach benefits from the lower (i.e. 75%) risk weighting applied to retail/SME exposures, and the use of credit risk mitigation techniques (collateral in the form of cash/securities, guarantees and netting) to reduce the credit exposure to a counterparty. CBK also permits excess general provisions (i.e. the portion not included in Tier 2 capital) to be deducted from credit risk-weighted assets.

Total risk-weighted exposure at 31 December 2005 was KD1,668.1 million, requiring regulatory capital (at 12%) of KD200.2 million. The capital requirement was substantially lower than Gulf Bank's available regulatory capital (KD353.5 million) and the capital adequacy ratios were consequently well above the CBK minimum total ratio of 12.0%. The 31 December 2005 total capital adequacy ratio of 21.19% and the Tier 1 ratio of 16.72% leave the Bank strongly capitalised to support the continued expansion of its business activities in 2006. The capital adequacy ratios are well above the equivalent 31 December 2004 Basel I ratios: total ratio of 17.41% and Tier 1 ratio of 13.87%.

RISK MANAGEMENT

Risk management control overview

All banking activities involve the analysis, evaluation, acceptance and management of some degree of risk. The most important types of risk are credit risk, liquidity risk, market risk and operational risk. Market risk includes foreign exchange, interest rate and equity price risks.

Gulf Bank has a strong and prudent risk management culture. The identification and management of risk is a high priority and is integral to the execution of the Bank's activities. Gulf Bank's risk management policies are designed to identify and analyse risks, set appropriate risk limits and controls and monitor the risks and limits. The risk management policies and procedures are constantly reviewed and, where necessary, modified and enhanced to reflect changes in markets and products. Effective risk management relies on individual responsibility and collective oversight. Responsibility for risk resides at all levels of management, from the Board of Directors downwards, and each business manager is accountable for managing the risks in their own area, assisted where appropriate by risk specialists.

The two principal bodies responsible for managing and overseeing risk within Gulf Bank are the Risk Management function and the Asset and Liability Management Committee ('ALCO'). The internal audit function and the Audit Committee also play a key role, particularly in terms of monitoring the adherence to policies and procedures and reviewing the effectiveness of the Bank's internal control systems.

In accordance with CBK requirements, the Risk Management function reports directly to the Chief General Manager and Chief Executive Officer. The Risk Management team includes dedicated specialists for credit risk, market risk, liquidity risk and operational risk. They provide specialist guidance to the business areas and ensure that business activities fall within the Bank's agreed risk tolerances and strategies. The Bank is also in the process of establishing a Risk Management Committee, chaired by the Chief General Manager and Chief Executive Officer. This Committee will be responsible for reviewing the Bank's risk management policy and methodology, assessing the risk reward profile of the Bank, taking appropriate action to mitigate risks and updating the Board on the major risks run by the Bank.

ALCO is responsible for managing the asset/liability structure and funding strategy of Gulf Bank, based on a thorough review of domestic and international financial market conditions, interest rate and foreign exchange forecasts and the Bank's internal risk guidelines. ALCO meets monthly to monitor and review all aspects of the Bank's fundamental liquidity profile and key financial strategic exposures; adherence to internal and statutory ratio requirements; capital management (including internal capital allocation); asset and liability structure and balance sheet risk management; risk concentrations; transfer pricing and internal funds transfer; and the control of trading risk limits.

Credit risk

Credit risk is the risk that financial loss arises from the failure of a customer or counterparty to meet its obligations under a contract. It arises principally from lending, trade finance and treasury activities.

The Bank has comprehensive policies and procedures to control and monitor all such risks. Credit risk is minimised by monitoring credit exposures, limiting transactions with individual counterparties and continually assessing collateral coverage/ quality and the creditworthiness of counterparties. Individual customer, industry segment and cross-border limits are used to diversify lending and avoid undue concentrations. Credit exposure relating to trading activities is controlled by the use of strict counterparty limits, master netting agreements and collateral arrangements (where appropriate), and by limiting the duration of exposures.

Gulf Bank has four credit committees: the Executive Credit Committee ('ECC'), the Management Sub-Committee ('MSC'), the Retail Credit Committee ('RCC') and the Classification and Provisions Committee ('CPC'). The Board of Directors has delegated all authority for credit decisions to the ECC. The responsibilities of the ECC are to review and approve any amendments to the Bank's credit policies and risk strategies for submission to the Board of Directors for final approval and to review, approve, reject, modify or conditionally approve credit proposals in excess of the delegated authority of the MSC and in compliance with the credit policies of the Bank.

An independent credit control unit, reporting to the Head of Risk Management and Deputy General Manager, Credit Control, is responsible for providing high-level centralised management of credit risk. The responsibilities of this team include: formulating credit policies and monitoring adherence to credit policies and procedures; establishing and maintaining large credit exposure policies covering the maximum exposure to individual customers, customer groups and other risk concentrations; undertaking independent and objective 'pre-fact' reviews to assess the credit risk for both new facilities and renewals; controlling exposures to banks and other financial institutions; controlling cross-border exposures; controlling exposures to specific industry groups; maintaining and developing Gulf Bank's facility grading process in order to categorise exposures into meaningful segments; and preparing regular reports to senior management on areas such as customer/ industry risk concentrations, country limits and cross-border exposures and non-performing accounts and provisions.

The Bank has detailed credit approval guidelines for each of its individual retail loan products. The eligibility criteria vary according to the specific loan product, but include items such as minimum length of employment and minimum period of pre-existing banking relationship with Gulf Bank. Applicants must also provide a credit reference from their employer, specifying salary and length of service, and a commitment from the employer to pay their salary directly to their Gulf Bank account. In accordance with CBK regulations, the applicant's total monthly debt repayment to income ratio must not exceed 50% of their monthly income.

The RCC meets regularly and has the authority to approve, reject or modify credit applications from retail customers submitted to it within its delegated authority levels. An independent, centralised quality assurance function ensures the completeness and accuracy of the loan application documentation, undertakes credit and "black list" checks and monitors standing order commitments and other loan repayment obligations. In addition, all consumer credit applications are subject to a credit check by the industry-owned Credit Information Network ('Ci-Net') credit reference agency to assess the creditworthiness and indebtedness of the applicant.

Credit applications for corporate and international lending are reviewed by the MSC and typically include the following information: customer profile and summary of limits and amounts outstanding; pre-fact credit review prepared by the Bank's independent credit control unit; risk rating, credit analysis and customer profitability analysis; financial and cash flow analysis; details of purpose of loan, collateral, repayment source and details of guarantors, if applicable; and audited financial statements and/or personal net worth statements, as appropriate.

The MSC has the authority to approve, reject or modify credit applications submitted to it within its delegated authority levels. The MSC meets twice weekly. Applications that fall outside the delegated authority limits of the MSC are referred to the ECC, which meets weekly.

The Bank has legal lending limits, country limits and industry sector limits that must be adhered to when lending approval is being considered in respect of relevant applications or participations.

The industry sector limits are reviewed and approved on an annual basis by the MSC. The sector definitions used are: crude oil and gases; agriculture and fisheries; manufacturing; construction; trade and commerce; public utilities (including Government); other services; personal; real estate dealers and financial. The industry classification is normally based on the purpose of the loan and/or the borrower's line of business. Personal lending is further sub-divided into: securities; house purchase; and other personal (including consumer loans).

The Bank has a detailed credit policy defining its policy on acceptable country credit risk exposure, and evaluating and controlling cross border risk. The Bank uses a ranking system to differentiate between the quality of various sovereign risks. There are five categories of sovereign risk employed by the Bank ranging from 'Very Low Risk' countries (i.e. major OECD and AAA rated countries) to 'Very High Risk' countries (i.e. BB/B rated countries). The individual country limits are approved and kept under review by the ECC. This approval is based on the country analysis and assessment of business requirements undertaken by the Bank's International Banking Group and recommended by the MSC.

The International Banking Group reviews the Bank's overall cross border limits and exposure risk ratings at least every six months. The review focuses on the overall spread of cross border risk and recommendations to alter individual country risk limits are made where necessary.

Market risk

Market risk is the risk that movements in market rates, including foreign exchange rates, interest rates, credit spreads and equity and commodity prices will reduce a bank's income or the value of its portfolios. Gulf Bank is exposed to market risk through its trading activities, which are carried out both for customers and on a proprietary basis. The Treasury Group monitors and controls the Bank's market risk exposure using detailed and comprehensive daily management reports. Individual dealer position and trading limits are set for each portfolio, product and risk type to ensure that the Bank's market risk is managed within the overall CBK regulatory guidelines and the market risk profile set by ALCO. Interest rate, currency and liquidity mismatches are monitored constantly by the Treasury Group and regularly reviewed by ALCO. The degrees of mismatch permitted by ALCO are minimal.

The Bank's primary treasury business involves foreign exchange transactions on behalf of corporate customers. All customer transactions are undertaken on a strictly back-to-back basis. The Treasury Group also undertakes a limited amount of proprietary foreign exchange trading, mainly in the G7 currencies but also in the regional and other minor currencies. The risks are limited since the open foreign exchange positions are very small and in strict adherence with the open currency position limits set by CBK. Foreign exchange risk is controlled through strict intraday and overnight daily limits by currency for each dealer. Maximum deal limits for individual transactions in each currency are also set for each dealer. Foreign exchange transactions and interest rate derivatives are undertaken to hedge the Bank's underlying market risk exposures. The Bank does not trade fixed income or equities.

Interest rate trading is restricted to meeting the funding requirements of the Bank's domestic and international foreign currency assets and investing any surpluses. As a matter of general policy, these positions do not contain any material element of interest rate risk. A modest amount of proprietary money market trading and foreign and local currency interbank activity is undertaken. The mismatch risks are minimal and are again governed by strict CBK limits.

The Bank utilises a limited range of derivative instruments such as futures, swaps and options for the purpose of hedging its own positions and for hedging customer transactions. The Bank operates within the very strict CBK guidelines when entering into derivative transactions and foreign exchange options are only undertaken on a back-to-back basis. The Treasury Group also maintains a portfolio of Kuwait Government treasury bills and bonds and CBK bonds to meet the CBK statutory liquidity requirements and to manage surplus domestic currency liquidity.

The Kuwaiti Dinar is the Bank's functional currency. Almost all of the Bank's assets and liabilities are denominated in either KD or USD and are match funded in the same currency. As a result, there is limited structural cross currency foreign currency exposure, and currency risk management is confined to a small volume of proprietary trading positions. Most of the Bank's assets and liabilities are floating rate and reprice immediately, so reducing interest rate risk.

Liquidity risk

Liquidity risk arises in the general funding of a bank's activities. For example, a bank may be unable to fund its portfolio of assets at appropriate maturities and rates, or may find itself unable to liquidate a position in a timely manner at a reasonable price. Under the guidance of ALCO, the Treasury Group manages the liquidity and funding of Gulf Bank to ensure that sufficient funds are available to meet the Bank's known cash funding requirements and any unanticipated needs that may arise. At all times, the Bank holds what it considers to be adequate levels of liquidity to meet deposit withdrawals, repay borrowings and fund new loans, even under stressed conditions.

The liquidity and funding management process includes: projecting cash flows by major currency; monitoring balance sheet liquidity ratios against internal and regulatory requirements; maintaining a diverse range of funding sources with adequate back-up facilities; monitoring depositor concentration in order to avoid undue reliance on large individual depositors and ensure a satisfactory overall funding mix; and managing debt financing needs. The Bank maintains a diversified and stable funding base of core retail and corporate deposits, and the Treasury Group maintains liquidity and funding contingency plans to cope with potential difficulties that may arise from local or regional markets or geopolitical events.

Liquidity risk is further minimised by adherence to the strict CBK liquidity requirements, namely: maturity ladder mismatch limits for specific time periods: 10% for 7 days or less; 20% for 1 month or less; 30% for 3 months or less; 40% for 6 months or less; and the requirement to hold 20% of KD customer deposits in Kuwait Government treasury bills and bonds, current account/deposit balances with CBK and/or any other financial instruments issued by CBK.

Operational risk

Operational risk is the risk of loss arising through fraud, unauthorised activities, error, omission, inefficiency, systems failure and external events. This risk includes operational risk events such as IT problems, shortcomings in the organisational structure, lapses in internal controls, human error, fraud and external threats. It is inherent in every business organisation and covers a wide spectrum of issues. Gulf Bank manages operational risk through a controls-based environment in which processes are documented, authorisation is independent and transactions are reconciled and monitored. Managers throughout the Bank are required to establish a strong internal control structure to minimise the risk of operational and financial failure.

Operational risk is managed through the Risk Management function, in accordance with the Basel Committee guidelines and CBK instructions issued in 2003 regarding 'Sound Practices for the Management and Supervision of Operational Risk' and the CBK instructions issued in 1996 on 'Internal Control Systems'. Risk Management approves all of the Bank's policies and procedures, prior to gaining the approval of the Executive Committee and the Board of Directors. Internal Audit monitors compliance with policies and procedures through an independent programme of regular reviews and there is a comprehensive annual Internal Controls Review ('ICR') conducted by an external accounting firm. The Bank's Audit Committee reviews the internal audit and ICR reports and a copy of the ICR report is submitted to CBK. Risk mitigation, including insurance, is considered where it is cost-effective and the Bank maintains contingency facilities to support operations in the event of disasters.

Interest rate risk (banking book)

Future net interest income is affected by movements in interest rates and a principal part of the Bank's management of market risk in the banking (i.e. non-trading) book is to manage the sensitivity of the Bank's net interest income to changes in market interest rates. Several measures are used by ALCO to monitor and limit non-trading interest rate risk, including scenario analysis, interest rate gap analysis and market value limits. Treasury monitors and controls the Bank's interest rate gaps using the IPS Sendero asset and liability management ('ALM') software package. The potential profit and loss implications are regularly reviewed at ALCO to ensure that they are within the Bank's limited appetite for interest rate risk.

In reality, Gulf Bank has limited exposure to interest rate risk since most of the Bank's assets and liabilities are floating rate and tied either to the CBK discount rate, Kuwait interbank offered rates ('KIBOR') or USD LIBOR. Most deposits and loans tend to reprice simultaneously which renders interest rate hedging largely unnecessary.

Equity risk (banking book)

The Strategic Investments Group is responsible for managing the investment securities portfolio in the banking (i.e. non-trading) book. In accordance with IAS 39, the assets are classified as 'available for sale', i.e. assets acquired to be held for an indefinite period of time which may be sold in response to needs for liquidity or changes in interest rates, exchange rates or equity prices. The assets are initially recognised at fair value and the subsequent unrealised gains and losses arising from changes in fair value are taken to the fair value reserve in equity. When the asset is disposed of, the related accumulated fair value adjustments are transferred to the income statement as gains or losses.

The strategy for minimising and managing equity risk in the banking book is one of diversification. Limits are set for individual asset classes and geographical exposure. The overall aim is to minimise economic and political risk, and to minimise the correlation of the portfolio to market volatility by maintaining the majority of investments in asset classes with low correlation to the market. Similarly, limits are set for exposure to a single company, and for the maximum possible investment relative to the Bank's capital. CBK also sets a maximum limit for total non-GCC investment of 50% of the Bank's capital. Investment in government bonds is restricted to countries with investment grade ratings.

Credit risk exposures

Gulf Bank's internal grading process for credit facilities is designed to highlight exposures requiring greater management attention based on a higher probability of default and potential loss. Under the current grading framework, a uniform methodology for analysing credit risks is used to assign credit facilities to one of ten risk ratings: high quality – risk ratings 1 (GCC/OECD government) to 3 (good credit quality or bank guaranteed); medium quality – risk ratings 4 to 6; watchlist – risk rating 7; and low quality – risk ratings 8 to 10 (classified accounts and unacceptable risk). The risk rating methodology focuses on factors such as: key financial performance measures and ratios; the quality of information available (audited financial statements, business plans and financial projections, etc); the quality, structure and style of the borrower's management team; and the structure of the facilities and the degree/quality of the collateral coverage or other credit risk mitigation.

The Bank categorises watchlist and classified accounts, which are risk rated from 7 to 10, using the following classification policy:

Watchlist (risk rating 7): where loans are classified as watchlist, no loss of principal or interest is currently anticipated. The credit problem is assessed to be not serious, but justifies close monitoring. Possible concerns include: declining sales or profitability; changes of management, industry decline or adverse press comment; breach of loan covenants or frequent excesses.

Below standard (risk rating 8): below standard loans display serious credit problems, which the Bank assesses can be solved within a reasonable period of time. Interest and principal on such loans may or may not be current. Loans that have payments overdue for between 91 and 180 days are automatically classified as below standard.

Doubtful (risk rating 9): loans classified as doubtful indicate that the borrower is in poor financial condition and the loans have obvious loss potential. Loans that have payments overdue of between 181 and 365 days are automatically classified as doubtful.

Bad (risk rating 10): bad loans are loans in respect of which total loss is anticipated; these loans are fully provided for.

The classification is applied to the whole credit relationship and not just the specific transaction or account in trouble. Problem loans are classified in accordance with CBK regulations, and a quarterly report detailing the problem loans is submitted to CBK.

The Bank is currently developing and implementing a more sophisticated grading framework for credit facilities, using the Moody's KMV Risk Advisor system. This system uses sophisticated financial analytics and market data-based tools as core inputs to the assessment of counterparty risk and the risk of borrower default. It allows a more granular analysis of risk trends, based on default probability and loss estimates. Gulf Bank's intention is to develop as quickly as possible a minimum of 5 years of historic data for predicting the long-run average probability of default ('PD') for each new internal rating grade. Stress testing and back testing will be used to validate the predictive accuracy and consistency of the new credit risk assessment system. The Moody's KMV system will enable the Bank to migrate from the standardised approach to the more sophisticated foundation IRB approach at such a time as CBK allows the banks in Kuwait to adopt the IRB approach for determining the regulatory capital requirements for credit risk under Pillar 1 of the Basel II framework.

The quality of the loan portfolio and the adequacy of the impairment provisions for loans and advances are reviewed monthly by the Classification and Provisions Committee ('CPC'). Charges for new provisions or releases of existing provisions are calculated for each non-performing credit facility, based on the loan classification, the Bank's aggregate exposure to the customer (including any contingent liabilities) and the value (and enforceability) of any collateral. Two types of impairment provision are taken: specific and general. Specific provisions represent the quantification of actual and inherent losses from individually identified accounts. General provisions augment specific provisions and provide cover for loans which may be impaired at the balance sheet date but which will not be individually identified as such until some time in the future. Charges for impairment provisions are reflected in the Bank's income statement. Any increase in these provisions has the effect of reducing Gulf Bank's profit by a corresponding amount (while any decrease in provisions or release of provisions has the opposite effect). The provisions are deducted from the gross loans and advances in the balance sheet. Loans (and the related specific provisions) are written off (normally in full) when there is no realistic prospect of recovery of the outstanding amounts.

The Bank's financial statements are prepared in accordance with International Financial Reporting Standards ('IFRS') as adopted by the State of Kuwait for financial services institutions regulated by CBK. These regulations require adoption of all IFRS requirements except for the IAS 39 requirements relating to collective impairment provisions on credit facilities. The policy of the Bank for the calculation of specific impairment provisions complies in all material respects with the specific provision requirements of CBK. The categorisation of non-performing loans (risk rating 8 to 10) is as follows:

Category	Overdue (Days)	Specific provision
Below standard	**91-180**	**20%**
Doubtful	**181-365**	**50%**
Bad	**>1 year**	**100%**

The Bank also complies with IAS 39 and assesses the need for specific credit impairment provisions by calculating the net present value of the expected future cash flows for each loan. The specific provisions are calculated on the net amount outstanding after deducting the current market value of any eligible collateral.

The IAS 39 requirements regarding collective provisions have been replaced by CBK's requirement for a minimum general provision of 2% on all credit facilities to customers, net of certain restricted categories of collateral to which CBK instructions are applicable, that are not subject to specific provision. The assessment of general provision requirements is also based on judgement as to whether the current economic and credit conditions are such that the actual level of inherent loss in the current loan portfolio is likely to be greater than the amount currently provided for by the stock of available specific provisions.

The Bank exercises tight control over its loan portfolio to prevent loans going bad in the first place. The loan portfolio is monitored on a regular basis to ensure the early detection of potential credit problems. The relationship managers are responsible for the day-to-day monitoring of their accounts, but the independent credit control unit also undertake regular 'post fact' credit reviews after the loans have been disbursed. The credit control unit also submits regular surveillance reports to senior management regarding the following matters: collateral; insurance and guarantee details; values and expiry dates; documentation deficiencies; credit portfolio analysis by risk rating; and any incidents of non-compliance by borrowers with additional loan approval conditions imposed by the MSC or the ECC.

The CPC meets monthly to follow up and monitor the status of the Bank's non-performing loans. A detailed report showing all past dues and excesses over 10 days (not just classified accounts) is circulated to division heads and account officers on a monthly basis for their immediate follow up. This report is reviewed with the loan officers at the monthly CPC meeting to determine necessary corrective actions and/or provisioning requirements. CPC reviews and independently evaluates the quality of the credit facilities extended by the Bank and ensures that they are in accordance with the credit policy of the Bank and CBK requirements.

The Bank also has a separate, specialist remedial credit unit, reporting to the Head of Risk Management and Deputy General Manager, Credit Control, that is responsible for handling non-performing loans. The remedial unit provides customers with intensive management and control support in order to help them avoid default wherever possible, thereby ensuring maximum recoveries for the Bank. The remedial unit reports on the progress made on each non-performing loan account to CPC on a monthly basis, and provides a monthly progress report for each such account to the MSC. In addition, the Bank's legal department is fully involved throughout the remedial process, initiating appropriate legal action where necessary.

Within thirty days of an account being classified as a problem loan, a work out plan is presented to MSC. This thirty day period enables the relevant relationship manager to review the collateral and documentation and to develop a strategy to improve the quality of the risk or work out the credit with minimum loss to the Bank. This may involve a complete restructuring, legal action against the borrower or guarantors or the taking of additional collateral. Once the relationship manager has instituted the necessary actions to minimise the Bank's risk, classified accounts are transferred to the remedial credit unit.

Accounts that have been rescheduled continue to be classified as problem loans until at least three installments have been made. In accordance with CBK regulations, previously made provisions for rescheduled loans are not released immediately, but are gradually reduced in line with the rescheduled repayment programme. The Bank maintains a 20% provision until the problem loan is fully settled.

Under the Basel II standardised approach for credit risk, credit exposures are assigned to one of twelve standard portfolios: cash items; claims on sovereigns; claims on international organisations; claims on public sector entities; claims on multilateral development banks; claims on banks; claims on corporates; regulatory retail exposures; qualifying residential housing loans; past due exposures; other assets; and securitised exposures. Each standard portfolio has its own risk-weighting scale, based on certain standard characteristics of the exposure in question (such as the nature of the borrower and the repayment status). These standardised risk-weightings are applied to each portfolio, supported by the external credit assessments of approved external credit assessment institutions (where such ratings are available). Gulf Bank uses the ratings assigned by Standard & Poor's, Moody's Investors Service and Fitch Ratings for this purpose. The mid-point rating is used in those instances when the counterparty rating differs among the various external credit assessment institutions.

Off-balance-sheet items under the standardised approach are converted into credit exposure equivalent amounts through the use of credit conversion factors (such as 20% for trade-related contingencies such as documentary letters of credit collateralised by the underlying shipments). The credit equivalent amount is then multiplied by the applicable risk weighting of the original obligor (in the same way as for on-balance-sheet exposures), to arrive at the risk-weighted amount for the exposure. A different treatment, based on mark-to-market replacement costs and add-on factors, is used for derivative contracts.

Credit exposures may be reduced by the use of approved credit risk mitigation techniques (see the following discussion of 'credit risk mitigation' below).

The summary of Gulf Bank's gross credit risk exposure (before credit risk mitigation) in 2005 and 2004 is shown below. The unfunded (i.e. off-balance-sheet) amounts represent the gross credit risk exposure before the credit conversion factor ('CCF') adjustments, since the gross amounts reflect the Bank's ultimate credit risk in the event of default by the counterparties.

(KD thousands)	**2005**	2004
Year-end gross exposure		
Funded gross credit risk exposure	**2,642,082**	2,304,634
Unfunded gross credit risk exposure	**1,126,554**	770,364
Total year-end gross credit risk exposure	**3,768,636**	3,074,998
Full year average gross exposure		
Funded gross credit risk exposure	**2,395,840**	
Unfunded gross credit risk exposure	**949,733**	
Total average gross credit risk exposure	**3,345,573**	

Total year-end gross credit risk exposure increased by KD693.6 million (23%), from KD3.07 billion at 31 December 2004 to KD3.77 billion at 31 December 2005. Funded (i.e. on-balance-sheet) exposure grew by KD337.4 million (15%), from KD2.30 billion to KD2.64 billion. Unfunded (i.e. off-balance-sheet) exposure grew by KD356.2 million (46%), from KD770.4 million to KD1,126.6 million: guarantees increased by KD178.9 million (39%) and letters of credit increased by KD170.5 million (88%). The unfunded exposures comprise contingent liabilities and commitments (2005: KD1.04 billion; 2004: KD0.69 billion); and credit default swaps (2005: KD83.2 million; 2004: KD76.6 million). Note 28 in the Financial Statements gives the breakdown of the contingent liabilities and commitments between guarantees, letters of credit and irrevocable commitments to extend credit.

Average gross credit risk exposure in 2005 was KD3.35 billion: funded exposure of KD2.40 billion and unfunded exposure of KD949.7 million. The full year average amounts are calculated using a 13-point average of the month end figures from 31 December 2004 to 31 December 2005 inclusive.

The geographical distribution of the total gross credit risk exposure, broken down by standard credit risk portfolio and split between funded and unfunded facilities, as at 31 December 2005 and 31 December 2004 is shown below. The geographical distribution is based on the primary purpose of the credit facilities. The Bank's credit risk exposures are assigned to eight of the twelve standard portfolios: cash items; claims on sovereigns; claims on public sector entities ('PSEs'); claims on banks; claims on corporates; regulatory retail exposures; past due exposures; and other assets.

Total gross credit risk exposure as at 31 December 2005

(KD thousands)	**Kuwait**	**Other Middle East**	**Western Europe**	**USA & Canada**	**Asia Pacific**	**Rest of World**	**Total gross exposure**
Cash items	**17,348**	**-**	**-**	**-**	**-**	**-**	**17,348**
Claims on sovereigns	**581,484**	**-**	**-**	**-**	**43,800**	**14,600**	**639,884**
Claims on PSEs	**-**	**1,773**	**-**	**-**	**-**	**-**	**1,773**
Claims on banks	**65,848**	**142,616**	**77,008**	**21,710**	**120,990**	**563**	**428,735**
Claims on corporates	**1,580,907**	**202,450**	**8,477**	**18,281**	**3,009**	**22,232**	**1,835,356**
Retail exposures	**538,496**	**-**	**-**	**-**	**-**	**-**	**538,496**
Past due exposures	**19,655**	**-**	**-**	**-**	**-**	**-**	**19,655**
Other assets	**230,336**	**157**	**5,497**	**17,375**	**13,911**	**20,113**	**287,389**
	3,034,074	**346,996**	**90,982**	**57,366**	**181,710**	**57,508**	**3,768,636**
Percentage of gross exposure by geographical region	**80.5%**	**9.2%**	**2.4%**	**1.5%**	**4.9%**	**1.5%**	**100.0%**

Total gross credit risk exposure as at 31 December 2004

(KD thousands)	Kuwait	Other Middle East	Western Europe	USA & Canada	Asia Pacific	Rest of World	Total gross exposure
Cash items	16,397	-	-	-	-	-	16,397
Claims on sovereigns	515,993	12,111	-	-	29,470	14,735	572,309
Claims on PSEs	-	9,339	-	-	-	-	9,339
Claims on banks	174,501	75,532	71,550	5,250	59,562	2,570	388,965
Claims on corporates	1,280,871	74,590	44,826	37,437	500	14,646	1,452,870
Retail exposures	424,577	-	-	-	-	-	424,577
Past due exposures	20,348	-	-	-	-	-	20,348
Other assets	148,556	15,701	7,833	3,471	-	14,632	190,193
	2,581,243	187,273	124,209	46,158	89,532	46,583	3,074,998
Percentage of gross exposure by geographical region	84.0%	6.1%	4.0%	1.5%	2.9%	1.5%	100.0%

Funded (on-balance-sheet) credit facilities as at 31 December 2005

(KD thousands)	**Kuwait**	**Other Middle East**	**Western Europe**	**USA & Canada**	**Asia Pacific**	**Rest of World**	**Total gross exposure**
Cash items	**17,348**	**-**	**-**	**-**	**-**	**-**	**17,348**
Claims on sovereigns	**581,484**	**-**	**-**	**-**	**-**	**-**	**581,484**
Claims on PSEs	**-**	**1,773**	**-**	**-**	**-**	**-**	**1,773**
Claims on banks	**56,379**	**119,156**	**63,815**	**18,345**	**28,056**	**3**	**285,754**
Claims on corporates	**886,719**	**32,781**	**1,460**	**602**	**2,294**	**22,232**	**946,088**
Retail exposures	**524,776**	**-**	**-**	**-**	**-**	**-**	**524,776**
Past due exposures	**18,829**	**-**	**-**	**-**	**-**	**-**	**18,829**
Other assets	**208,977**	**157**	**5,497**	**17,375**	**13,911**	**20,113**	**266,030**
	2,294,512	**153,867**	**70,772**	**36,322**	**44,261**	**42,348**	**2,642,082**
Percentage of gross exposure by geographical region	**86.8%**	**5.8%**	**2.7%**	**1.4%**	**1.7%**	**1.6%**	**100.0%**

Funded (on-balance-sheet) credit facilities as at 31 December 2004

(KD thousands)	Kuwait	Other Middle East	Western Europe	USA & Canada	Asia Pacific	Rest of World	Total gross exposure
Cash items	16,397	-	-	-	-	-	16,397
Claims on sovereigns	515,993	12,111	-	-	-	-	528,104
Claims on PSEs	-	6,955	-	-	-	-	6,955
Claims on banks	167,819	57,088	50,836	4,130	20,477	2,536	302,886
Claims on corporates	772,980	16,548	31,827	-	-	14,646	836,001
Retail exposures	413,539	-	-	-	-	-	413,539
Past due exposures	19,210	-	-	-	-	-	19,210
Other assets	139,905	15,701	7,833	3,471	-	14,632	181,542
	2,045,843	108,403	90,496	7,601	20,477	31,814	2,304,634
Percentage of gross exposure by geographical region	88.8%	4.7%	3.9%	0.3%	0.9%	1.4%	100.0%

Unfunded (off-balance-sheet) credit facilities as at 31 December 2005

(KD thousands)	**Kuwait**	**Other Middle East**	**Western Europe**	**USA & Canada**	**Asia Pacific**	**Rest of World**	**Total gross exposure**
Claims on sovereigns	**-**	**-**	**-**	**-**	**43,800**	**14,600**	**58,400**
Claims on banks	**9,469**	**23,460**	**13,193**	**3,365**	**92,934**	**560**	**142,981**
Claims on corporates	**694,188**	**169,669**	**7,017**	**17,679**	**715**	**-**	**889,268**
Retail exposures	**13,720**	**-**	**-**	**-**	**-**	**-**	**13,720**
Past due exposures	**826**	**-**	**-**	**-**	**-**	**-**	**826**
Other assets	**21,359**	**-**	**-**	**-**	**-**	**-**	**21,359**
	739,562	**193,129**	**20,210**	**21,044**	**137,449**	**15,160**	**1,126,554**
Percentage of gross exposure by geographical region	**65.7%**	**17.1%**	**1.8%**	**1.8%**	**12.2%**	**1.4%**	**100.0%**

Unfunded (off-balance-sheet) credit facilities as at 31 December 2004

(KD thousands)	Kuwait	Other Middle East	Western Europe	USA & Canada	Asia Pacific	Rest of World	Total gross exposure
Claims on sovereigns	-	-	-	-	29,470	14,735	44,205
Claims on PSEs	-	2,384	-	-	-	-	2,384
Claims on banks	6,682	18,444	20,714	1,120	39,085	34	86,079
Claims on corporates	507,891	58,042	12,999	37,437	500	-	616,869
Retail exposures	11,038	-	-	-	-	-	11,038
Past due exposures	1,138	-	-	-	-	-	1,138
Other assets	8,651	-	-	-	-	-	8,651
	535,400	78,870	33,713	38,557	69,055	14,769	770,364
Percentage of gross exposure by geographical region	69.5%	10.2%	4.4%	5.0%	9.0%	1.9%	100.0%

The bulk of the Bank's credit exposure is in Kuwait: KD3.03 billion (80.5% of total gross credit exposure) at 31 December 2005, compared with KD2.58 billion (84.0% of total gross credit exposure) at 31 December 2004. The credit exposure mix by standard portfolio remained broadly unchanged in 2005, being mainly concentrated in claims on corporates: 48.7% of total gross exposure at 31 December 2005 (2004: 47.2%); retail exposures: 14.3% of gross exposure at 31 December 2005 (2004: 13.8%); and claims on banks: 11.4% of gross exposure at 31 December 2005 (2004: 12.6%). The significant exposure in Kuwait against claims on sovereigns (KD581.5 million at end 2005) reflects the Bank's holdings of Kuwait Government treasury bills and bonds and CBK bonds, and current account/ deposit balances with CBK.

The average gross credit risk exposure for 2005, broken down by geographical region and standard credit risk portfolio, and split between funded and unfunded exposure is shown below.

Total gross credit risk exposure (2005 Average)

(KD thousands)	**Kuwait**	**Other Middle East**	**Western Europe**	**USA & Canada**	**Asia Pacific**	**Rest of World**	**Total gross exposure**
Cash items	**17,278**	**-**	**-**	**-**	**-**	**-**	**17,278**
Claims on sovereigns	**515,787**	**-**	**-**	**-**	**33,800**	**14,600**	**564,187**
Claims on PSEs	**-**	**3,634**	**-**	**-**	**-**	**-**	**3,634**
Claims on banks	**67,426**	**100,130**	**121,676**	**6,981**	**113,143**	**1,635**	**410,991**
Claims on corporates	**1,436,252**	**107,512**	**25,551**	**27,162**	**3,705**	**8,679**	**1,608,861**
Retail exposures	**457,928**	**120**	**834**	**-**	**217**	**-**	**459,099**
Past due exposures	**31,494**	**3,625**	**19**	**-**	**-**	**-**	**35,138**
Other assets	**180,483**	**15,147**	**4,869**	**15,874**	**11,589**	**18,423**	**246,385**
	2,706,648	**230,168**	**152,949**	**50,017**	**162,454**	**43,337**	**3,345,573**
Percentage of gross exposure by geographical region	**80.9%**	**6.9%**	**4.6%**	**1.5%**	**4.9%**	**1.2%**	**100.0%**

Funded (on-balance-sheet) credit facilities (2005 Average)

(KD thousands)	Kuwait	Other Middle East	Western Europe	USA & Canada	Asia Pacific	Rest of World	Total gross exposure
Cash items	17,278	-	-	-	-	-	17,278
Claims on sovereigns	515,787	-	-	-	-	-	515,787
Claims on PSEs	-	3,202	-	-	-	-	3,202
Claims on banks	61,527	80,937	102,829	5,010	26,569	1,457	278,329
Claims on corporates	829,399	21,586	12,812	46	2,503	8,679	875,025
Retail exposures	444,249	30	-	-	217	-	444,496
Past due exposures	30,546	3,625	19	-	-	-	34,190
Other assets	161,631	15,147	4,869	15,874	11,589	18,423	227,533
	2,060,417	124,527	120,529	20,930	40,878	28,559	2,395,840
Percentage of gross exposure by geographical region	86.0%	5.2%	5.0%	0.9%	1.7%	1.2%	100.0%

Unfunded (off-balance-sheet) credit facilities (2005 Average)

(KD thousands)	Kuwait	Other Middle East	Western Europe	USA & Canada	Asia Pacific	Rest of World	Total gross exposure
Claims on sovereigns	-	-	-	-	33,800	14,600	48,400
Claims on PSEs	-	432	-	-	-	-	432
Claims on banks	5,899	19,193	18,847	1,971	86,574	178	132,662
Claims on corporates	606,853	85,926	12,739	27,116	1,202	-	733,836
Retail exposures	13,679	90	834	-	-	-	14,603
Past due exposures	948	-	-	-	-	-	948
Other assets	18,852	-	-	-	-	-	18,852
	646,231	105,641	32,420	29,087	121,576	14,778	949,733
Percentage of gross exposure by geographical region	68.0%	11.1%	3.4%	3.1%	12.8%	1.6%	100.0%

The 2005 full year average figures show the same broad distribution as the year-end figures. The bulk of the Bank's credit exposure is in Kuwait: KD2.71 billion (80.9% of total gross credit exposure), comprising funded (on-balance-sheet) facilities of KD2.06 billion (86.0% of total funded exposure) and unfunded (off-balance-sheet) facilities of KD646.2 million (68.0% of total unfunded exposure). The 2005 average mix by standard portfolio was similarly concentrated in claims on corporates (48.1%); retail exposures (13.7%); and claims on banks (12.3%).

The industry segment split of the gross credit risk exposure, broken down by standard credit risk portfolio and split between funded and unfunded facilities, as at 31 December 2005 and 31 December 2004 is shown on the next page.

Total gross credit risk exposure as at 31 December 2005

(KD thousands)	Personal	Financial	Trade & commerce	Crude oil & gas	Const-ruction	Manu-facturing	Real estate	Other	Total gross exposure
Cash items	-	-	-	-	-	-	-	17,348	17,348
Claims on sovereigns	-	-	-	-	-	-	-	639,884	639,884
Claims on PSEs	-	-	-	515	-	-	-	1,258	1,773
Claims on banks	-	428,735	-	-	-	-	-	-	428,735
Claims on corporates	101,705	130,477	387,987	14,682	484,208	284,415	197,402	234,480	1,835,356
Retail exposures	514,433	443	6,516	72	6,273	1,180	4,065	5,514	538,496
Past due exposures	288	4,251	9,693	-	1,211	697	3,144	371	19,655
Other assets	14,304	5,230	16,514	-	7,378	1,299	73,584	169,080	287,389
	630,730	569,136	420,710	15,269	499,070	287,591	278,195	1,067,935	3,768,636
Percentage of gross exposure by industry segment	16.7%	15.1%	11.2%	0.4%	13.2%	7.6%	7.4%	28.4%	100.0%

Total gross credit risk exposure as at 31 December 2004

(KD thousands)	Personal	Financial	Trade & commerce	Crude oil & gas	Const-ruction	Manu-facturing	Real estate	Other	Total gross exposure
Cash items	-	-	-	-	-	-	-	16,397	16,397
Claims on sovereigns	-	-	-	-	-	-	-	572,309	572,309
Claims on PSEs	-	-	-	2,600	-	-	-	6,739	9,339
Claims on banks	-	388,965	-	-	-	-	-	-	388,965
Claims on corporates	76,584	128,755	311,127	24,621	381,885	134,117	213,168	182,613	1,452,870
Retail exposures	398,062	33	6,817	69	5,254	1,472	2,617	10,253	424,577
Past due exposures	7,885	3,309	5,699	-	205	500	2,501	249	20,348
Other assets	856	11,331	19,600	-	1,866	2,590	62,155	91,795	190,193
	483,387	532,393	343,243	27,290	389,210	138,679	280,441	880,355	3,074,998
Percentage of gross exposure by industry segment	15.7%	17.3%	11.2%	0.9%	12.7%	4.5%	9.1%	28.6%	100.0%

Funded (on-balance-sheet) credit facilities as at 31 December 2005

(KD thousands)	Personal	Financial	Trade & commerce	Crude oil & gas	Const-ruction	Manu-facturing	Real estate	Other	Total gross exposure
Cash items	-	-	-	-	-	-	-	17,348	17,348
Claims on sovereigns	-	-	-	-	-	-	-	581,484	581,484
Claims on PSEs	-	-	-	515	-	-	-	1,258	1,773
Claims on banks	-	285,754	-	-	-	-	-	-	285,754
Claims on corporates	67,286	105,129	222,478	8,356	218,837	52,343	181,790	89,869	946,088
Retail exposures	513,101	443	4,317	72	368	637	4,051	1,787	524,776
Past due exposures	288	4,251	9,692	-	594	697	3,144	163	18,829
Other assets	9,625	5,029	10,991	-	5,175	863	72,438	161,909	266,030
	590,300	400,606	247,478	8,943	224,974	54,540	261,423	853,818	2,642,082
Percentage of gross exposure by industry segment	22.3%	15.2%	9.4%	0.3%	8.5%	2.1%	9.9%	32.3%	100.0%

Funded (on-balance-sheet) credit facilities as at 31 December 2004

(KD thousands)	Personal	Financial	Trade & commerce	Crude oil & gas	Const-ruction	Manu-facturing	Real estate	Other	Total gross exposure
Cash items	-	-	-	-	-	-	-	16,397	16,397
Claims on sovereigns	-	-	-	-	-	-	-	528,104	528,104
Claims on PSEs	-	-	-	2,600	-	-	-	4,355	6,955
Claims on banks	-	302,886	-	-	-	-	-	-	302,886
Claims on corporates	30,287	111,469	194,680	5,844	156,814	27,797	190,714	118,396	836,001
Retail exposures	398,052	33	5,175	69	1,012	972	2,617	5,609	413,539
Past due exposures	7,885	3,309	4,855	-	205	455	2,501	-	19,210
Other assets	856	10,861	15,416	-	175	1,543	61,059	91,632	181,542
	437,080	428,558	220,126	8,513	158,206	30,767	256,891	764,493	2,304,634
Percentage of gross exposure by industry segment	18.9%	18.6%	9.6%	0.4%	6.9%	1.3%	11.1%	33.2%	100.0%

Unfunded (off-balance-sheet) credit facilities as at 31 December 2005

(KD thousands)	**Personal**	**Financial**	**Trade & commerce**	**Crude oil & gas**	**Const-ruction**	**Manu-facturing**	**Real estate**	**Other**	**Total gross exposure**
Claims on sovereigns	-	-	-	-	-	-	-	**58,400**	**58,400**
Claims on banks	-	**142,981**	-	-	-	-	-	-	**142,981**
Claims on corporates	**34,419**	**25,348**	**165,509**	**6,326**	**265,371**	**232,072**	**15,612**	**144,611**	**889,268**
Retail exposures	**1,332**	-	**2,199**	-	**5,905**	**543**	**14**	**3,727**	**13,720**
Past due exposures	-	-	**1**	-	**617**	-	-	**208**	**826**
Other assets	**4,679**	**201**	**5,523**	-	**2,203**	**436**	**1,146**	**7,171**	**21,359**
	40,430	**168,530**	**173,232**	**6,326**	**274,096**	**233,051**	**16,772**	**214,117**	**1,126,554**
Percentage of gross exposure by industry segment	**3.6%**	**14.9%**	**15.4%**	**0.6%**	**24.3%**	**20.7%**	**1.5%**	**19.0%**	**100.0%**

Unfunded (off-balance-sheet) credit facilities as at 31 December 2004

(KD thousands)	Personal	Financial	Trade & commerce	Crude oil & gas	Const-ruction	Manu-facturing	Real estate	Other	Total gross exposure
Claims on sovereigns	-	-	-	-	-	-	-	44,205	44,205
Claims on PSEs	-	-	-	-	-	-	-	2,384	2,384
Claims on banks	-	86,079	-	-	-	-	-	-	86,079
Claims on corporates	46,297	17,286	116,447	18,777	225,071	106,320	22,454	64,217	616,869
Retail exposures	10	-	1,642	-	4,242	500	-	4,644	11,038
Past due exposures	-	-	844	-	-	45	-	249	1,138
Other assets	-	470	4,184	-	1,691	1,047	1,096	163	8,651
	46,307	103,835	123,117	18,777	231,004	107,912	23,550	115,862	770,364
Percentage of gross exposure by industry segment	6.0%	13.5%	16.0%	2.4%	30.0%	14.0%	3.1%	15.0%	100.0%

Credit facilities are well spread across the various industrial sectors. Funded (on-balance-sheet) facilities increased by KD337.4 million (15%) in 2005, from KD2.30 billion to KD2.64 billion. Personal facilities comprised 22.3% of total funded facilities at end 2005 (2004: 18.9%) and over 45% of the growth in 2005 related to personal (mainly retail) lending.

The residual maturity of the gross credit risk exposure, broken down by standard credit risk portfolio and split between funded and unfunded facilities, as at 31 December 2005 and 31 December 2004 is shown below.

Total gross credit risk exposure as at 31 December 2005

(KD thousands)	**Up to 1 month**	**1 to 3 months**	**3 to 6 months**	**6 to 12 months**	**1 to 3 years**	**Over 3 years**	**Total gross exposure**
Cash items	**17,348**	**-**	**-**	**-**	**-**	**-**	**17,348**
Claims on sovereigns	**185,185**	**59,350**	**87,955**	**292,794**	**-**	**14,600**	**639,884**
Claims on PSEs	**-**	**515**	**1,258**	**-**	**-**	**-**	**1,773**
Claims on banks	**222,963**	**55,886**	**23,206**	**17,293**	**78,851**	**30,536**	**428,735**
Claims on corporates	**267,426**	**354,337**	**535,163**	**337,303**	**244,771**	**96,356**	**1,835,356**
Retail exposures	**20,200**	**4,642**	**9,184**	**9,088**	**40,602**	**454,780**	**538,496**
Past due exposures	**13,129**	**1,115**	**545**	**251**	**1,318**	**3,297**	**19,655**
Other assets	**42,680**	**23,672**	**14,776**	**50,895**	**15,557**	**139,809**	**287,389**
	768,931	**499,517**	**672,087**	**707,624**	**381,099**	**739,378**	**3,768,636**
Percentage of gross exposure by residual contract maturity	**20.4%**	**13.3%**	**17.8%**	**18.8%**	**10.1%**	**19.6%**	**100.0%**

Total gross credit risk exposure as at 31 December 2004

(KD thousands)	Up to 1 month	1 to 3 months	3 to 6 months	6 to 12 months	1 to 3 years	Over 3 years	Total gross exposure
Cash items	16,397	-	-	-	-	-	16,397
Claims on sovereigns	69,967	71,940	156,688	217,398	44,205	12,111	572,309
Claims on PSEs	5,331	-	-	-	4,008	-	9,339
Claims on banks	193,168	31,819	54,953	49,090	35,866	24,069	388,965
Claims on corporates	311,655	248,436	372,436	265,732	174,183	80,428	1,452,870
Retail exposures	21,420	5,355	6,047	9,090	53,837	328,828	424,577
Past due exposures	12,386	2,936	314	425	1,034	3,253	20,348
Other assets	19,769	26,852	11,343	6,453	3,799	121,977	190,193
	650,093	387,338	601,781	548,188	316,932	570,666	3,074,998
Percentage of gross exposure by residual contract maturity	21.1%	12.6%	19.6%	17.8%	10.3%	18.6%	100.0%

Funded (on-balance-sheet) credit facilities as at 31 December 2005

(KD thousands)	**Up to 1 month**	**1 to 3 months**	**3 to 6 months**	**6 to 12 months**	**1 to 3 years**	**Over 3 years**	**Total gross exposure**
Cash items	**17,348**	**-**	**-**	**-**	**-**	**-**	**17,348**
Claims on sovereigns	**185,185**	**44,750**	**58,755**	**292,794**	**-**	**-**	**581,484**
Claims on PSEs	**-**	**515**	**1,258**	**-**	**-**	**-**	**1,773**
Claims on banks	**207,831**	**23,505**	**14,483**	**8,760**	**17,520**	**13,655**	**285,754**
Claims on corporates	**95,876**	**131,497**	**344,932**	**181,936**	**114,388**	**77,459**	**946,088**
Retail exposures	**18,086**	**2,609**	**5,159**	**7,192**	**37,082**	**454,648**	**524,776**
Past due exposures	**13,105**	**680**	**507**	**44**	**1,196**	**3,297**	**18,829**
Other assets	**37,974**	**20,146**	**11,702**	**43,651**	**13,901**	**138,656**	**266,030**
	575,405	**223,702**	**436,796**	**534,377**	**184,087**	**687,715**	**2,642,082**
Percentage of gross exposure by residual contract maturity	**21.8%**	**8.5%**	**16.5%**	**20.2%**	**7.0%**	**26.0%**	**100.0%**

Funded (on-balance-sheet) credit facilities as at 31 December 2004

(KD thousands)	Up to 1 month	1 to 3 months	3 to 6 months	6 to 12 months	1 to 3 years	Over 3 years	Total gross exposure
Cash items	16,397	-	-	-	-	-	16,397
Claims on sovereigns	69,967	71,940	156,688	217,398	-	12,111	528,104
Claims on PSEs	2,947	-	-	-	4,008	-	6,955
Claims on banks	178,055	25,412	45,891	27,943	18,094	7,491	302,886
Claims on corporates	191,684	120,181	283,269	97,508	79,854	63,505	836,001
Retail exposures	19,282	3,462	5,454	7,402	49,161	328,778	413,539
Past due exposures	12,234	2,455	249	127	892	3,253	19,210
Other assets	17,473	23,715	10,156	5,585	2,894	121,719	181,542
	508,039	247,165	501,707	355,963	154,903	536,857	2,304,634
Percentage of gross exposure by residual contract maturity	22.0%	10.7%	21.8%	15.4%	6.7%	23.4%	100.0%

Unfunded (off-balance-sheet) credit facilities as at 31 December 2005

(KD thousands)	**Up to 1 month**	**1 to 3 months**	**3 to 6 months**	**6 to 12 months**	**1 to 3 years**	**Over 3 years**	**Total gross exposure**
Claims on sovereigns	**-**	**14,600**	**29,200**	**-**	**-**	**14,600**	**58,400**
Claims on banks	**15,132**	**32,381**	**8,723**	**8,533**	**61,331**	**16,881**	**142,981**
Claims on corporates	**171,550**	**222,840**	**190,231**	**155,367**	**130,383**	**18,897**	**889,268**
Retail exposures	**2,114**	**2,033**	**4,025**	**1,896**	**3,520**	**132**	**13,720**
Past due exposures	**24**	**435**	**38**	**207**	**122**	**-**	**826**
Other assets	**4,706**	**3,526**	**3,074**	**7,244**	**1,656**	**1,153**	**21,359**
	193,526	**275,815**	**235,291**	**173,247**	**197,012**	**51,663**	**1,126,554**
Percentage of gross exposure by residual contract maturity	**17.2%**	**24.5%**	**20.9%**	**15.4%**	**17.5%**	**4.5%**	**100.0%**

Unfunded (off-balance-sheet) credit facilities as at 31 December 2004

(KD thousands)	Up to 1 month	1 to 3 months	3 to 6 months	6 to 12 months	1 to 3 years	Over 3 years	Total gross exposure
Claims on sovereigns	-	-	-	-	44,205	-	44,205
Claims on PSEs	2,384	-	-	-	-	-	2,384
Claims on banks	15,113	6,407	9,062	21,147	17,772	16,578	86,079
Claims on corporates	119,971	128,255	89,167	168,224	94,329	16,923	616,869
Retail exposures	2,138	1,893	593	1,688	4,676	50	11,038
Past due exposures	152	481	65	298	142	-	1,138
Other assets	2,296	3,137	1,187	868	905	258	8,651
	142,054	140,173	100,074	192,225	162,029	33,809	770,364
Percentage of gross exposure by residual contract maturity	18.4%	18.2%	13.0%	25.0%	21.0%	4.4%	100.0%

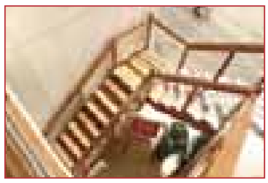
Funded (on-balance-sheet) credit facilities with a residual contract maturity in excess of 3 years increased in 2005, from KD536.9 million (23.4% of total exposure) at 31 December 2004 to KD687.7 million (26.0% of total exposure) at 31 December 2005. The increase reflected the strong growth in retail lending – retail loans have an average tenor of approximately 10 years.

The industry segment split of impaired loans (past due portion and balance outstanding) and the associated provisions (specific, general and total) as at 31 December 2005 and 31 December 2004 is shown below.

Impaired loans and provisions (by industry segment) as at 31 December 2005

	Impaired Loans (NPLs)		**Balance Sheet Provisions**			
(KD thousands)	**Past due Portion**	**Balance outstanding**	**Specific**	**General**	**Total**	**Specific provisions cover**
Personal	**288**	**6,696**	**4,759**	**11,342**	**16,101**	**71.1%**
Financial	**4,251**	**6,291**	**6,279**	**10,003**	**16,282**	**99.8%**
Trade & commerce	**10,270**	**14,026**	**580**	**7,872**	**8,452**	**4.1%**
Crude oil & gas	**-**	**417**	**417**	**247**	**664**	**100.0%**
Construction	**594**	**2,736**	**2,703**	**9,833**	**12,536**	**98.8%**
Manufacturing	**119**	**313**	**148**	**5,342**	**5,490**	**47.3%**
Real estate	**3,144**	**3,548**	**409**	**5,158**	**5,567**	**11.5%**
Government	**-**	**1,208**	**1,208**	**1,865**	**3,073**	**100.0%**
Other	**163**	**3,130**	**2,981**	**4,604**	**7,585**	**95.2%**
Total	**18,829**	**38,365**	**19,484**	**56,266**	**75,750**	**50.8%**



Impaired loans and provisions (by industry segment) as at 31 December 2004

(KD thousands)	Impaired Loans (NPLs) Past due portion	Impaired Loans (NPLs) Balance outstanding	Balance Sheet Provisions Specific	Balance Sheet Provisions General	Balance Sheet Provisions Total	Specific provisions cover
Personal	7,885	14,360	9,741	3,939	13,680	67.8%
Financial	3,309	6,329	3,021	9,451	12,472	47.7%
Trade & commerce	4,855	12,874	4,246	6,556	10,802	33.0%
Crude oil & gas	-	421	421	598	1,019	100.0%
Construction	205	2,137	2,094	7,154	9,248	98.0%
Manufacturing	455	928	367	2,330	2,697	39.5%
Real estate	2,501	2,726	108	5,009	5,076	4.0%
Government	-	1,415	1,415	1,281	2,696	100.0%
Other	-	4,011	4,011	3,668	7,720	100.0%
Total	19,210	45,201	25,424	39,986	65,410	56.2%

The industry segment split of the provision charges and write-offs in 2005 is shown below.

Provision charges and write-offs during 2005 (by industry segment)

(KD thousands)	Charge/(Release) for Impairment Provisions Specific charge	Charge/(Release) for Impairment Provisions General charge	Charge/(Release) for Impairment Provisions Total charge	Write-offs
Personal	2,219	7,407	9,626	8,029
Financial	3,469	552	4,021	-
Trade & commerce	(3,374)	1,312	(2,062)	288
Crude oil & gas	(4)	(351)	(355)	-
Construction	609	2,679	3,288	-
Manufacturing	(29)	3,012	2,983	190
Real estate	342	149	491	-
Government	(207)	584	377	-
Other	1,429	936	2,365	2,500
Total	4,454	16,280	20,734	11,007

Non-performing loans ('NPLs') declined by KD6.8 million (15%) in 2005, from KD45.2 million at 31 December 2004 to KD38.4 million at 31 December 2005. Personal NPLs fell by KD7.7 million (53%), from KD14.4 million at end 2004 (31.7% of total NPLs) to KD6.7 million (17.5% of total NPLs) at 31 December 2005. The net reduction in NPLs (total and personal) was mainly due to write-offs of KD11.0 million in 2005, mainly in personal (KD8.0 million) and other (KD2.5 million) credit facilities. Specific provisions cover declined from 56.2% of NPLs in 2004 to 50.8% of NPLs at 31 December 2005, since the loans written off were fully provided for; but total provisions cover (including general provisions), improved from 144.7% to 197.4%.

The total provisions charge in 2005 of KD20.7 million comprised specific provisions of KD4.4 million and general provisions of KD16.3 million. Provisions for personal credit facilities represented over 46% of the 2005 charge and comprised: specific provisions of KD2.2 million (approximately 50% of the total specific provision charge) and general provisions of KD7.4 million (over 45% of the total general provision charge). Lending to personal customers has increased substantially in recent years, due to the Bank's success in building on its strong retail banking franchise. This growth is reflected in the movements in personal credit facilities, personal NPLs and provisions (specific and general) for personal lending.

CBK require a minimum general provision of 2% on all credit facilities, net of certain restricted categories of collateral, that are not subject to specific provision. Further to the minimum 2% general provision, the Bank had an additional general provision of KD10.4 million at the end of 2005 (2004: KD4.6 million).

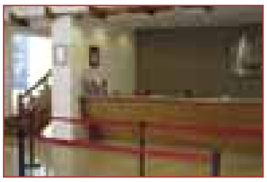
The geographical split of impaired (i.e. non-performing) loans and the associated provisions cover as at 31 December 2005 and 31 December 2004 is shown below.

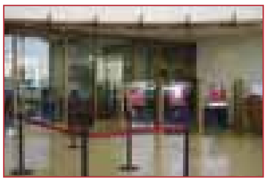
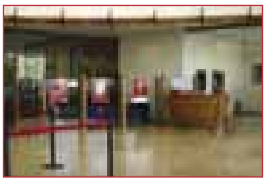
Impaired loans and provisions (by geographical region) as at 31 December 2005

	Impaired Loans (NPLs)		**Balance Sheet Provisions**			
(KD thousands)	**Past due portion**	**Balance outstanding**	**Specific**	**General**	**Total**	**Specific provisions cover**
Kuwait	**18,829**	**25,554**	**6,674**	**44,539**	**51,213**	**26.1%**
Other Middle East	**-**	**11,581**	**11,581**	**6,665**	**18,246**	**100.0%**
Western Europe	**-**	**22**	**21**	**1,786**	**1,807**	**95.5%**
USA & Canada	**-**	**-**	**-**	**452**	**452**	**-**
Asia Pacific	**-**	**-**	**-**	**2,392**	**2,392**	**-**
Rest of the World	**-**	**1,208**	**1,208**	**432**	**1,640**	**100.0%**
Total	**18,829**	**38,365**	**19,484**	**56,266**	**75,750**	**50.8%**

Impaired loans and provisions (by geographical region) as at 31 December 2004

	Impaired Loans (NPLs)		Balance Sheet Provisions			
(KD thousands)	Past due portion	Balance outstanding	Specific	General	Total	Specific provisions cover
Kuwait	19,210	33,783	12,331	30,375	42,706	36.5%
Other Middle East	-	9,980	11,655	4,472	16,127	116.8%
Western Europe	-	23	23	3,361	3,384	100.0%
USA & Canada	-	-	-	255	255	-
Asia Pacific	-	-	-	1,269	1,269	-
Rest of the World	-	1,415	1,415	254	1,669	100.0%
Total	19,210	45,201	25,424	39,986	65,410	56.2%



The geographical split of provision charges and write-offs in 2005 is shown below.

Provision charges and write-offs during 2005 (by geographical region)

(KD thousands)	Charge/(Release) for Impairment Provisions			
	Specific charge	General charge	Total charge	Write-offs
Kuwait	4,526	14,164	18,690	11.007
Other Middle East	137	2,193	2,330	-
Western Europe	(2)	(1,575)	(1,577)	-
USA & Canada	-	197	197	-
Asia Pacific	-	1,123	1,123	-
Rest of the World	(207)	178	(29)	-
Total	4,454	16,280	20,734	11,007

The bulk of the Bank's non-performing loans (66.7% of the total as at 31 December 2005), and the bulk of the provisions (67.6% of the total at end 2005) are concentrated in Kuwait, reflecting the geographical concentration of the Bank's credit facilities.

The movements in the provisions for loan impairment between 31 December 2004 and 31 December 2005 are shown below.

Provision movements during 2005

(KD thousands)	Charge/(Release) for Impairment Provisions		
	Specific charge	General charge	Total charge
At 1 January 2005			
Funded (on-balance-sheet)	25,405	29,961	55,366
Unfunded (off-balance-sheet)	19	10,025	10,044
Total at 1 January	25,424	39,986	65,410
Exchange adjustments	73	-	73
Recoveries	122	-	122
Amounts written off	(11,007)	-	(11,007)
Amounts to be ceded to CBK	(284)	-	(284)
Transfer to provision for 'assets sold'	702	-	702
Income statement charge/(release):			
Funded (on-balance-sheet)	4,458	11,570	16,028
Unfunded (off-balance-sheet)	(4)	4,710	4,706
Total income statement charge	4,454	16,280	20,734
At 31 December 2005	19,484	56,266	75,750

The total credit exposure before credit risk mitigation ('CRM') as at 31 December 2005, broken down by standard credit risk portfolio, is shown below.

Gross credit risk exposure before CRM as at 31 December 2005

	Gross Credit Exposure			Credit Exposure before CRM			
(KD thousands)	Funded	Unfunded	Total	Funded credit exposure	Unfunded credit after CCF	FX contracts after CCF	Total before CRM
Cash items	17,348	-	17,348	17,348	-	-	17,348
Claims on sovereigns	581,484	58,400	639,884	581,484	58,400	102	639,986
Claims on PSEs	1,773	-	1,773	1,773	-	-	1,773
Claims on banks	285,754	142,981	428,735	285,754	67,963	1,156	354,873
Claims on corporates	946,088	889,268	1,835,356	946,088	358,015	1,662	1,305,765
Retail exposures	524,776	13,720	538,496	524,776	6,716	-	531,492
Past due exposures	18,829	826	19,655	18,829	413	-	19,242
Other assets	266,030	21,359	287,389	266,030	11,480	-	277,510
Total	2,642,082	1,126,554	3,768,636	2,642,082	502,987	2,920	3,147,989

The gross credit risk exposure of KD3.77 billion at 31 December 2005 comprised funded (on-balance-sheet) credit facilities of KD2.64 billion and unfunded (off-balance-sheet) exposures of KD1.13 billion. The unfunded exposure comprised: contingent liabilities and commitments of KD1.04 billion (Note 28 in the Financial Statements gives the breakdown between guarantees, letters of credit and irrevocable commitments to extend credit); and credit default swaps of KD83.2 million.

The total credit exposure before CRM was KD3.15 billion at 31 December 2005, comprising: funded gross credit risk exposure of KD2.64 billion; unfunded off-balance-sheet credit facilities, after applying the relevant Basel II standardised approach credit conversation factors ('CCF'), of KD503.0 million; and foreign exchange contracts after CCF of KD2.9 million.

The exposure after CRM, as at 31 December 2005 is shown below. The resulting credit risk-weighted assets are further divided into rated and unrated exposures.

Credit risk exposure after CRM; risk-weighted assets ('RWAs') as at 31 December 2005

	Credit Exposure/CRM			Risk-Weighted Assets		
(KD thousands)	Exposure before CRM	CRM	Exposure after CRM	Rated	Unrated	Total
Cash items	17,348	-	17,348	-	-	-
Claims on sovereigns	639,986	-	639,986	-	58,400	58,400
Claims on PSEs	1,773	-	1,773	767	-	767
Claims on banks	354,873	27,795	327,078	114,547	63	114,610
Claims on corporates	1,305,765	558,594	747,171	-	747,171	747,171
Retail exposures	531,492	37,503	493,989	-	370,492	370,492
Past due exposures	19,242	-	19,242	-	19,158	19,158
Other assets	277,510	8,886	268,624	-	268,624	268,624
Total	3,147,989	632,778	2,515,211	115,314	1,463,908	1,579,222

Credit risk-weighted assets of KD1.58 billion at 31 December 2005 were mainly concentrated in claims on corporates: KD747.2 million (47.3% of credit RWAs); retail exposures: KD370.5 million (23.5% of credit RWAs); and claims on banks: KD114.6 million (7.3% of credit RWAs). The bulk of the credit facilities are unrated since very few corporate customers in Kuwait have external credit ratings from the three external credit assessment institutions approved by CBK, namely Standard & Poor's, Moody's Investors Service and Fitch Ratings. Rated credit risk-weighted assets comprised only KD115.3 million (7.3% of the total) and were mostly concentrated in claims on banks.

Credit risk mitigation

Under the Basel II standardised approach for credit risk, credit risk mitigation ('CRM') techniques are used to reduce the risk-weighted amount of credit risk exposures for capital adequacy purposes. CBK has instructed the banks in Kuwait to use the 'comprehensive approach' for CRM, whereby the gross credit exposure is effectively reduced by the value ascribed to the collateral. Three types of CRM technique are recognised by CBK: eligible financial collateral (such as cash deposits and equities listed on a recognised stock exchange); legally enforceable on-balance-sheet netting arrangements for loans and deposits; and unconditional, irrevocable guarantees.

Gulf Bank employs a range of policies and practices to reduce credit risk. The Bank seeks collateral coverage, the assignment of contract proceeds and other forms of protection to secure lending and minimise credit risks wherever possible. The Bank's borrowing agreements also include legally enforceable netting arrangements for loans and deposits enabling the Bank to consolidate the customer's various accounts with Gulf Bank and either transfer credit balances to cover any outstanding borrowings or freeze the credit balances until the customer settles their outstanding obligations to the Bank.

As at 31 December 2005, approximately 37% of the Bank's corporate credit facilities were secured by collateral, consisting primarily of: equities listed on the Kuwait Stock Exchange; real estate (land and buildings); fixed term deposits and cash balances with Gulf Bank that are blocked and legally pledged in the Bank's favour; and direct, explicit, irrevocable and unconditional bank guarantees. In certain cases, personal/corporate guarantees from high net worth individuals or companies are also used to help secure credit facilities. The personal/corporate guarantees and the real estate collateral do not constitute eligible CRM techniques for capital adequacy purposes under the Basel II standardised approach.

The Bank's credit procedures include very conservative minimum collateral coverage ratios, supported by strict top-up ratios. When the value of the collateral held in respect of a particular loan falls below the initial prescribed collateral coverage ratio and reaches the top up ratio threshold, the customer is required to provide additional collateral in order to restore the prescribed collateral coverage ratio. Real estate collateral is valued once a year by independent real estate valuers (the lowest of two valuations being taken) and quoted shares are valued daily using current stock exchange prices.

The liquidity of the collateral taken by the Bank has been significantly enhanced in recent years through the introduction of a portfolio scheme whereby the collateral (typically local shares or real estate) is held by an approved portfolio manager who is independent of the Bank. As part of the collateral management scheme, the customer provides a power of attorney authorising the Bank to liquidate the portfolio of collateral at the Bank's discretion in the event of any default in the payment of the covered loan. The Bank actively promotes the adoption of the portfolio scheme for new lending and loan renewals and an increasing share of the collateral taken by the Bank is held in the portfolio scheme. This enhances the security of repayment and the liquidity of the Bank's collateral. The portfolio managers provide portfolio valuations weekly.

The liquidity of the Bank's collateral has consequently improved over the last 5 years. The proportion of collateral held in portfolios has increased from 21% in 2001 (when the portfolio concept was introduced) to approximately 50% at 31 December 2005. The proportion of 'quick liquidity' collateral (i.e. fixed deposits, bank guarantees and shares) has similarly improved from 45.9% in 2000 to 66.6% in 2005.

Consumer loans are generally not secured, but the credit risk is minimised by the 'assignment of salary' condition that requires the customer's employer (normally a Government Ministry) to pay their salary directly to their Gulf Bank account. Collateral or security, normally in the form of a blocked customer deposit with Gulf Bank, the assignment of an employment 'End of Service Benefit' or a personal guarantee, is taken on the rare occasions when consumer loans are granted without an assignment of salary.

As discussed earlier under 'credit risk exposures', Gulf Bank's total credit exposure before CRM at 31 December 2005 was KD3.15 billion. Eligible CRM of KD632.8 million reduced this to net credit exposure after CRM of KD2.52 billion. The amount of CRM eligible financial collateral and eligible guarantees for each standard portfolio as at 31 December 2005 is shown below.

Credit risk mitigation (CRM) as at 31 December 2005

(KD thousands)	Total exposure before CRM	Eligible financial collateral	Eligible guarantees	Total CRM	Total exposure after CRM
Cash items	17,348	-	-	-	17,348
Claims on sovereigns	639,986	-	-	-	639,986
Claims on PSEs	1,773	-	-	-	1,773
Claims on banks	354,873	27,795	-	27,795	327,078
Claims on corporates	1,305,765	553,914	4,680	558,594	747,171
Retail exposures	531,492	37,303	200	37,503	493,989
Past due exposures	19,242	-	-	-	19,242
Other assets	277,510	8,886	-	8,886	268,624
Total	3,147,989	627,898	4,880	632,778	2,515,211

Most of the CRM (KD627.9 million, or 99.2% of the total) takes the form of eligible financial collateral, mainly equities listed on the Kuwait stock exchange and cash deposits. Most of this financial collateral is against claims on corporate customers. The gross credit exposure against corporate customers at 31 December 2005 of KD1.31 billion was reduced by KD558.6 million (42.8%) as a result of eligible CRM techniques (financial collateral and guarantees), to give a net corporate credit exposure after CRM of KD747.2 million. Gross retail exposures of KD531.5 million were reduced by total CRM of KD37.5 million (7.1%) to give a net retail exposure of KD494.0 million. Gross claims on banks of KD354.9 million were reduced by total CRM of KD27.8 million (7.8%) to give net bank credit exposure of KD327.1 million.

Trading portfolio

As defined in the Basel II guidelines, a trading book consists of positions in financial instruments and commodities held either with trading intent or in order to hedge other elements of the trading book.

The management of market risk in the trading portfolio is principally undertaken through strict risk limits, approved by senior management. Limits are specified for each dealer for maximum open currency positions and maximum losses. Adherence to these limits is strictly monitored and enforced by the Chief Dealer and the Treasurer.

All outstanding exposures are revalued daily on a mark-to-market basis. The independent Treasury financial control team measures the market risk exposures and monitors and reports these exposures against the prescribed limits on a daily basis. The reports detail all outstanding positions by currency and show the profit and loss impact by dealer and the overall Bank profitability. The reports are circulated to the dealers and reviewed by the Chief Dealer and the Treasurer.

The prime responsibility for the mark-to-market valuation and related price verification process rests with the Bank's central financial control team. They are totally independent of the risk-taking treasury front office and they determine the fair values included in the Bank's financial statements and ensure that the accounting policies and procedures governing mark-to-market valuation and validation are strictly adhered to.

Gulf Bank uses the standardised approach for determining the capital required for market risk. The Bank does not use trading value at risk ('VAR') or an internal models approach for estimating and monitoring market risk exposure since the Bank's trading portfolio and open foreign exchange positions are limited.

Under the standardised approach, the risks subject to capital charges for market risk include the following: interest rate position risk relating to instruments in the trading book; equity position risk relating to instruments in the trading book; foreign exchange risk throughout the bank; commodities risk throughout the bank; and options. The capital charges for interest rate related instruments and equities apply to the market value of the items in the Bank's trading book. The capital charges for foreign exchange risk and commodities risk apply to the Bank's total currency and commodity positions (i.e. trading book and banking book).

Total market risk-weighted exposures are determined by multiplying the market risk capital charge by 8.33 (i.e. the reciprocal of the minimum CBK capital adequacy ratio requirement of 12%) and adding the resulting figure to the sum of credit and operational risk-weighted assets to yield the total risk-weighted exposures which are then used to calculate the Bank's capital adequacy ratio.

The details of the market risk capital charge for Gulf Bank as at 31 December 2005 and 31 December 2004 are shown on the next page.

(KD thousands)	31 Dec 2005	31 Dec 2004
Interest rate position risk	129	-
Equity position risk	-	-
Foreign exchange risk	1,277	804
Commodities risk	-	-
Options	-	-
Total capital requirement for market risk	1,406	804
Market risk-weighted assets	11,715	6,697

The 31 December 2005 total market risk capital charge of KD1.41 million was equivalent to market risk-weighted assets of KD11.72 million. Market risk-weighted assets were KD5.02 million (75%) higher than 2004 but still reflected a very modest level of market risk.

Operational risk

Under the Basel II standardised approach for operational risk, a bank's activities are divided into eight business lines: corporate finance, trading and sales, retail banking, commercial banking, payment and settlement, agency services, asset management, and retail brokerage. Within each business line, gross income is a broad indicator that serves as a proxy for the scale of business operations and thus the likely scale of operational risk exposure within each of the business lines. The operational risk capital charge for each business line is therefore calculated by multiplying its gross income by a factor (denoted beta) assigned to that business line. The beta serves as a proxy for the industry-wide relationship between the operational risk loss experience for a given business line and the aggregate gross income for that business line. The total operational risk capital charge is calculated as the summation of the three-year average gross income multiplied by the beta factor across each of the business lines in each year. The beta factors set by the Basel Committee, and used by CBK in the implementation of the standardised approach to operational risk in Kuwait, are: 18% (corporate finance, trading and sales, and payment and settlement); 15% (commercial banking and agency services); and 12% (retail banking, asset management, and retail brokerage).

Total operational risk-weighted exposures are determined by multiplying the operational risk capital charge by 8.33 (i.e. the reciprocal of the minimum CBK capital adequacy ratio requirement of 12%) and adding the resulting figure to the sum of credit and market risk-weighted assets to yield the total risk-weighted exposures which are then used to calculate the Bank's capital adequacy ratio.

Gulf Bank's business activities are mapped into the following three business lines: trading and sales, commercial banking and retail banking. The Bank's internal funds transfer pricing methodology is used to allocate interest income and interest expense between the three business lines. Senior management are responsible for the Bank's mapping policy and the Board of Directors approves the mapping.

The details of the operational risk capital charge for Gulf Bank as at 31 December 2005 are shown on the next page.

(KD thousands)	3 year average gross income	Beta factor	Operational risk capital charge
Trading and sales	20,777	18%	3,740
Commercial banking	37,061	15%	5,559
Retail banking	36,230	12%	4,348
Total	94,068		13,647
Operational risk-weighted exposure			113,676

In accordance with the Basel II guidelines, gross income includes net interest income and non-interest income, but excludes realised profits from the sale of securities in the banking book. The 31 December 2005 total operational risk capital charge of KD13.65 million was equivalent to operational risk-weighted exposure of KD113.68 million.

Equity risk in the banking book

Gulf Bank does not trade equities. All of the Bank's investment securities are held in the banking (i.e. non-trading) book and are classified as 'available for sale' financial assets, i.e. they represent assets acquired to be held for an indefinite period of time which may be sold in response to needs for liquidity or changes in interest rates, exchange rates or equity prices. In accordance with IAS 39, the assets are initially recognised at fair value and the subsequent unrealised gains and losses arising from changes in fair value are taken to the fair value reserve in equity. When the asset is disposed of, the related accumulated fair value adjustments are transferred to the income statement as gains or losses.

The fair values of quoted instruments are based on the quoted closing bid prices or by using the current market rate of interest for the instrument. The fair values of unquoted instruments are estimated using the applicable price/earnings or price/cash flow ratios, modified to reflect the specific circumstances of the issuer. The fair values of investments in mutual funds, unit trusts or similar investment vehicles are based on the last published bid price.

The fair value of the investment securities held at 31 December 2005 is shown in the table on the next page, along with the cumulative unrealised gains in the fair value reserve in equity and the regulatory capital implications. The income statement realisation gain from disposals made in 2005 is also shown.

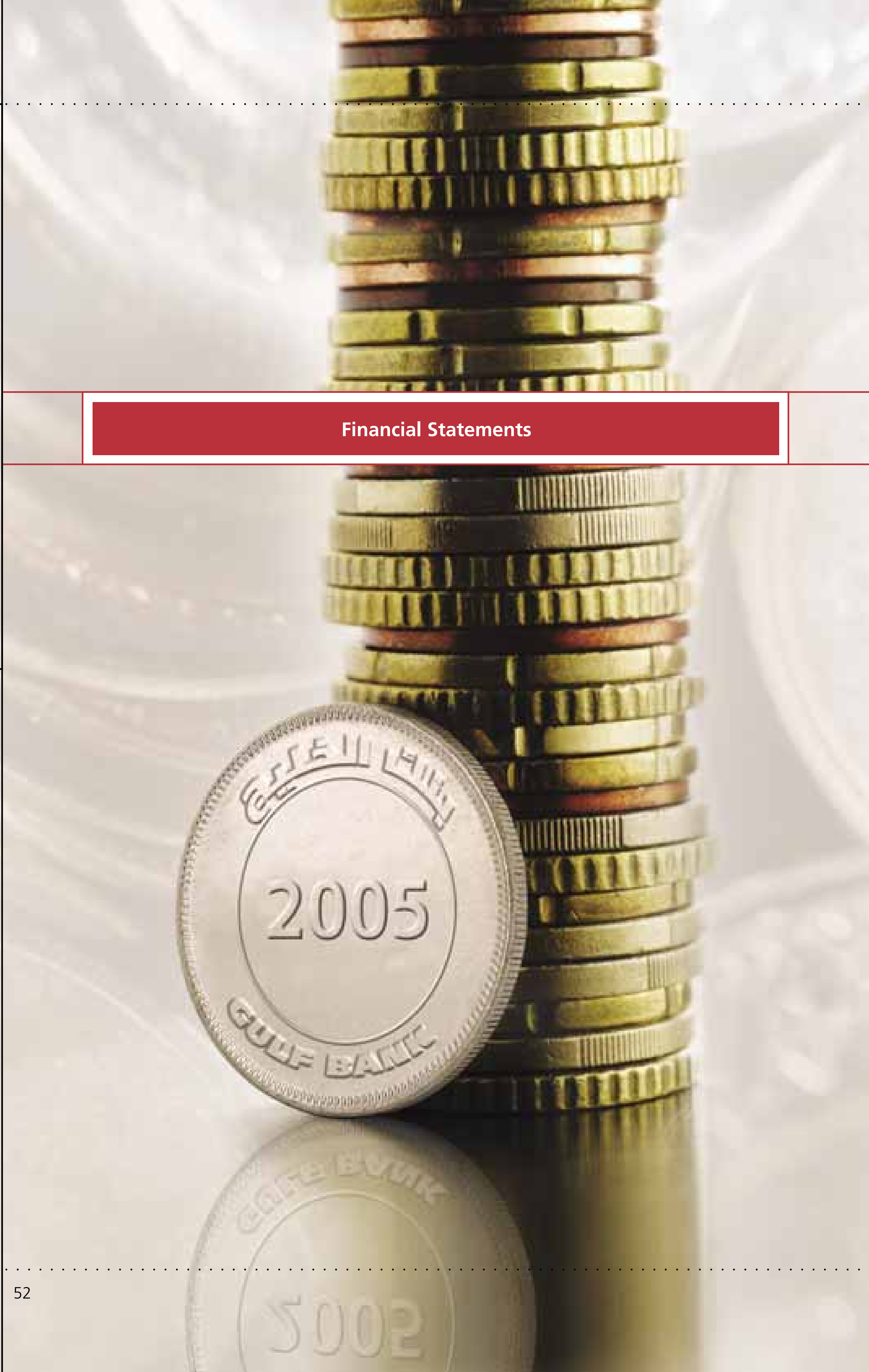
(KD thousands)	Publicly traded	Privately held	Total investment securities
Balance sheet details			
Fair value of investment securities:			
Debt securities	2,278	984	3,262
Equity securities	10,843	91,761	102,604
Total fair value of investment securities	13,121	92,745	105,866
Unrealised gains in equity	4,384	12,703	17,087
Latent revaluation gains	0	0	0
Regulatory capital details			
Unrealised gains in Tier 2 capital (45%)	1,973	5,716	7,689
Regulatory capital requirement	1,338	10,443	11,781
Income statement details			
Income from disposal of investment securities	14,220	4,613	18,833

Interest rate risk in the banking book

Future net interest income is affected by movements in interest rates and a principal part of the Bank's management of market risk in the banking (i.e. non-trading) book is to manage the sensitivity of the Bank's net interest income to changes in market interest rates.

The sensitivity of net interest income to interest rate changes is assessed by assuming a gradual parallel shift up and down in the term structure of interest rates during a period of 12 months. Assuming no management actions, a 100 basis points parallel fall in all yield curves would reduce net interest income for the 12 months to 31 December 2006 by approximately KD6.4 million while a hypothetical 100 basis points rise in all yield curves would increase net interest income by approximately KD6.9 million. These interest rate sensitivities are illustrative only and are based on the Bank's current interest rate risk profile and current repricing behaviour, principally that: foreign currency loans to banks reprice at the next interest payment date, while KD loans to banks reprice immediately; KD loans to customers (86% of total loans and advances to customers) reprice immediately, while foreign currency loans to customers reprice with a 3 month lag; 60% of current account balances are non-interest bearing and the remaining 40% reprice immediately; savings accounts reprice immediately while time deposits reprice at maturity.

The above projections do not reflect the actions that could be taken by the Bank to mitigate the impact of interest rate risk. In reality, the Bank would seek to proactively change the interest rate risk profile to minimise losses and optimise net revenues. The projections also assume that rates on all maturities move by the same amount and that all positions run to maturity. Such a simplified scenario does not happen in practice. In reality, projecting the movement in net interest income from prospective changes in interest rates is a complex interaction of structural and managed exposures.



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Independent Auditors' Report To The Shareholders

We have audited the accompanying balance sheet of Gulf Bank K.S.C as of 31 December 2005 and the related statements of income, cash flows and changes in equity for the year then ended. These financial statements are the responsibility of the Bank's management. Our responsibility is to express an opinion on these financial statements based on our audit.

We conducted our audit in accordance with International Standards on Auditing. Those Standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audit provides a reasonable basis for our opinion.

In our opinion, the financial statements present fairly, in all material respects, the financial position of the Bank as of 31 December 2005 and the results of its operations and its cash flows for the year then ended in accordance with International Financial Reporting Standards as adopted for use by the State of Kuwait.

Furthermore, in our opinion proper books of accounts have been kept by the Bank and the financial statements, together with the contents of the report of the Board of Directors relating to these financial statements, are in accordance therewith. We further report that we obtained all the information and explanations that we required for the purpose of our audit and that the financial statements incorporate all information that is required by the Commercial Companies Law of 1960, as amended, and by the Bank's Articles of Association, that an inventory was duly carried out and that, to the best of our knowledge and belief, no violation of the Commercial Companies Law of 1960, as amended, or of the Articles of Association have occurred during the year ended 31 December 2005 that might have had a material effect on the business of the Bank or on its financial position.

We further report that, during the course of our examination, we have not become aware of any material violations of the provisions of law No. 32 of 1968, as amended, concerning currency, the Central Bank of Kuwait and the organisation of banking business, and its related regulations, during the year ended 31 December 2005.

24 January 2006

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Income Statement

Year ended 31 December 2005

	NOTES	2005 KD 000's	2004 KD 000's
Interest income	3	**136,261**	106,935
Interest expense	4	**54,717**	39,285
Net interest income		**81,544**	67,650
Dividend income		**1,855**	1,623
Net fees and commissions		**25,324**	17,476
Net gains from dealing in foreign currencies and derivatives		**5,449**	4,779
Income from disposal of investment securities		**18,833**	11,440
Other income	5	**150**	257
OPERATING INCOME		**133,155**	103,225
Staff expenses		**13,747**	11,730
Occupancy costs		**1,198**	1,114
Depreciation	14	**1,149**	873
Other expenses		**8,003**	4,951
Operating expenses		**24,097**	18,668
Operating profit before provisions		**109,058**	84,557
Provisions for impairment - specific		**4,454**	2,145
- general		**16,280**	5,170
OPERATING PROFIT		**88,324**	77,242
Contribution to Kuwait Foundation for the Advancement of Sciences		**883**	772
Directors' emoluments		**108**	108
National Labour Support Tax		**1,963**	1,716
NET PROFIT FOR THE YEAR		**85,370**	74,646
EARNINGS PER SHARE (Fils)	6	**101.759**	86.939

The attached notes 1 to 31 form part of these financial statements

Balance Sheet

As at 31 December 2005

	NOTES	2005 KD 000's	2004 KD 000's (Restated)
ASSETS			
Cash and short term funds	7	**347,647**	234,612
Treasury bills and bonds	8	**396,299**	484,359
Central Bank of Kuwait bonds	9	**59,798**	-
Deposits with banks and other financial institutions	10	**17,370**	-
Loans and advances to banks	11	**63,473**	116,305
Loans and advances to customers	11	**1,578,565**	1,338,286
Investment securities	12	**105,866**	87,587
Other assets	13	**25,291**	12,836
Premises and equipment	14	**13,932**	12,179
TOTAL ASSETS		**2,608,241**	2,286,164
LIABILITIES AND EQUITY			
LIABILITIES			
Due to banks	15	**65,844**	108,208
Medium term loans from banks	15	**-**	154,205
Deposits from financial institutions	15	**205,783**	167,967
Customer deposits	16	**1,829,001**	1,393,738
Floating rate notes	17	**58,400**	58,940
Subordinated loans	18	**43,800**	44,205
Other liabilities	19	**50,728**	38,465
		2,253,556	1,965,728
EQUITY			
Share capital	20	**86,190**	82,086
Proposed bonus shares	23	**8,619**	4,104
Statutory reserve	21	**64,924**	56,092
General reserve	21	**2,356**	2,356
Share premium	21	**46,044**	46,044
Property revaluation reserve	21	**7,669**	7,496
Treasury share reserve	21	**12,587**	9,393
Fair valuation reserve		**17,087**	25,536
Retained earnings		**69,510**	52,150
		314,986	285,257
Treasury shares	22	**(11,396)**	(20,937)
		303,590	264,320
Proposed dividend	23	**51,095**	56,116
		354,685	320,436
TOTAL LIABILITIES AND EQUITY		**2,608,241**	2,286,164

These financial statements have been approved for issue by the Board of Directors on 24 January 2006 and signed on its behalf by:

Salah Khaled Al-Fulaij
Deputy Chairman

Dr. Yousef A. Al-Awadi KBE
Chief General Manager & Chief Executive Officer

David Pace
Corporate Controller

The attached notes 1 to 31 form part of these financial statements

Cash Flow Statement

Year ended 31 December 2005

	NOTES	2005 KD 000's	2004 KD 000's
CASH FLOWS FROM OPERATING ACTIVITIES			
Net profit for the year		**85,370**	74,646
Adjustments:			
Dividend income		**(1,855)**	(1,623)
Income from disposal of investment securities		**(18,833)**	(11,440)
Depreciation		**1,149**	873
Provisions for impairment		**20,734**	7,315
OPERATING PROFIT BEFORE CHANGES IN OPERATING ASSETS AND LIABILITIES		**86,565**	69,771
(Increase) decrease in operating assets:			
Treasury bills and bonds		**88,060**	(32,275)
Central Bank of Kuwait bonds		**(59,798)**	-
Deposits with banks and other financial institutions		**(17,370)**	300,000
Loans and advances to banks		**52,832**	82,385
Loans and advances to customers		**(255,898)**	(131,803)
Government debt bonds		**-**	15,780
Other assets		**(12,455)**	13
Increase (decrease) in operating liabilities:			
Due to banks		**(42,364)**	(450,415)
Medium term loans from banks		**(154,205)**	(50,000)
Deposits from financial institutions		**37,816**	65,020
Customer deposits		**435,263**	165,569
Floating rate notes		**(540)**	-
Subordinated loans		**(405)**	44,205
Other liabilities		**7,273**	3,438
NET CASH FROM OPERATING ACTIVITIES		**164,774**	81,688
CASH FLOWS FROM INVESTING ACTIVITIES			
Purchase of investment securities		**(65,979)**	(23,216)
Sale of investment securities		**57,959**	32,826
Purchase of premises and equipment		**(2,729)**	(1,308)
Dividends received		**1,855**	1,623
NET CASH (USED IN) FROM INVESTING ACTIVITIES		**(8,894)**	9,925
CASH FLOWS FROM FINANCING ACTIVITIES			
Dividends paid		**(55,580)**	(35,923)
Purchase of treasury shares		**(12,795)**	(20,921)
Sale of treasury shares		**25,530**	3,571
NET CASH USED IN FINANCING ACTIVITIES		**(42,845)**	(53,273)
NET INCREASE IN CASH AND SHORT TERM FUNDS		**113,035**	38,340
CASH AND SHORT TERM FUNDS AT 1 JANUARY		**234,612**	196,272
CASH AND SHORT TERM FUNDS AT 31 DECEMBER	7	**347,647**	234,612

The attached notes 1 to 31 form part of these financial statements

Statement of Changes in Equity

Year ended 31 December 2005

			RESERVES										
	Share capital KD 000's	Proposed bonus shares KD 000's	Statutory reserve KD 000's	General reserve KD 000's	Share premium KD 000's	Property revaluation reserve KD 000's	Treasury share reserve KD 000's	Fair valuation reserve KD 000's	Retained earnings KD 000's	Subtotal reserves KD 000's	Treasury shares KD 000's	Proposed dividend KD 000's	Total KD 000's
Balance at 1 January 2004 (as previously stated)	82,086	-	48,368	2,356	46,044	7,115	8,749	22,428	47,371	182,431	(2,943)	35,923	297,497
Adjustment arising from the application of IAS 39 (revised)	-	-	-	-	-	-	-	1,923	(1,923)	-	-	-	-
Balance at 1 January 2004 restated	82,086	-	48,368	2,356	46,044	7,115	8,749	24,351	45,448	182,431	(2,943)	35,923	297,497
Dividend paid	-	-	-	-	-	-	-	-	-	-	-	(35,923)	(35,923)
Effect of changes in fair values of "available for sale" financial assets	-	-	-	-	-	-	-	12,046	-	12,046	-	-	12,046
Net realised gains during the year	-	-	-	-	-	-	-	(10,861)	-	(10,861)	-	-	(10,861)
Surplus on revaluation of properties	-	-	-	-	-	381	-	-	-	381	-	-	381
Net income directly recognised in equity	-	-	-	-	-	381	-	1,185	-	1,566	-	-	1,566
Net profit for the year	-	-	-	-	-	-	-	-	74,646	74,646	-	-	74,646
Total recognised income for the year	-	-	-	-	-	381	-	1,185	74,646	76,212	-	-	76,212
Purchase of treasury shares	-	-	-	-	-	-	-	-	-	-	(20,921)	-	(20,921)
Sale of treasury shares	-	-	-	-	-	-	-	-	-	-	2,927	-	2,927
Profit on sale of treasury shares	-	-	-	-	-	-	644	-	-	644	-	-	644
Transfers from profit	-	-	7,724	-	-	-	-	-	(7,724)	-	-	-	-
Proposed bonus shares	-	4,104	-	-	-	-	-	-	(4,104)	(4,104)	-	-	-
Proposed dividend	-	-	-	-	-	-	-	-	(56,116)	(56,116)	-	56,116	-
At 31 December 2004	82,086	4,104	56,092	2,356	46,044	7,496	9,393	25,536	52,150	199,067	(20,937)	56,116	320,436
Dividend paid	-	-	-	-	-	-	-	-	**536**	**536**	-	**(56,116)**	**(55,580)**
Issue of capital	**4,104**	**(4,104)**	-	-	-	-	-	-	-	-	-	-	-
Effect of changes in fair values of "available for sale" financial assets	-	-	-	-	-	-	-	**7,811**	-	**7,811**	-	-	**7,811**
Net realised gains during the year	-	-	-	-	-	-	-	**(16,260)**	-	**(16,260)**	-	-	**(16,260)**
Surplus on revaluation of properties	-	-	-	-	-	**173**	-	-	-	**173**	-	-	**173**
Net income directly recognised in equity	-	-	-	-	-	**173**	-	**(8,449)**	-	**(8,276)**	-		**(8,276)**
Net profit for the year	-	-	-	-	-	-	-	-	**85,370**	**85,370**	-		**85,370**
Total recognised income for the year		-	-	-	-	**173**	-	**(8,449)**	**85,370**	**77,094**	-	-	**77,094**
Purchase of treasury shares	-	-	-	-	-	-	-	-	-	-	**(12,795)**	-	**(12,795)**
Sale of treasury shares	-	-	-	-	-	-	-	-	-	-	**22,336**	-	**22,336**
Profit on sale of treasury shares	-	-	-	-	-	-	**3,194**	-	-	**3,194**	-	-	**3,194**
Transfers from profit	-	-	**8,832**	-	-	-	-	-	**(8,832)**	-	-	-	-
Proposed bonus shares	-	**8,619**	-	-	-	-	-	-	**(8,619)**	**(8,619)**	-	-	-
Proposed dividend	-	-	-	-	-	-	-	-	**(51,095)**	**(51,095)**	-	**51,095**	-
At 31 December 2005	**86,190**	**8,619**	**64,924**	**2,356**	**46,044**	**7,669**	**12,587**	**17,087**	**69,510**	**220,177**	**(11,396)**	**51,095**	**354,685**

The attached notes 1 to 31 form part of these financial statements

NOTES TO THE FINANCIAL STATEMENTS

31 December 2005

1. INCORPORATION AND REGISTRATION

Gulf Bank K.S.C. is a public shareholding company incorporated in Kuwait on 29 October 1960 and is registered as a bank with the Central Bank of Kuwait. Its registered office is at Mubarak Al Kabir Street, PO Box 3200, 13032 Safat, Kuwait. The number of employees as of 31 December 2005 was 914 (2004: 809).

2. SIGNIFICANT ACCOUNTING POLICIES

a. Basis of presentation

The financial statements of the Bank have been prepared in accordance with International Financial Reporting Standards (IFRS) as adopted for use by the State of Kuwait for financial services institutions regulated by the Central Bank of Kuwait. These regulations require adoption of all International Financial Reporting Standards (IFRS) except for the IAS 39 requirement for collective provision, which has been replaced by the Central Bank of Kuwait's requirement for a minimum general provision as described under the accounting policy for impairment and uncollectability of financial assets.

The financial statements are prepared under the historical cost basis of measurement as modified by the revaluation of financial assets carried at fair value through income statement and available for sale, all derivative contracts and land and buildings.

The accounting policies, with the exception of the adoption of the revised version of IAS 32 and 39, are consistent with those used in the previous year.

The financial statements have been presented in Kuwaiti Dinars rounded off to the nearest thousand.

b. Adoption of revised versions of IAS 32 and 39

The Bank has adopted the revised versions of IAS 32 and 39 which have become mandatory for the financial years beginning on or after 1 January 2005. The principal effects of these changes in policies are as follows:

Originated financial assets

Financial assets that are created by the Bank by providing money directly to a borrower were earlier classified as "originated financial assets". In accordance with the revised IAS 39 these assets are now reclassified with effect from 1 January 2004 as "loans and receivables".

Impairment of available for sale investments

In the case of available for sale equity investments, reversal of previously recognised impairment losses are no longer recorded through the income statement but as increases in fair valuation reserve. There was no impact on the income statement for 2005 as there were no such reversals during the year.

Derecognition of financial assets

With effect from 1 January 2005 a financial asset (in whole or in part) is derecognised when the contractual rights to cash flows from the financial asset expire, the Bank has transferred substantially all the risks and rewards of ownership or when it has neither transferred nor retained substantially all the risks and rewards and when it no longer has control over the asset or a proportion of the asset.

The adoption of the other revised and new accounting standards that formed part of the International Accounting Standards Board's improvements project, and are applicable from 1 January 2005, has had no material impact on the Bank's financial statements for the year ended 31 December 2005.

2. SIGNIFICANT ACCOUNTING POLICIES (continued)

c. Financial instruments

Classification, recognition/de-recognition and measurement of financial instruments

Classification

In accordance with the revised IAS 39 the Bank classifies its financial assets as "carried at fair value through income statement", "loans and receivables" and "available for sale", and its financial liabilities as "non-trading financial liabilities".

Financial assets "carried at fair value through income statement" are divided into two sub categories: financial assets held for trading, and those designated at fair value through income statement at inception. A financial asset is classified in this category if acquired principally for the purpose of selling in the short term or if so designated by management. Derivatives are also classified as "held for trading" unless they are designated as hedges and are effective hedging instruments.

Loans and receivables are non-derivative financial assets with fixed or determinable payments that are not quoted in an active market. These are carried at amortised cost using the effective interest method, adjusted for effective fair value hedges, less any provision for impairment.

Financial assets which are not classified as above are classified as "available for sale", and are principally those acquired to be held for an indefinite period of time, which may be sold in response to needs for liquidity or changes in interest rates, exchange rates or equity prices.

Financial liabilities, which are not held for trading, are classified as "non-trading financial liabilities".

Management determines the classification of these financial instruments at the time of acquisition.

Recognition/de-recognition

A financial asset or a financial liability is recognised when the Bank becomes a party to the contractual provisions of the instrument. A financial asset (in whole or in part) is de-recognised when the contractual rights to the cash flows from the financial asset expire or when the Bank transfers substantially all the risks and rewards of ownership or when the Bank has neither transferred or retained substantially all the risks and rewards of ownership and when it no longer has control over the asset or a proportion of the assets. A financial liability is derecognised when the obligation specified in the contract is discharged, cancelled or expired.

All regular way purchases and sales of financial assets are recognised using settlement date accounting. Changes in fair value between the trade date and settlement date are recognised in the income statement. Regular way purchases or sales are purchases or sales of financial assets that require delivery of assets within the time frame generally established by regulations or conventions in the market place.

Measurement

All financial instruments are initially recognised at fair value. Transaction costs are included only for those financial instruments that are not measured at fair value through the income statement.

On subsequent re-measurement, financial assets classified as "carried at fair value through income statement" are carried at fair value with resultant unrealised gains or losses arising from changes in fair value included in the income statement. "Loans and receivables" are carried at amortised cost using the effective yield method. Those classified as "available for sale" are subsequently measured and carried at fair values. Unrealised gains and losses arising from changes in fair value of those classified as "available for sale" are taken to fair valuation reserve

2. SIGNIFICANT ACCOUNTING POLICIES (continued)

in equity. Investments in equity instruments that do not have a quoted market price in an active market and whose fair value cannot be reliably measured and derivatives that are linked to and must be settled by delivery of such unquoted instruments are measured at cost. "Non-trading financial liabilities" are carried at amortised cost using the effective interest method.

When the "available for sale" asset is disposed of, or impaired, the related accumulated fair value adjustments are transferred to the income statement as gains or losses.

Fair values

Fair values of quoted instruments are based on quoted closing bid prices or using the current market rate of interest for that instrument. Fair values for unquoted instruments are estimated using applicable price/earnings or price/cash flow ratios refined to reflect the specific circumstances of the issuer. The fair value of investments in mutual funds, unit trusts or similar investment vehicles are based on the last published bid price.

The fair value of financial instruments carried at amortised cost is estimated by discounting the future contractual cash flows at the current market interest rates for similar financial instruments.

The fair value of a derivative is the equivalent of the unrealised gain or loss from marking to market the derivative using prevailing market rates or internal pricing models.

Impairment and uncollectibility of financial assets

An assessment is made at each balance sheet date to determine whether there is objective evidence that a specific financial asset or a group of similar financial assets may be impaired.

If such evidence exists, any impairment loss is recognised in the income statement.

Impairment is determined as follows:

a) for financial assets with fixed interest rates, carried at amortised cost, impairment is based on estimated cash flows (excluding future credit losses that have not been incurred) discounted at the original effective interest rate; and for financial assets with variable interest rates, carried at amortised cost, discounted at the effective interest rate;

b) for financial assets carried at fair value, impairment is the difference between cost and fair value;

c) for financial assets carried at cost, impairment is the difference between cost and present value of future cash flows discounted at the current market rate of return for a similar financial asset.

For available for sale equity investments, reversals of impairment losses are recorded as increases in fair valuation reserve through equity.

In addition, in accordance with Central Bank of Kuwait instructions, a minimum general provision of 2% on all credit facilities net of certain categories of collateral, to which CBK instructions are applicable and not subject to specific provision, is made.

Financial assets are written off when there is no realistic prospect of recovery.

Offsetting

Financial assets and financial liabilities are only offset and the net amounts reported in the balance sheet when there is a legally enforceable right to set off the recognised amounts and the Bank intends to either settle on a net basis, or to realise the asset and settle the liability simultaneously.

d. Derivative financial instruments and hedging

Derivatives with positive fair values (unrealised gains) are included in other assets and derivatives with

2. SIGNIFICANT ACCOUNTING POLICIES (continued)

negative fair values (unrealised losses) are included in other liabilities in the balance sheet.

Fair values are generally obtained by reference to quoted market prices, discounted cash flow models and pricing models as appropriate. Any changes in the fair value of derivatives that are held for trading are taken directly to the income statement and are disclosed in trading income. Derivatives held for trading also include those derivatives which do not qualify for hedge accounting described below. For the purpose of hedge accounting, hedges are classified into two categories: (a) fair value hedges which hedge the exposure to changes in the fair value of a recognised asset or liability; and (b) cash flow hedges which hedge exposure to variability in cash flows that is either attributable to a particular risk associated with a recognised asset or liability, or to a forecast transaction and firm commitment that will affect the reported net gain or loss.

In order to qualify for hedge accounting, the hedge should be expected to be highly effective, i.e. the changes in fair value or cash flows of the hedging instrument should effectively offset corresponding changes in the hedged item, and should be reliably measurable. At the inception of the hedge, the risk management objective and strategy is documented, including the identification of the hedging instrument, the related hedged item, the nature of risk being hedged, and how the Bank will assess the effectiveness of the hedging relationship. Subsequently, the hedge is required to be assessed and determined to be an effective hedge on an ongoing basis.

In relation to fair value hedges which meet the criteria for hedge accounting, any gain or loss from remeasuring the hedging instruments to fair value is recognised immediately in the income statement. The related portion of the hedged item is adjusted against the carrying amount of the hedged item and is recognised in the income statement. Where the fair value hedge of a commission bearing financial instrument ceases to meet the criteria for hedge accounting, the adjustment in the carrying value is amortised to the income statement over the remaining life of the instrument.

Hedge accounting is discontinued when the hedging instrument expires or is sold, terminated or exercised, or it no longer qualifies for hedge accounting or the forecast transaction is no longer expected to occur or the designation is revoked. At that point in time, any cumulative gain or loss on the hedging instrument recognised in equity is kept there until the forecast transaction occurs. In cases where the forecast transaction is no longer expected to occur or the designation is revoked, the net cumulative gain or loss recognised in equity is transferred to the income statement.

For hedges, which do not qualify for hedge accounting and for “held for trading” derivatives, any gains or losses arising from changes in the fair value of the hedging instrument are taken directly to the income statement.

In the case of fair value hedges of interest-bearing financial instruments, any adjustment to its carrying value relating to the hedge is amortized over the remaining term to maturity.

e. Premises and equipment

Premises and equipment other than freehold land are stated at cost less accumulated depreciation and impairment losses. Depreciation is provided on a straight-line basis over the estimated useful lives of all premises and equipment, other than freehold land which is deemed to have an indefinite life as follows:

2. SIGNIFICANT ACCOUNTING POLICIES (continued)

Freehold premises	20 years
Leasehold premises	5 years or period of lease if less
Furniture and equipment	3 to 5 years
Vehicles	4 years

When an asset is revalued, any increase in the carrying amount arising on revaluation is credited directly to equity under the property revaluation reserve, except to the extent that a revaluation increase merely restores the carrying value of an asset to its original cost, whereby it is recognised as income. A decrease resulting from a revaluation is initially charged directly against any related revaluation surplus held in respect of that same asset, the remaining portion being charged as an expense.

f. Collateral pending sale

The Bank occasionally acquires property in settlement of certain loans and advances. Such property is stated at the lower of the carrying value of the related loans and advances and the current fair value of such assets. Gains or losses on disposal, and revaluation losses, are recognised in the income statement.

g. Provisions

Provisions are recognised when, as a result of past events, it is probable that an outflow of economic resources will be required to settle a present, legal or constructive obligation and the amount can be reliably estimated.

h. Treasury shares

The cost of the Bank's own shares purchased, including directly attributable costs, is recognised as a change in equity. Gains or losses arising on sale are separately disclosed under equity and in accordance with the instructions of Central Bank of Kuwait, these amounts are not available for distribution. These shares are not entitled to any cash dividends.

i. Revenue recognition

Interest income and fees which are considered an integral part of the effective yield of a financial asset are recognised using the effective yield method, unless collectibility is in doubt. Once a financial instrument categorised as 'loans and receivables' is impaired, interest is calculated based on expected future cash flows (excluding future credit losses that have not been incurred) used for the purpose of measuring the impairment.

Other fees receivable are recognised as the services are provided. Dividend income is recognised when the right to receive payment is established.

j. Fiduciary assets

Assets held in trust or in a fiduciary capacity are not treated as assets of the Bank and accordingly are not included in these financial statements.

k. Foreign currencies

Foreign currency transactions are recorded at rates of exchange ruling at the dates of the transactions. Monetary assets and liabilities in foreign currencies at the year end are translated into Kuwaiti Dinars at rates of exchange ruling at the balance sheet date. Translation gains and losses on non-monetary items such as equities classified as available for sale financial assets are included in the fair valuation reserve in equity, unless part of an effective hedging strategy. Foreign exchange contracts outstanding at the year end are revalued at the forward rates ruling at the balance sheet date. Any resultant gains or losses are taken to the income statement.

l. Cash and cash equivalents

Cash and cash equivalents consists of cash on hand and deposits with banks and other financial institutions (including Central Bank of Kuwait) having original maturities not exceeding 30 days.

2. SIGNIFICANT ACCOUNTING POLICIES (continued)

m. Significant accounting judgements and estimates

Judgements

In the process of applying the Bank's accounting policies, management has made the following judgements, apart from those involving estimations, which have the most significant effect in the amounts recognised in the financial statements:

Classification of investments

Management has to decide on acquisition of an investment whether it should be classified as held for trading, carried at fair value through income statement, or available for sale.

The Bank classifies investments as held for trading if they are acquired primarily for the purpose of short term profit making.

With regard to investments carried at fair value through income statement, the classification is based on how management monitors the performance of these investments. For those investments not classified as held for trading, and for which there are readily available reliable fair values, and the changes in fair values are reported as part of profit or loss in the management accounts, these are classified as fair value through income statement.

All other investments are classified as available for sale.

Impairment of investments

The Bank treats available for sale equity investments as impaired when there has been a significant or prolonged decline in the fair value below its cost or where other objective evidence of impairment exists. The determination of what is "significant" or "prolonged" requires considerable judgement.

Estimation uncertainty

The key assumptions concerning the future and other key sources of estimation uncertainty at the balance sheet date, that have a significant risk of causing a material adjustment to the carrying amounts of assets and liabilities within the next financial year are discussed below:

Impairment losses on loans and advances and investment in debt instruments

The Bank reviews problem loans and advances and investment in debt instruments on an ongoing basis to assess whether a provision for impairment should be recorded in the income statement. In particular, considerable judgement by management is required in the estimation of the amount and timing of future cash flows when determining the level of provisions required. Such estimates are necessarily based on assumptions about several factors involving varying degrees of judgment and uncertainty, and actual results may differ resulting in future changes to such provisions.

Valuation of unquoted equity investments

Valuation of unquoted equity investments is normally based on one of the following:

- the expected cash flows discounted at current rates applicable for items with similar terms and risk characteristics;
- recent arm's length market transactions;
- current fair value of another instrument that is substantially the same; or
- valuation models.

The Bank calibrates the valuation techniques periodically and tests these for validity using either prices from observable current market transactions in the same instrument or other available observable market data.

3. INTEREST INCOME

	2005 KD 000's	2004 KD 000's
Treasury bills and bonds, Central Bank of Kuwait bonds, and other investments	**13,561**	13,170
Placements with banks	**7,724**	8,529
Loans and advances to banks and customers	**114,976**	85,236
	136,261	106,935

4. INTEREST EXPENSE

	2005 KD 000's	2004 KD 000's
Call accounts	**2,919**	1,882
Savings accounts	**1,777**	1,099
Time deposits	**42,566**	22,194
Bank borrowings	**7,455**	14,110
	54,717	39,285

5. OTHER INCOME

	2005 KD 000's	2004 KD 000's
Customer portfolio management fee	**117**	89
Sundry income	**33**	168
	150	257

6. EARNINGS PER SHARE

Basic earnings per share is based on the weighted average number of shares outstanding during the year as follows:

	2005 KD 000's	2004 KD 000's
Net profit for the year	**85,370**	74,646

	Shares	Shares
Bank's issued and paid up shares	**861,901,485**	861,901,485
Less: weighted average number of treasury shares	**(22,958,369)**	(3,303,076)
	838,943,116	858,598,409

	Fils	Fils
Earnings per share	**101.759**	86.939

Earnings per share reported for the year ended 31 December 2004 was 91.286 fils before retroactive adjustment relating to the issue of bonus shares at 5% of the paid up capital approved by the shareholders in the General Assembly meeting dated 19 February 2005.

The issued and paid up shares for 2004 have been adjusted for the bonus shares issued in 2005.

7. CASH AND SHORT TERM FUNDS

	2005 KD 000's	2004 KD 000's
Balances with the Central Bank of Kuwait	**125,387**	31,634
Cash on hand and in current accounts with other banks	**43,491**	26,542
Money at call and short notice	**5,000**	19,450
Deposits with banks and other financial institutions maturing within one month	**173,769**	156,986
	347,647	234,612

8. TREASURY BILLS AND BONDS

These financial instruments are issued by the Central Bank of Kuwait on behalf of the Ministry of Finance. They mature within a period not exceeding one year.

	2005 KD 000's	2004 KD 000's
Treasury bills	**-**	194,894
Treasury bonds	**396,299**	289,465
	396,299	484,359

9. CENTRAL BANK OF KUWAIT BONDS

These financial instruments are issued by the Central Bank of Kuwait. They mature within a period not exceeding one year.

	2005 KD 000's	2004 KD 000's
Central Bank of Kuwait bonds	**59,798**	-
	59,798	-

10. DEPOSITS WITH BANKS AND OTHER FINANCIAL INSTITUTIONS

	2005 KD 000's	2004 KD 000's
Time deposits	**17,370**	-
	17,370	-

11. LOANS AND ADVANCES TO BANKS AND CUSTOMERS

Loans and advances represent monies paid to banks and customers. The Bank's assessment of the credit risk concentration, based on the primary purpose of the loans and advances given, is provided below.

At 31 December 2005 :

Loans and advances to customers

	Kuwait KD 000's	Other Middle East KD 000's	Western Europe KD 000's	Asia Pasific KD 000's	Rest of World KD 000's	Total KD 000's
Personal	**595,059**	**-**	**-**	**-**	**-**	**595,059**
Financial	**114,357**	**2,999**	**1,481**	**2,294**	**-**	**121,131**
Trade and commerce	**244,556**	**3,486**	**-**	**-**	**-**	**248,042**
Crude oil and gas	**8,428**	**932**	**-**	**-**	**-**	**9,360**
Construction	**217,278**	**9,797**	**-**	**-**	**602**	**227,677**
Government	**-**	**1,258**	**-**	**-**	**22,232**	**23,490**
Others	**95,376**	**2,910**	**-**	**-**	**-**	**98,286**
Manufacturing	**37,752**	**16,936**	**-**	**-**	**-**	**54,688**
Real estate	**261,832**	**-**	**-**	**-**	**-**	**261,832**
	1,574,638	**38,318**	**1,481**	**2,294**	**22,834**	**1,639,565**
Less : Provision for impairment						**(61,000)**
						1,578,565
Loans and advances to banks	**3,120**	**24,090**	**21,685**	**14,578**	**-**	**63,473**

At 31 December 2004 :

Loans and advances to customers

	Kuwait KD 000's	Other Middle East KD 000's	Western Europe KD 000's	Asia Pasific KD 000's	Rest of World KD 000's	Total KD 000's
Personal	446,820	-	-	-	-	446,820
Financial	80,600	3,012	31,850	-	13,231	128,693
Trade and commerce	220,581	3,772	-	-	-	224,353
Crude oil and gas	8,513	421	-	-	-	8,934
Construction	157,786	2,514	-	-	-	160,300
Government	-	6,955	-	-	1,415	8,370
Others	125,170	2,920	-	-	-	128,090
Manufacturing	16,736	14,398	-	-	-	31,134
Real estate	256,958	-	-	-	-	256,958
	1,313,164	33,992	31,850	-	14,646	1,393,652
Less : Provision for impairment						(55,366)
						1,338,286
Loans and advances to banks	14,918	34,358	46,571	17,977	2,481	116,305

11. LOANS AND ADVANCES TO BANKS AND CUSTOMERS (continued)

Movement in provisions for impairment

	2005 KD 000's			2004 KD 000's		
	Specific	**General**	**Total**	Specific	General	Total
At 1 January	**25,405**	**29,961**	**55,366**	23,162	26,677	49,839
Exchange adjustments	**73**	**-**	**73**	118	-	118
Recoveries	**122**	**-**	**122**	116	-	116
Amounts written off	**(11,007)**	**-**	**(11,007)**	(36)	-	(36)
Amount to be ceded to Central Bank of Kuwait	**(284)**	**-**	**(284)**	(30)	-	(30)
Income statement	**4,458**	**11,570**	**16,028**	2,075	3,354	5,429
Transfer to provision for "assets sold"	**702**	**-**	**702**	-	(70)	(70)
At 31 December	**19,469**	**41,531**	**61,000**	25,405	29,961	55,366

The provision charge for the year on non-cash facilities is KD4,706,000 (2004: KD1,886,000), net of release of specific provisions of KD4,000. The available provision on non-cash facilities of KD14,750,000 (2004: KD 10,044,000) is included in other liabilities (Note 19).

The analysis of specific and general provisions set out above is based on the requirements of the Central Bank of Kuwait. According to the Central Bank of Kuwait instructions, a minimum general provision of 2% (including KD10,424,000 above the minimum required) on all credit facilities net of certain categories of collateral, to which CBK instructions are applicable and not subject to specific provision, is made.

As at 31 December 2005, non-performing loans and advances amounted to KD38,365,000 (2004: KD45,201,000) split between facilities granted pre-invasion and post-liberation as follows:

	2005		2004	
	Loans & advances KD 000's	**Provisions KD 000's**	Loans & advances KD 000's	Provisions KD 000's
Pre-invasion	**12,903**	**12,903**	13,207	13,207
Post-liberation	**25,462**	**6,566**	31,994	12,198
Total	**38,365**	**19,469**	45,201	25,405

In accordance with Decree 32/1992, when the pre-invasion provisions are no longer required they must be repaid to the Central Bank of Kuwait.

12. INVESTMENT SECURITIES

	2005 KD 000's	2004 KD 000's
Available for sale		
Debt securities		
Quoted	**2,278**	16,256
Unquoted	**984**	968
	3,262	17,224
Equity securities		
Quoted	**10,843**	32,363
Unquoted	**91,761**	38,000
	102,604	70,363
Total	**105,866**	87,587

During the year, the Bank recognised KD7,811,000 (2004: KD12,046,000) in equity as the net gain arising from changes in fair value of investment securities and re-cycled a profit of KD16,260,000 (2004: KD10,861,000) to the income statement arising from the disposal of "available for sale" investment securities.

The determination of the cash flows and discount factors for unquoted equity investments requires significant estimation. There are a number of investments where this estimation cannot be reliably determined, and as a result investments with a carrying amount of KD22,306,000 (2004: KD16,491,000) are carried at cost.

13. OTHER ASSETS

	2005 KD 000's	2004 KD 000's
Accrued interest receivable	**16,529**	9,927
Sundry debtors and others	**8,450**	2,513
Net positive fair value of derivatives (Note 31)	**312**	396
	25,291	12,836

14. PREMISES AND EQUIPMENT

The estimated useful lives of the assets for the calculation of depreciation are as follows:

	Freehold land and buildings KD 000's	Leasehold premises KD 000's	Furniture, equipment and vehicles KD 000's	Total KD 000's
Cost / revaluation				
At 1 January 2005	13,720	5,866	19,994	39,580
Additions	-	1,276	1,453	2,729
Change in fair value	173	-	-	173
At 31 December 2005	**13,893**	**7,142**	**21,447**	**42,482**
Depreciation:				
At 1 January 2005	5,891	3,154	18,356	27,401
Provided during the year	5	529	615	1,149
At 31 December 2005	**5,896**	**3,683**	**18,971**	**28,550**
Net book value:				
At 31 December 2005	**7,997**	**3,459**	**2,476**	**13,932**
At 31 December 2004	7,829	2,712	1,638	12,179

Revaluation of freehold land and buildings

The Bank engages two accredited independent valuers to determine the fair value of its freehold land and buildings every year. Fair value is determined by reference to market based evidence.

15. DUE TO BANKS, MEDIUM TERM LOANS FROM BANKS AND DEPOSITS FROM FINANCIAL INSTITUTIONS

	2005 KD 000's	2004 KD 000's
Due to banks		
Current accounts and demand deposits	5,251	5,532
Time deposits	60,593	102,676
	65,844	108,208
Medium term loans from banks	-	154,205
Deposits from financial institutions		
Current accounts and demand deposits	69,430	16,639
Time deposits	136,353	151,328
	205,783	167,967

16. CUSTOMER DEPOSITS

	2005 KD 000's	2004 KD 000's
Current accounts	387,143	316,989
Savings accounts	202,581	200,777
Time deposits	1,239,277	875,972
	1,829,001	1,393,738

17. FLOATING RATE NOTES

On 22 October 2003, the Bank issued five year floating rate notes (due October 2008), with a principal amount of USD200 million (equivalent KD58,940,000) at an issue price of 100%. The notes bear interest at the rate of 0.65% per annum above the London interbank offered rate (LIBOR) for three month US dollar deposits, payable quarterly in arrear. The notes are in bearer form in the denomination of USD100,000 each. They are listed on the Luxembourg Stock Exchange and are redeemable at par on or before 22 October 2008. The fair value of the floating rate notes as at 31 December 2005 is USD201,220,000 (equivalent KD58,756,000).

18. SUBORDINATED LOANS

As at 31 December 2005, Gulf Bank had subordinated borrowings of USD150million (equivalent KD43,800,000). The borrowings comprise two 10 year subordinated loans: USD50 million due June 2014 and USD100 million due December 2014. The borrowings were obtained from financial institutions outside of Kuwait and qualify as Tier 2 subordinated loan capital. The loans are repayable at maturity, with an option for early pre-payment with the prior approval of Central Bank of Kuwait, and interest is variable and related to interbank offered rates.

19. OTHER LIABILITIES

	2005 KD 000's	2004 KD 000's
Interest payable	18,083	11,144
Deferred income	3,065	4,297
Provisions for non-cash facilities	14,750	10,044
Provisions to be ceded to the Central Bank of Kuwait	284	30
Provisions for assets sold	-	702
Contribution to Kuwait Foundation for the Advancement of Sciences	883	772
Staff related provisions	3,417	3,158
National Labour Support Tax	1,963	1,716
Other	8,283	6,602
	50,728	38,465

20. SHARE CAPITAL

	2005 KD 000's	2004 KD 000's
Authorised, issued and fully paid ordinary shares	86,190	82,086
	86,190	82,086

The number of authorised, issued and fully paid ordinary shares of KD0.100 each as at 31 December 2005 is 861,901,485 (2004: 820,858,550).

21. RESERVES

In accordance with the Law of Commercial Companies and the Bank's Articles of Association, 10% of the Bank's operating profit for the year is transferred to statutory reserve.

Only that part of the statutory reserve in excess of 50% of paid-up share capital is freely distributable and useable with approval of the Annual General Meeting. Distribution of the balance of the statutory reserve is limited to the amount required to enable the payment of a dividend of 5% of paid-up share capital to be made in years when accumulated profits are not sufficient for the payment of a dividend of that amount.

The general reserve represents the surplus general provision on credit facilities arising on implementation of Central Bank of Kuwait instructions issued on 18 December 1996 as well as additional instructions issued on 1 June 1999, and dividends distributed on treasury shares up until the end of 1997.

The property revaluation reserve represents the surplus of market value over carrying value of freehold land and buildings owned by the Bank. The balance in this reserve is taken directly to retained earnings when the underlying assets are disposed of. The balances in the share premium account and treasury share reserve cannot be distributed.

22. TREASURY SHARES	2005	2004
Number of treasury shares	**10,317,697**	19,201,736
Percentage of treasury shares	**1.197%**	2.339%
Cost of treasury shares (KD 000's)	**11,396**	20,937
Market value of treasury shares (KD 000's)	**13,619**	20,354

23. PROPOSED DIVIDEND AND BONUS SHARES

At 31 December 2005, the following dividend has been proposed and will be submitted for formal approval at the Annual General Meeting: cash dividend of KD0.060 per share (totalling KD51,095,000) payable to the shareholders registered in the Bank's records as of the date of the Annual General Meeting; and bonus shares of 10% on the outstanding shares as at 31 December 2005.

A cash dividend of KD0.070 per share (totalling KD56,116,000) and bonus shares of 5% on the outstanding shares proposed as of 31 December 2004, was approved at the 2004 Annual General Meeting and was paid in 2005 following that approval.

24. PROVISION TO BE CEDED TO THE CENTRAL BANK OF KUWAIT

As at 31 December 2005, provisions to be ceded to the Central Bank of Kuwait are KD284,000 (2004: KD30,000). The identification of provisions no longer required was made in the same manner as adopted at the end of 2004 and in accordance with Central Bank of Kuwait instructions.

25. RELATED PARTY TRANSACTIONS

Certain related parties (directors and officers of the Bank, their families and companies of which they are principal owners) were customers of the Bank in the ordinary course of business. Such transactions were made on substantially the same terms, including interest rates and collateral, as those prevailing at the same time for comparable transactions with unrelated parties, and did not involve more than a normal amount of risk.

25. RELATED PARTY TRANSACTIONS (continued)

The transactions and balances included in the balance sheet are as follows:

	No. of Board and executive management members	No. of related parties	Value KD 000's
2005			
Board members			
Loans	**6**	**1**	**10,739**
Deposits	**6**	**1**	**132**
Guarantees issued	**-**	**2**	**251**
Executive management			
Loans	**10**	**-**	**3,933**
Deposits	**2**	**-**	**10**

	No. of Board and executive management members	No. of related parties	Value KD 000's
2004			
Board members			
Loans	5	1	5,221
Deposits	6	1	90
Guarantees issued	-	2	86
Executive management			
Loans	8	-	322
Deposits	4	-	16

There was no impairment in respect of loans given to related parties (2004: Nil).

The loans issued to directors and key management personnel are repayable within 3 years and have interest rates of 6% to 8% (2004: 4.25% to 6.25%). The loans advanced to directors during the year are collateralised by equities. The fair value of these equities as at 31 December 2005 was KD18,959,000 (2004: KD9,279,000). The transactions included in the income statement are as follows:

	2005 KD 000's	2004 KD 000's
Directors and key management personnel:		
Interest income earned	**740**	312
Interest expense on deposits	**10**	9
Key management compensation:		
Salaries and other short-term benefits	**1,331**	977
End of Service/Termination benefits	**52**	42

26. FINANCIAL INSTRUMENTS

Strategy in using financial instruments

As a commercial bank, the Bank's activities are principally related to the use of financial instruments including derivatives. It accepts deposits from customers at both fixed and floating rates for various periods and seeks to earn above average interest margins by investing these funds in high quality assets. It also seeks to increase these margins by consolidating short term funds and lending for longer periods at higher rates while maintaining sufficient liquidity to meet all claims that may fall due. With the exception of specific hedging arrangements, foreign exchange and interest rate exposures associated with these derivatives are normally offset by entering into counterbalancing positions, thereby controlling the variability in the net cash amounts required to liquidate market positions.

Risk management

The use of financial instruments also brings with it the associated inherent risks. The Bank recognises the relationship between returns and risks associated with the use of financial instruments and the management of risk forms an integral part of the Bank's strategic objectives.

The strategy of the Bank is to maintain a strong risk management culture and manage the risk/reward relationship within and across each of the Bank's major risk-based lines of business. The Bank continuously reviews its risk management policies and practices to ensure that the Bank is not subject to large asset valuation volatility and earnings volatility.

The following sections describe the several risks inherent in the banking process, their nature and how they are managed.

A. CREDIT RISK

Credit risk is the risk that one party to a financial instrument will fail to discharge an obligation and cause the other party to incur a financial loss. The Bank attempts to control credit risk by monitoring credit exposures, limiting transactions with specific counterparties, and continually assessing the creditworthiness of counterparties. In addition to monitoring credit limits, the Bank manages the credit exposure relating to its trading activities by entering into master netting agreements and collateral arrangements with counterparties in appropriate circumstances, and limiting the duration of exposure. In certain cases, the Bank may also close out transactions or assign them to other counterparties to mitigate credit risk.

Concentrations of credit risk arise when a number of counterparties are engaged in similar business activities, or activities in the same geographical region, or have similar economic features that would cause their ability to meet contractual obligations to be similarly affected by changes in economic, political or other conditions. Concentrations of credit risk indicate the relative sensitivity of the Bank's

26. FINANCIAL INSTRUMENTS (continued)

performance to developments affecting a particular industry or geographic location.

The Bank seeks to manage its credit risk exposure through diversification of lending activities to avoid undue concentrations of risks with individuals or groups of customers in specific locations or business. It also obtains security when appropriate.

Concentration of assets, liabilities and off-balance-sheet items

a. Credit risk concentration

The credit risk concentration within loans and advances, which form the significant portion of assets subject to credit risk, is given in Note 11.

b. Geographical concentration of assets, liabilities and off-balance-sheet items

At 31 December 2005:

Assets:	Kuwait KD 000's	Other Middle East KD 000's	Western Europe KD 000's	USA & Canada KD 000's	Asia Pacific KD 000's	Rest of World KD 000's	Total KD 000's
Cash and short term funds	185,995	90,032	39,794	18,345	13,478	3	347,647
Treasury bills and bonds	396,299	-	-	-	-	-	396,299
Central Bank of Kuwait bonds	59,798	-	-	-	-	-	59,798
Deposits with banks and financial institutions	10,000	5,034	2,336	-	-	-	17,370
Loans and advances to banks	3,120	24,090	21,685	-	14,578	-	63,473
Loans and advances to customers	1,517,424	34,553	1,460	602	2,294	22,232	1,578,565
Investment securities	43,568	233	6,180	17,981	14,542	23,362	105,866
Other assets	25,291	-	-	-	-	-	25,291
Premises and equipment	13,932	-	-	-	-	-	13,932
	2,255,427	153,942	71,455	36,928	44,892	45,597	2,608,241

Liabilities:	Kuwait KD 000's	Other Middle East KD 000's	Western Europe KD 000's	USA & Canada KD 000's	Asia Pacific KD 000's	Rest of World KD 000's	Total KD 000's
Due to banks	11,396	35,063	18,254	675	446	10	65,844
Deposits from financial institutions	192,870	12,912	-	-	-	1	205,783
Customer deposits	1,681,734	139,371	6,773	970	153	-	1,829,001
Floating rate notes	-	-	58,400	-	-	-	58,400
Subordinated loans	-	43,800	-	-	-	-	43,800
Other liabilities	50,728	-	-	-	-	-	50,728
	1,936,728	231,146	83,427	1,645	599	11	2,253,556
Commitments and contingent liabilities	739,578	190,209	20,209	3,524	89,269	560	1,043,349

26. FINANCIAL INSTRUMENTS (continued)

At 31 December 2004:

Assets:	Kuwait KD 000's	Other Middle East KD 000's	Western Europe KD 000's	USA & Canada KD 000's	Asia Pacific KD 000's	Rest of World KD 000's	Total KD 000's
Cash and short term funds	200,932	22,730	4,265	4,130	2,500	55	234,612
Treasury bills and bonds	484,359	-	-	-	-	-	484,359
Loans and advances to banks	14,918	34,358	46,571	-	17,977	2,481	116,305
Loans and advances to customers	1,269,682	23,546	31,827	-	-	13,231	1,338,286
Investment securities	22,836	36,198	7,980	3,683	-	16,890	87,587
Other assets	12,836	-	-	-	-	-	12,836
Premises and equipment	12,179	-	-	-	-	-	12,179
	2,017,742	116,832	90,643	7,813	20,477	32,657	2,286,164

Liabilities:	Kuwait KD 000's	Other Middle East KD 000's	Western Europe KD 000's	USA & Canada KD 000's	Asia Pacific KD 000's	Rest of World KD 000's	Total KD 000's
Due to banks	23,609	40,193	35,004	357	8,988	57	108,208
Medium term loans from banks	154,205	-	-	-	-	-	154,205
Deposits from financial institutions	167,967	-	-	-	-	-	167,967
Customer deposits	1,305,175	74,287	13,036	1,014	226	-	1,393,738
Floating rate notes	-	-	58,940	-	-	-	58,940
Subordinated loans	-	44,205	-	-	-	-	44,205
Other liabilities	38,465	-	-	-	-	-	38,465
	1,689,421	158,685	106,980	1,371	9,214	57	1,965,728
Commitments and contingent liabilities	538,462	79,352	2,613	33,715	39,619	-	693,761

26. FINANCIAL INSTRUMENTS (continued)

Financial instruments with contractual amounts representing credit risk

The primary purpose of these instruments is to ensure that funds are available to a customer as required. The contractual amounts represent the credit risk, assuming that the amounts are fully advanced and that any collateral or other security is of no value. However, the total contractual amount of commitments to extend credit does not necessarily represent future cash requirements, since many of these commitments will expire or terminate without being funded. These instruments are disclosed in Note 28.

Financial instruments with contractual or notional amounts that are subject to credit risk

These derivative financial instruments, comprising foreign exchange and interest rate contracts, allow the Bank and its customers to transfer, modify or reduce their foreign exchange and interest rate risks.

The amount subject to credit risk is insignificant and is limited to the current replacement value of instruments that are favourable to the Bank, which is only a fraction of the contractual or notional amounts used to express the volumes outstanding. This credit risk exposure is managed as part of the overall borrowing limits granted to customers. Collateral security is not usually obtained for credit risk exposures on these instruments. These instruments are disclosed in Note 31.

B. INTEREST RATE RISK

Interest rate risk arises from the possibility that changes in interest rates will affect the fair value or cash flows of the financial instruments. The Bank is exposed to interest rate risk as a result of mismatches or gaps in the amounts of assets and liabilities and off-balance-sheet instruments that mature or reprice in a given period. The Bank manages this risk by matching the repricing of assets and liabilities through risk management strategies.

A majority of the Bank's assets and liabilities reprice within one year. Accordingly there is a limited exposure to interest rate risk. The effective interest rate (effective yield) of a monetary financial instrument is the rate that, when used in a present value calculation, results in the carrying amount of the instrument. The rate is the historical rate for a fixed rate instrument carried at amortised cost and a current market rate for a floating rate instrument or an instrument carried at fair value.

26. FINANCIAL INSTRUMENTS (continued)

The Bank's interest sensitivity position was as follows:

At 31 December 2005:

Assets:	Up to 1 month KD 000's	1-3 months KD 000's	3-12 months KD 000's	Over 1 year KD 000's	Non interest sensitive KD 000's	Total KD 000's
Cash and short term funds	330,299	-	-	-	17,348	347,647
Treasury bills and bonds	-	44,750	351,549	-	-	396,299
Central Bank of Kuwait bonds	59,798	-	-	-	-	59,798
Deposits with banks and financial institutions	-	10,876	6,494	-	-	17,370
Loans and advances to banks	7,300	39,931	9,156	5,534	1,552	63,473
Loans and advances to customers	166,323	157,859	596,255	719,128	(61,000)	1,578,565
Investment securities	-	723	2,278	261	102,604	105,866
Other assets	-	-	-	-	25,291	25,291
Premises and equipment	-	-	-	-	13,932	13,932
	563,720	254,139	965,732	724,923	99,727	2,608,241
Liabilities and equity:						
Due to banks	42,733	11,680	9,879	-	1,552	65,844
Deposits from financial institutions	129,029	36,368	40,335	51	-	205,783
Customer deposits	1,210,381	319,438	270,368	28,814	-	1,829,001
Floating rate notes	58,400	-	-	-	-	58,400
Subordinated loans	-	43,800	-	-	-	43,800
Other liabilities	-	-	-	-	50,728	50,728
Equity	-	-	-	-	354,685	354,685
	1,440,543	411,286	320,582	28,865	406,965	2,608,241
On-balance-sheet gap	(876,823)	(157,147)	645,150	696,058	(307,238)	-
Off-balance-sheet gap	-	10,289	-	(10,289)	-	-
Total interest rate sensitive gap	(876,823)	(146,858)	645,150	685,769	(307,238)	-
Cumulative interest rate sensitive gap	(876,823)	(1,023,681)	(378,531)	307,238	-	-

26. FINANCIAL INSTRUMENTS (continued)

At 31 December 2004:

Assets:	Up to 1 month KD 000's	1-3 months KD 000's	3-12 months KD 000's	Over 1 year KD 000's	Non interest sensitive KD 000's	Total KD 000's
Cash and short term funds	211,581	-	-	-	23,031	234,612
Treasury bills and bonds	38,333	71,940	374,086	-	-	484,359
Loans and advances to banks	9,887	56,402	48,464	-	1,552	116,305
Loans and advances to customers	237,421	186,409	411,452	558,370	(55,366)	1,338,286
Investment securities	-	729	-	16,495	70,363	87,587
Other assets	-	-	-	-	12,836	12,836
Premises and equipment	-	-	-	-	12,179	12,179
	497,222	315,480	834,002	574,865	64,595	2,286,164
Liabilities and equity:						
Due to banks	37,751	59,489	9,416	-	1,552	108,208
Medium term loans from banks	110,000	44,205	-	-	-	154,205
Deposits from financial institutions	69,734	79,548	18,685	-	-	167,967
Customer deposits	947,175	272,245	133,219	5,938	35,161	1,393,738
Floating rate notes	58,940	-	-	-	-	58,940
Subordinated loans	-	44,205	-	-	-	44,205
Other liabilities	-	-	-	-	38,465	38,465
Equity	-	-	-	-	320,436	320,436
	1,223,600	499,692	161,320	5,938	395,614	2,286,164
On-balance-sheet gap	(726,378)	(184,212)	672,682	568,927	(331,019)	-
Off-balance-sheet gap	-	-	-	-	-	-
Total interest rate sensitive gap	(726,378)	(184,212)	672,682	568,927	(331,019)	-
Cumulative interest rate sensitive gap	(726,378)	(910,590)	(237,908)	331,019	-	-

26. FINANCIAL INSTRUMENTS (continued)

Effective interest rates

At 31 December 2005:

Assets:	0%-3% KD 000's	3%-6% KD 000's	6%-9% KD 000's	9%-12% KD 000's	Non interest sensitive KD 000's	Total KD 000's
Cash and short term funds	**99,410**	**230,889**	**-**	**-**	**17,348**	**347,647**
Treasury bills and bonds	**-**	**396,299**	**-**	**-**	**-**	**396,299**
Central Bank of Kuwait bonds	**-**	**59,798**	**-**	**-**	**-**	**59,798**
Deposits with banks and financial institutions	**2,336**	**15,034**	**-**	**-**	**-**	**17,370**
Loans and advances to banks	**4,066**	**51,815**	**6,040**	**-**	**1,552**	**63,473**
Loans and advances to customers	**44,602**	**162,523**	**816,351**	**616,089**	**(61,000)**	**1,578,565**
Investment securities	**-**	**3,232**	**30**	**-**	**102,604**	**105,866**
Other assets	**-**	**-**	**-**	**-**	**25,291**	**25,291**
Premises and equipment	**-**	**-**	**-**	**-**	**13,932**	**13,932**
	150,414	**919,590**	**822,421**	**616,089**	**99,727**	**2,608,241**

Liabilities and equity:	0%-3% KD 000's	3%-6% KD 000's	6%-9% KD 000's	9%-12% KD 000's	Non interest sensitive KD 000's	Total KD 000's
Due to banks	**5,135**	**59,157**	**-**	**-**	**1,552**	**65,844**
Deposits from financial institutions	**46,552**	**130,131**	**29,100**	**-**	**-**	**205,783**
Customer deposits	**626,095**	**1,132,049**	**70,539**	**318**	**-**	**1,829,001**
Floating rate notes	**-**	**58,400**	**-**	**-**	**-**	**58,400**
Subordinated loans	**-**	**14,600**	**29,200**	**-**	**-**	**43,800**
Other liabilities	**-**	**-**	**-**	**-**	**50,728**	**50,728**
Equity	**-**	**-**	**-**	**-**	**354,685**	**354,685**
	677,782	**1,394,337**	**128,839**	**318**	**406,965**	**2,608,241**

At 31 December 2004:

Assets:	0%-3% KD 000's	3%-6% KD 000's	6%-9% KD 000's	9%-12% KD 000's	Non interest sensitive KD 000's	Total KD 000's
Cash and short term funds	171,010	40,571	-	-	23,031	234,612
Treasury bills and bonds	484,359	-	-	-	-	484,359
Loans and advances to banks	58,215	56,538	-	-	1,552	116,305
Loans and advances to customers	117,805	263,962	999,425	12,460	(55,366)	1,338,286
Investment securities	729	209	30	16,256	70,363	87,587
Other assets	-	-	-	-	12,836	12,836
Premises and equipment	-	-	-	-	12,179	12,179
	832,118	361,280	999,455	28,716	64,595	2,286,164

26. FINANCIAL INSTRUMENTS (continued)

At 31 December 2004 (continued):

Liabilities and equity:	0%-3% KD 000's	3%-6% KD 000's	6%-9% KD 000's	9%-12% KD 000's	Non interest sensitive KD 000's	Total KD 000's
Due to banks	71,525	35,131	-	-	1,552	108,208
Medium term loans from banks	134,205	20,000	-	-	-	154,205
Deposits from financial institutions	19,244	148,723	-	-	-	167,967
Customer deposits	864,128	494,449	-	-	35,161	1,393,738
Floating rate notes	-	58,940	-	-	-	58,940
Subordinated loans	-	44,205	-	-	-	44,205
Other liabilities	-	-	-	-	38,465	38,465
Equity	-	-	-	-	320,436	320,436
	1,089,102	801,448	-	-	395,614	2,286,164

C. CURRENCY RISK

Currency risk is the risk that the value of a financial instrument will fluctuate due to changes in foreign exchange rates. The Bank views itself as a Kuwaiti entity with Kuwaiti Dinars as its functional currency. The Board of Directors has set limits on positions by currency. Positions are monitored on a daily basis and hedging strategies used to ensure positions are maintained within established limits.

The Bank had the following significant net exposures denominated in foreign currencies as at 31 December:

Net assets (liabilities)	**2005** KD 000's	2004 KD 000's
US Dollars	**48,059**	46,315
Euros	**5,158**	543
Swiss Francs	**17,243**	256
Sterling Pounds	**(8,189)**	1,686
Japanese Yen	**5,523**	14,982
Australian Dollars	**(3)**	(259)
Canadian Dollars	**(14)**	118
Saudi Riyals	**435**	(16,291)
Others	**778**	3,549
	68,990	50,899

26. FINANCIAL INSTRUMENTS (continued)

D. LIQUIDITY RISK

Liquidity risk is the risk that the Bank will be unable to meet its net funding requirements. Liquidity risk can be caused by market disruptions or credit downgrades which may cause certain sources of funding to dry up immediately. To guard against this risk, management has diversified funding sources and assets are managed with liquidity in mind, maintaining a sufficient balance of cash, cash equivalents and readily marketable securities.

The table below summarises the maturity profile of the Bank's assets and liabilities. The contractual maturities of assets and liabilities have been determined on the basis of the remaining period at the balance sheet date to the contractual maturity date and do not take account of the effective maturities as indicated by the Bank's deposit retention history and the availability of liquid funds. The maturity profile is monitored by management to ensure that adequate liquidity is maintained. The maturity profile of the assets and liabilities at the year end based on contractual repayment arrangements is as follows:

At 31 December 2005:

	Up to 1 month	1-3 months	3-6 months	6-12 months	1-3 years	Over 3 years	Total
Assets:	KD 000's	KD 000's	KD 000's	KD 000's	KD 000's	KD 000's	KD 000's
Cash and short term funds	347,647	-	-	-	-	-	347,647
Treasury bills and bonds	-	44,750	58,755	292,794	-	-	396,299
Central Bank of Kuwait bonds	59,798	-	-	-	-	-	59,798
Deposits with banks and OFIs	-	10,876	5,034	1,460	-	-	17,370
Loans and advances to banks	2,920	12,630	9,448	7,300	17,520	13,655	63,473
Loans and advances to customers	98,217	155,447	363,558	232,823	166,568	561,952	1,578,565
Investment securities	-	-	-	-	-	105,866	105,866
Other assets	25,291	-	-	-	-	-	25,291
Premises and equipment	-	-	-	-	-	13,932	13,932
	533,873	223,703	436,795	534,377	184,088	695,405	2,608,241
Liabilities and equity:							
Due to banks	44,285	11,680	9,879	-	-	-	65,844
Deposits from financial institutions	129,029	36,368	35,240	5,095	51	-	205,783
Customer deposits	1,210,382	319,438	125,429	144,939	28,552	261	1,829,001
Floating rate notes	-	-	-	-	58,400	-	58,400
Subordinated loans	-	-	-	-	-	43,800	43,800
Other liabilities	50,728	-	-	-	-	-	50,728
Equity	-	51,095	-	-	-	303,590	354,685
	1,434,424	418,581	170,548	150,034	87,003	347,651	2,608,241
Net liquidity gap	(900,551)	(194,878)	266,247	384,343	97,085	347,754	-

26. FINANCIAL INSTRUMENTS (continued)

At 31 December 2004:

Assets:	Up to 1 month KD 000's	1-3 months KD 000's	3-6 months KD 000's	6-12 months KD 000's	1-3 years KD 000's	Over 3 years KD 000's	Total KD 000's
Cash and short term funds	234,612	-	-	-	-	-	234,612
Treasury bills and bonds	38,333	71,940	156,688	217,398	-	-	484,359
Loans and advances to banks	6,207	10,679	45,891	27,944	25,584	-	116,305
Loans and advances to customers	200,819	149,813	299,128	110,623	148,303	429,600	1,338,286
Investment securities	-	-	-	-	-	87,587	87,587
Other assets	12,836	-	-	-	-	-	12,836
Premises and equipment	-	-	-	-	-	12,179	12,179
	492,807	232,432	501,707	355,965	173,887	529,366	2,286,164
Liabilities and equity:							
Due to banks	37,751	59,489	9,416	-	1,552	-	108,208
Medium term loans from banks	-	44,205	-	50,000	60,000	-	154,205
Deposits from financial institutions	69,734	79,548	17,529	1,156	-	-	167,967
Customer deposits	982,336	272,245	76,235	56,984	5,938	-	1,393,738
Floating rate notes	-	-	-	-	-	58,940	58,940
Subordinated loans	-	-	-	-	-	44,205	44,205
Other liabilities	30,644	-	4,343	3,478	-	-	38,465
Equity	-	56,116	-	-	-	264,320	320,436
	1,120,465	511,603	107,523	111,618	67,490	367,465	2,286,164
Net liquidity gap	(627,658)	(279,171)	394,184	244,347	106,397	161,901	-

E. OPERATIONAL RISK

Operational risk arises from a failure to control properly all aspects of the documentation, processing, settlement of, and accounting for, transactions and, more widely, all the hazards to which a bank is exposed as a result of being in business and of doing business. The Bank has a set of policies and procedures, which are approved by the Board of Directors and are applied to identify, assess and supervise operational risk in addition to other types of risks relating to the banking and financial activities of the Bank. Operational risk is managed through the Risk Management Department. This department ensures compliance with policies and procedures to identify, assess, supervise and monitor operational risk as part of overall risk management.

The operational risks are managed through the Risk Management Department in line with the Central Bank of Kuwait instructions dated 14 November 1996, concerning the general guidelines for internal controls and the instructions dated 13 October 2003, regarding the sound practices for managing and supervising operational risks in banks.

26. FINANCIAL INSTRUMENTS (continued)

F. PRICE RISK

This is the risk that the value of a financial instrument will fluctuate as a result of changes in market prices, whether those changes are caused by factors specific to the individual instrument or its issuer or factors affecting all instruments traded in the market. The Bank manages this risk through diversification of investments in terms of geographical distribution and industry concentration.

27. FAIR VALUE OF FINANCIAL ASSETS AND LIABILITIES

Fair value is the amount at which an asset, liability or financial instrument could be exchanged or settled between knowledgeable parties in an arm's length transaction. Underlying the definition of fair value is the presumption that the Bank is a going concern without any intention, or need, to liquidate, curtail materially the scale of its operations or undertake a transaction on adverse terms.

Fair values of interest bearing financial assets and liabilities not represented on the Bank's balance sheet at fair values have been estimated using prevailing interest rates for debts with similar credit risk and residual maturity. The carrying value of such financial instruments generally approximates their fair values.

As explained in note 12, included under investment securities are unquoted equity investments with a carrying value of KD22,306,000 (2004: KD16,491,000) for which fair value cannot be reliably determined.

28. CONTINGENT LIABILITIES AND COMMITMENTS

These financial statements do not reflect the following commitments and contingent liabilities which arise in the normal course of business.

	2005 *KD 000's*	2004 *KD 000's*
Guarantees:		
Contract	**321,196**	259,010
Tender	**60,841**	50,718
Syndicated	**70,742**	19,850
Other	**180,773**	125,116
	633,552	454.694
Letters of credit:		
Sight	**219,382**	96.424
Syndicated	**21,586**	15.597
Acceptance	**120,455**	76.191
Confirmed	**2,329**	5.022
	363,752	193.234
Irrevocable commitments to extend credit:		
Original term to maturity of one year or less	**45,046**	45.833
Original term to maturity of more than one year	**999**	-
	46,045	45.833
	1,043,349	693.761

29. SEGMENTAL ANALYSIS

a. By Business Unit

Treasury & International	Principally providing money market, trading and treasury services, as well as the management of the Bank's funding operations by use of treasury bills, government securities and placements and acceptances with other banks, through treasury and wholesale banking.
Domestic Banking	Principally handling individual customer deposits and providing consumer loans, overdrafts, credit card facilities and funds transfer facilities to individuals; and handling loans and other credit facilities, deposits and current accounts for corporate and institutional customers.

29. SEGMENTAL ANALYSIS (continued)

At 31 December 2005:

	Treasury & International KD 000's	Domestic Banking KD 000's	Total KD 000's
Income Statement:			
Interest income from external sources	**31,154**	**105,107**	**136,261**
Net profit	**17,091**	**68,279**	**85,370**
Balance Sheet:			
Assets	**968,374**	**1,639,867**	**2,608,241**
Liabilities:			
Deposits	**697,400**	**1,505,428**	**2,202,828**
Other liabilities	**10,182**	**40,546**	**50,728**
Central treasury	**(93,893)**	**93,893**	**-**
	613,689	**1,639,867**	**2,253,556**
Capital expenditure	**124**	**2,605**	**2,729**
Depreciation	**5**	**1,144**	**1,149**

At 31 December 2004:

	Treasury & International KD 000's	Domestic Banking KD 000's	Total KD 000's
Income Statement:			
Interest income from external sources	31,075	75,860	106,935
Net profit	24,000	50,646	74,646
Balance Sheet:			
Assets	988,957	1,297,207	2,286,164
Liabilities:			
Deposits	544,292	1,382,971	1,927,263
Other liabilities	5,106	33,359	38,465
Central treasury	119,123	(119,123)	-
	668,521	1,297,207	1,965,728
Capital expenditure	98	1,210	1,308
Depreciation	2	871	873

29. SEGMENTAL ANALYSIS (continued)

b. By Geographical Area

All significant segment revenue from external customers is derived from customers based in Kuwait. Geographic segment information relating to location of assets is given in note 26 A.

30. FIDUCIARY ASSETS

The aggregate value of assets held in a fiduciary capacity by the Bank at 31 December 2005 amounted to KD310,000 (2004: KD521,000).

31. DERIVATIVES

In the ordinary course of business the Bank enters into various types of transactions that involve derivative financial instruments. A derivative financial instrument is a financial contract between two parties where payments are dependent upon movements in price of one or more underlying financial instruments, reference rate or index.

The table below shows the positive and negative fair values of derivative financial instruments, together with the notional amounts analysed by the term to maturity. The notional amount is the amount of a derivative's underlying asset, reference rate or index and is the basis upon which changes in the value of derivatives are measured.

The notional amounts indicate the volume of transactions outstanding at the year end and are not indicative of either market or credit risk.

At 31 December 2005:

	Net positive (negative) fair value	Notional amount Total	Notional amounts by term to maturity		
Derivatives instruments held as:			Within 3 months	3-12 months	1-5 years
	KD 000's	KD 000's	KD 000's	KD 000's	KD 000's
Trading (and non qualifying hedges)					
Interest rate swaps	**(52)**	**10,289**	**-**	**-**	**10,289**
Forward foreign exchange contracts	**366**	**190,208**	**159,624**	**30,584**	**-**
Credit default swaps	**(2)**	**83,220**	**32,120**	**29,200**	**21,900**
	312	**283,717**	**191,744**	**59,784**	**32,189**

At 31 December 2004:

	Net positive (negative) fair value	Notional amount Total	Notional amounts by term to maturity		
Derivatives instruments held as:			Within 3 months	3-12 months	1-5 years
	KD 000's	KD 000's	KD 000's	KD 000's	KD 000's
Trading (and non qualifying hedges)					
Forward foreign exchange contracts	396	386,412	206,101	180,311	-
Credit default swaps	-	76,622	-	32,417	44,205
	396	463,034	206,101	212,728	44,205

31. DERIVATIVES (continued)

Derivative product types

Forwards and futures are contractual agreements to either buy or sell a specified currency, commodity or financial instrument at a specific price and date in the future. Forwards are customised contracts transacted in the over-the-counter market. Foreign currency and interest rate futures are transacted in standardised amounts on regulated exchanges and are subject to daily cash margin requirements.

Swaps are contractual agreements between two parties to exchange interest or foreign currency differentials based on a specific notional amount. For interest rate swaps, counterparties generally exchange fixed and floating rate interest payments based on a notional value in a single currency. For currency swaps, fixed or floating interest payments as well as notional amounts are exchanged in different currencies.

Derivatives held or issued for trading purposes

Most of the Bank's derivative trading activities relate to sales, positioning and arbitrage. Sales activities involve offering products to customers in order to enable them to transfer, modify or reduce current and expected risks. Positioning involves managing positions with the expectation of profiting from favourable movements in prices, rates or indices. Arbitrage involves identifying and profiting from price differentials between markets or products. Also included under this heading are any derivatives which do not meet IAS 39 hedging requirements.


GULF BANK