ANNUAL REPORT

A CONSTANT JOURNEY TOWARDS SUCCESS 2006

بنك الخليج
GULF BANK
ALWAYS MORE

H.H. Sheikh
Sabah Al Ahmed Al Jaber Al Sabah
(The Amir of the State of Kuwait)

H.H. Sheikh
Nawaf Al Ahmad Al Jaber Al Sabah
(The Crown Prince)

H.H. Sheikh
Nasser Al Mohammed Al Ahmad Al Sabah
(The Prime Minister)

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BOARD OF DIRECTORS

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BOARD OF DIRECTORS

Bassam Yusuf Ahmed Alghanim	Chairman & 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

FINANCIAL HIGHLIGHTS

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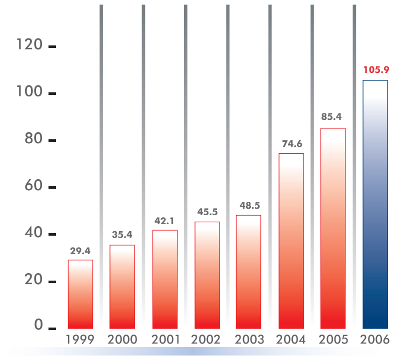
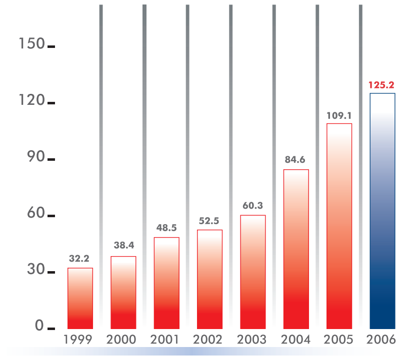
Financial Highlights

7 YEARS OF RECORD RESULTS

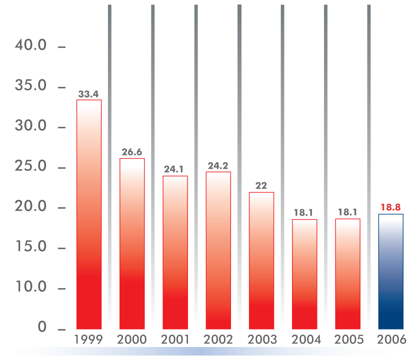
NET PROFIT (KD MILLION)



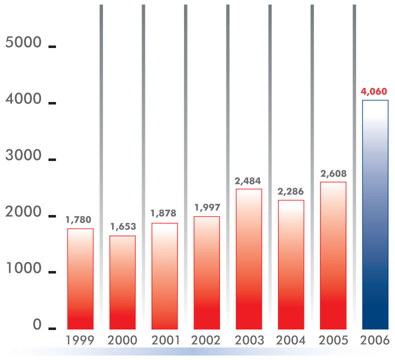
OPERATING PROFIT (BEFORE PROVISIONS) (KD MILLION)



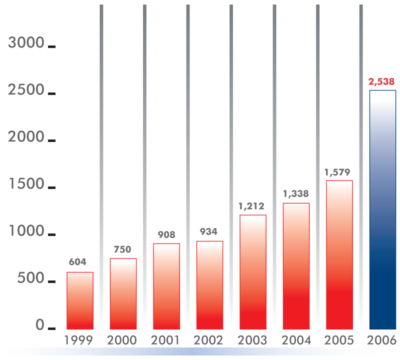
COST TO INCOME RATIO (%)



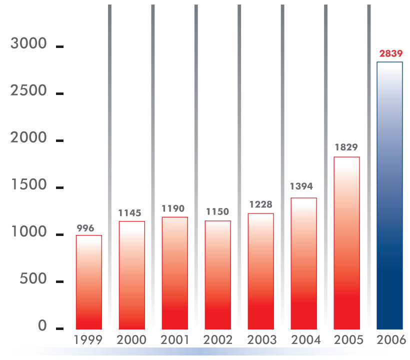
TOTAL ASSETS (KD MILLION)



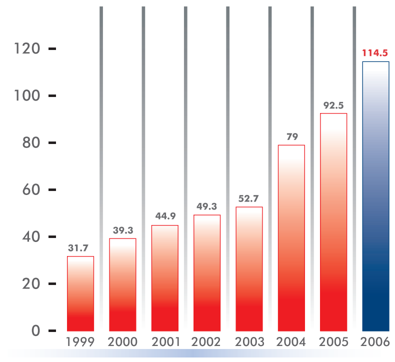
CUSTOMER LOANS (KD MILLION)



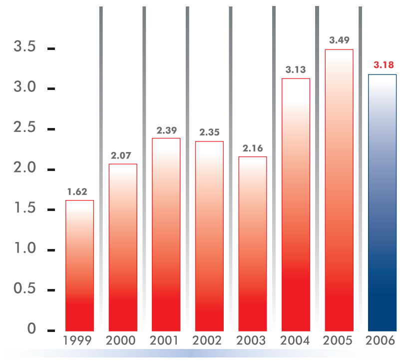
CUSTOMER DEPOSITS (KD MILLION)



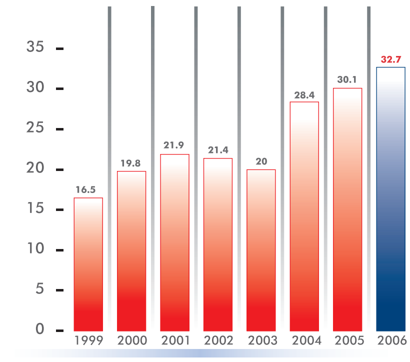
EARNINGS PER SHARE (FILS)



RETURN ON ASSETS (%)



RETURN ON EQUITY (%)



CHAIRMAN´S MESSAGE

"SUCCESS IN THE BANKING INDUSTRY REQUIRES TWO ESSENTIAL INGREDIENTS: A SOUND STRATEGY AND A DISCIPLINED FOCUS. I BELIEVE THESE TWIN IMPERATIVES ARE THE FOUNDATION OF THE GULF BANK STORY".

2006 ANNUAL REPORT CHAIRMAN'S MESSAGE

Dear Shareholders,

It is my great pleasure to report another outstanding year for Gulf Bank; a year in which the Bank continued on its path of record growth and profitability.

Success in the banking industry requires two essential ingredients: a sound strategy and a disciplined focus. I believe these twin imperatives are the foundation of the Gulf Bank story. When we embarked on our Bank-wide Transformation programme seven years ago, we were determined to play a leading role in Kuwait's banking market.

By concentrating our attention on the Kuwait market and getting our customer segmentation right, Gulf Bank has achieved remarkable results. In retail banking, we have built a stable base of customers and we've led the way in product and service innovation. In wholesale banking, we have developed solid customer relationships and have become the bank of first choice for many corporates in Kuwait. We have delivered outstanding shareholder returns and maintained an operational efficiency that is the envy of our competitors.

In 2006, the total annual Net Profit rose by 24% to a record KD105.9 million with strong earnings growth across all operating Groups. Asset growth was extremely strong: total assets climbed 55% to surpass the KD4 billion milestone for the first time.

Gulf Bank was again recognised for its excellence in 2006, awarded "Best Retail Bank in the Middle East" by the prestigious Banker Middle East magazine for the second consecutive year.

Gulf Bank also re-affirmed its position as a leading Kuwaiti employer, once again winning the Localization Award from the GCC Council of Ministers for Social Affairs and Labour for achieving the highest rate of Kuwaitization of any company in the country's private sector and for its investment in the development of the skills and abilities of Kuwaitis. In 2006, Gulf Bank became the first Kuwaiti company to be awarded a coveted Stevie® International Business Award for the best HR team.

Gulf Bank's goal is to become Kuwait's preferred local bank and in 2006 we made significant progress in several key areas of our customer-centric retail strategy. The Retail Banking Group continued the expansion of the Bank's branch network, growing the number of branches to 38.

Most branches are now in the new format - a contemporary architectural branding inspired by Kuwait's seafaring heritage which provides an attractive and efficient banking experience. The 24/ 7 Self Service area in the new branches was further enhanced with cash deposit machines to complement the existing services including internet banking, cash withdrawals and access to customer service agents 24 hours a day, 365 days per year. This remains a significant competitive advantage that is unique to Gulf Bank.

Systems enhancements have improved information availability to ensure customers can access their information whenever they want from anywhere in the world. Gulf Bank became the first bank in Kuwait to introduce a personalised ATM service utilising advanced software developed by NCR which allows for targeted messaging to a specific customer and also allows the customer to choose favourite transactions to minimize time at the ATM.

Gulf Bank achieved continued growth of market share in an intensely competitive retail banking environment.

The Retail Banking Group continued its success in targeting salary consumers with strong customer acquisition across all channels, especially the branch network and the Central Sales team. In 2006, the Bank saw strong growth in both the loan book and deposits.

Gulf Bank again established a new standard in compelling communication with the launch of the Salary for Life to reward new salary transfers while Red, the university/college student program, was re-launched in September with a distinctive and engaging marketing program. Gulf Bank has also redesigned the customer service experience for our highest-value customers through the re-launch of a new Priority Banking service.

As these initiatives demonstrate, Gulf Bank is committed to meeting and exceeding the expectations of our customers and to setting new standards of service and performance in our industry.

The Corporate Banking Group achieved an outstanding performance in 2006. The Group built on the success of the market-based segmentation of its business divisions and continued to grow its client relationships through a wider offering of Gulf Bank products and services.

Corporate Banking contributed to the progress of Kuwait's economy through major project finance deals including contractor financing for The Avenues Mall and The Lakes developments and for construction of the Main College for Girls in Ardiya, the State Audit Bureau Building and Phase 11 of the Subiya Highway project.

The Financial Markets division witnessed unprecedented growth while the Commercial division saw a strong upturn in deposit acquisition and a significant increase in its portfolio with a concentration on diversification in risk and market sectors. The Small & Medium Enterprise (SME) division also expanded its client base, developing new relationships in the transport & logistics, oil & gas and automotive sectors while helping small business entrepreneurs achieve their goals.

The International Banking Group achieved strong growth across all its products and services in 2006. The Group continued to expand its business in the Middle East and in emerging markets while supporting the overseas activities of its Kuwait-based clients. In addition, a restructuring of the Group's portfolio in light of Basel II requirements is generating growing income streams.

The Investment Banking Group performed well despite increased volatility in GCC equity markets, achieving excellent returns on both its foreign investment portfolio and its investments in Kuwait and the GCC Region.

In 2006, the Treasury Group consolidated its position as market leader in both Spot and Forward KD Foreign Exchange dealing with a significant increase in Foreign Exchange profitability. Treasury effectively managed a rapidly growing balance sheet and played a leading role in growing Gulf Bank's customer deposit base. 2006 also saw the Treasury Group offer Foreign Exchange and interest rate hedging products.

Gulf Bank has also led the way in compliance with the Pillar 3 Disclosures under the Basel II requirements mandated by the Central Bank of Kuwait (CBK), with Gulf Bank's disclosures rated as best of all the Kuwaiti banks. In 2006, the Finance Group continued to upgrade its systems and processes, achieving faster turnaround of financial reports and providing increasingly valuable market and performance analysis.

Gulf Bank remains one of the highest rated banks in the region. It is one of only seven banks in the GCC assigned an 'Aa3' long-term foreign currency deposit rating from Moody's Investors Service and enjoys strong ratings from Fitch Rating and Capital Intelligence ('A') and Standard & Poor's ('A-'). These ratings reflect the strength of our financial performance and capital adequacy and the integral role that Gulf Bank plays in Kuwait's domestic banking and financial services sector.

Gulf Bank's strategy of balanced growth, a strong domestic focus and a customer-centric mindset has again yielded excellent results for you, our shareholders. I am delighted to announce that the Board of Directors has recommended a cash dividend of 60 fils and 15% bonus share issue, a return of 24% for 2006.

On behalf of the Board of Directors, I would like to pay tribute to His Highness, The Amir Sheikh Sabah Al Ahmed Al Jaber Al Sabah for his wise guidance of the State of Kuwait since his accession in January 2006, the Crown Prince of the State of Kuwait, H.H Sheikh Nawaf Al Ahmad Al Jaber Al Sabah, and the Prime Minister of the State of Kuwait, H.H Sheikh Nasser Al Mohammed Al Ahmad Al Sabah.

We would also like to express our thanks to the Central Bank of Kuwait and other official authorities for their continued support of the Bank. On behalf of the Board of Directors, I would also like to take this opportunity to thank our loyal customers, our outstanding team of Management and staff who have made such a contribution to Gulf Bank's performance and our shareholders. I look forward to continued success in the years ahead.

Bassam Yusuf Alghanim

Chairman and Managing Director

FINANCIAL REVIEW

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GULF BANK – 2006 FINANCIAL REVIEW

SUMMARY OF FINANCIAL PERFORMANCE

(KD Millions)	**2006**	2005
Net interest income	**108.54**	81.54
Other operating income	**45.64**	51.61
Operating income	**154.18**	133.15
Operating expenses	**(28.98)**	(24.10)
Operating profit before provisions	**125.20**	109.05
Provisions	**(15.40)**	(20.73)
Operating profit	**109.80**	88.32
Directors' emoluments	**(0.11)**	(0.11)
KFAS/ National Labour Support Tax	**(3.81)**	(2.84)
NET PROFIT	**105.88**	85.37

Gulf Bank produced another record set of results in 2006, further building upon the new heightened level of profitability that produced 2005's record results. The 2006 performance marks 7 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 2006 and the Bank met all of its key 2006 business plan targets.

The record net profit of KD105.88 million (USD366.19 million) was KD20.51 million or 24% higher than 2005. Operating profit before provisions grew by KD16.15 million (15%) to KD125.20 million, reflecting strong growth in all business areas.

Net interest income increased by KD27.00 million (33%) as a result of 55% growth in corporate loans and 29% growth in retail loans.

SUMMARY OF FINANCIAL PERFORMANCE *(continued)*

Other operating income reduced by KD5.97 million (12%), due to lower investment disposal income and lower insurance income during 2006. However other operating income (excluding investment disposals and dividend income) grew by KD1.71 million (6%). There has been a strong growth in LC / LG income (14% and 27% respectively). Foreign exchange earnings are higher by 13%.

Operating expenses increased by KD4.88 million (20%) due to continuing investment in branches, people and systems. Staff costs were up KD4.17 million (30%) and non-staff costs were up KD0.72 million (7%). The Bank continues to have an industry-beating cost:income ratio of 18.8%. The cost growth was partly offset by a 16% 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 seven years.

The provisions charge of KD15.40 million was KD5.33 million (26%) lower than 2005.Specific provisions were KD1.20 million lower at KD3.25 million and general provisions were KD4.13 million lower at KD12.15 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 levels of 3.18% and 32.7%, respectively. These returns are exceptionally high by international banking standards. Earnings per share similarly grew by 24%, from 92.5 fils to 114.5 fils.

NET INTEREST INCOME

	2006	2005
Net interest income *(KDm)*	**108.54**	81.54
Average interest-earning assets *(KDm)*	**3,247.2**	2,380.1
Net interest spread *(per cent)*	**2.86%**	3.08%
Net interest margin *(per cent)*	**3.34%**	3.43%
Average KD Discount Rate *(per cent)*	**6.12%**	5.40%

Net interest income increased by KD27.00 million (33%) in 2006, 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 increased by 55% and deposit balances increased by 87%.

Average interest-earning assets grew substantially in 2006: up KD867.13 million (36%) to KD3.25 billion. This boosted the growth in net interest income by 33%. The yields on Treasury Bonds / CBK bonds & CBK time deposits (one month intervention rate) was higher during the year. However, the overall net interest spread was 22 basis points lower (at 2.86%), due to higher proportion of corporate loans in 2006 and higher cost of funds. The net interest margin was lower by only 9 basis points, at 3.34%, due to the added benefit of higher interest rates on the Bank's net free funds. During 2005, CBK had increased the discount rates broadly in line with the movement in the US interest rates. However, in 2006, CBK did not follow the first three increases in the US interest rates ('Fed' rate). The fourth increase in the Fed rate, in June 2006, led to increase in the KD Discount Rate from 6.00% to 6.25%. There were no subsequent increases in the Fed rate and consequently the KD discount rate was held at 6.25%.

OTHER OPERATING INCOME

(KD millions)	**2006**	2005
Net fees and commissions	**26.08**	25.32
Foreign exchange and derivatives income	**6.18**	5.45
Dividend income	**0.45**	1.86
Other income	**0.38**	0.15
Income from disposal of investment securities	**12.55**	18.83
TOTAL OTHER OPERATING INCOME	**45.64**	51.61

Other operating income was lower by KD5.97 million, primarily due to lower income from disposal of securities and dividend income as compared to 2005. Net fees and commissions increased by KD0.76 million (3%), despite lower insurance income during the current year, with strong business volume growth in all business areas across all products and services. The growth in letters of credit and guarantee commissions was particularly strong (14% and 27% respectively).

Foreign exchange earnings were up KD0.73 million (13%), reflecting increased customer business volumes.

Dividend income was KD1.41 million lower in 2006, at KD0.45 million. In 2005, the bank had received dividend on shares held in The Bank of Bahrain and Kuwait ('BBK'), which were sold in the end of 2005, leading to lower dividend income in 2006. Other income was KD0.23 million higher at KD0.38 million.

Income from the disposal of investment securities was lower by KD6.28 million (33%) at KD12.55 million. The income during the current year have been primarily from sale of equity investments. 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 earnings.

OPERATING EXPENSES

(KD millions)	**2006**	2005
Staff costs	**17.91**	13.75
Occupancy costs	**1.36**	1.20
Depreciation	**1.68**	1.15
Other expenses	**8.03**	8.00
Total operating expenses	**28.98**	24.10
Cost:income ratio *(per cent)*	**18.8%**	18.1%
Period end headcount	**1136**	914

Operating expenses increased by KD4.88 million (20%) in 2006. Staff costs grew by KD4.17 million (30%), mainly due to higher performance-related incentive payments and headcount growth. Year-end headcount was up 222 (24%), primarily reflecting headcount growth to support the growth in retail business and the expansion of the branch network.

Occupancy costs were 13% higher due to the opening of two new branches in 2006. Depreciation costs were KD0.53 million (46%) higher due to the significant investment in new branches and systems in line with the Bank's strategy.

Other expenses were at the same level as 2005. Marketing costs were higher by KD1.44 million, however this was offset by savings in other costs (2005 financial statements contained provisions for two long outstanding litigation claims amounting to KD2.2 million). The sharp increase in marketing costs reflects substantial marketing and promotional activity throughout 2006 comprising of marketing campaigns to support retail customer acquisition programmes and brand building activities.

The cost:income ratio continued to remain healthy at 18.8%. 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)	2006	2005
Specific provisions	3.25	4.45
General provisions	12.15	16.28
TOTAL PROVISIONS	15.40	20.73
Non-performing to total loans *(per cent)*	1.62%	2.25%
Specific provisions cover *(per cent)*	55.2%	50.7%
Total provisions cover *(per cent)*	214.6%	197.4%

The provisions charge of KD15.40 million was KD5.33 million (26%) lower than 2005. Specific provisions were KD1.20 million (27%) lower at KD3.25 million. Despite the significant growth in personal lending in recent years, retail specific provisions have increased marginally during the year. Other specific provisions have been at the same level as in 2005.

The general provisions charge of KD12.15 million was KD4.13 million (25%) lower than 2005.

Asset quality remains good, reflecting the Bank's prudent lending strategies and its strict and comprehensive credit policies and procedures. Non-performing loans (NPLs) increased by KD4.6 million (12%) to KD42.95 million at 31 December 2006, despite the substantial growth in the loan portfolio. The proportion of NPLs to total loans fell from 2.25% as at 31 Dec 2005 to 1.62% at 31 December 2006. Specific provisions cover increased from 50.7% of NPLs in 2005 to 55.2% of NPLs at 31 December 2006 and total provisions cover (including general provisions), improved from 197.4% to 214.6%.

BALANCE SHEET ANALYSIS

Selected balance sheet data (KD millions)	**31 Dec 2006**	31 Dec 2005
Cash & short term funds: balances with CBK	**435.0**	125.4
Loans and advances to banks	**48.1**	63.5
Loans and advances to customers	**2,538.3**	1,578.6
Deposits with banks and other financial institutions	**129.9**	17.4
Investment securities	**159.4**	105.9
Total assets	**4,060.0**	2,608.2
Due to banks	**229.0**	65.8
Floating rate notes	**57.8**	58.4
Subordinated loans	**86.7**	43.8
Deposits from other financial institutions	**372.5**	205.8
Customer deposits	**2,838.8**	1,829.0
Shareholders' funds	**343.5**	303.6
Key ratios (per cent)		
Return on average assets	**3.18%**	3.49%
Return on average equity	**32.7%**	30.1%
Loan/deposit ('80:20') ratio	**78.4%**	76.9%

Total assets increased by KD1.45 billion or 56% to KD4.06 billion (USD14.05 billion) at 31 December 2006. The substantial growth in customer loans and advances (up KD959.7 million or 61%) was made possible by the KD1,009.8 million (55%) growth in customer deposits and KD166.7 million (81%) growth in deposits from other financial institutions. Approximately 62.5% of the balance sheet was deployed in customer loans and advances at 31 December 2006, compared with approximately 60.5% at 31 December 2005.

Balances with CBK increased by KD309.6 million due to increased requirements, due to the '80:20' ratio.

Loans and advances to banks declined by KD15.4 million (24%) to KD48.1 million.

Loans and advances to customers increased by KD960 million (61%), across all the sectors. The bank has capitalized on the increasing lending opportunities in Kuwait, brought about by a buoyant economy.

Deposits with banks and other financial institutions ('OFIs') increased by KD112.5 million, mainly due to asset–liability management requirements.

Investment securities increased by KD53.5 million (51%) due to new investment opportunities in funds. Debt securities declined marginally by KD0.3 million to a level of KD3 million at end 2006. Equity securities increased by KD53.8 million (52%), from KD102.6 million to KD156.4 million, and increased as a portion of total investment securities from 96.9% at 31 December 2005 to 98.1% at end 2006. The geographical mix of the investment securities portfolio has become more broad-based. Kuwaiti securities declined from 41.2% at end 2005 to 26.0% of the portfolio at end 2006.

BALANCE SHEET ANALYSIS *(continued)*

The movements in liabilities in 2006 reflect the Bank's success in raising '80:20'deposits in order to support further loan growth.

'80:20'deposits increased by KD1.18 billion (58%) in 2006, from KD2.03 billion to KD3.21 billion. Deposits from non-bank financial institutions ('OFIs') grew by KD166.7 million (81%) to KD372.5 million reflecting strong growth in time deposits. Customer deposits increased by KD1.01 billion (55%) to KD2.84 billion. The increase was primarily in time deposit, which grew by KD1.04 billion (84%) as the Bank successfully increased customer deposits to fund the substantial growth in its loans and to meet the '80:20' ratio.

Other funding increased by KD205.6 million (122%) in 2006, from KD168.0 million to KD373.6 million. Due to banks (mostly time deposits) increased by KD163.2 million (248%), from KD65.8 million to KD229.0 million. Subordinated loans increased by KD42.9 million, due to a fresh subordinated debt issue of USD150 million in 2006, maturing in October 2016. Floating rate notes, comprise of the 5 year notes issued in Oct 2003 for USD200 million.The year-on-year decline in the KD-equivalent values of these notes was due to change in the USD / KD parity in 2006.

Shareholders' funds increased by KD39.9 million (13%) from KD303.6 million to KD343.5 million. The increase in the shareholders' funds was driven primarily by growth in retained earnings (up KD25.4 million), statutory reserves (up KD11.0 million), other reserves (up KD9.2 million) and proposed issue of bonus shares (KD5.6 million). The Bank had unrealised gains on its 'available for sale' financial assets of KD18.9 million at 31 December 2006 (2005: KD17.1 million).

The return on average assets dropped by 31 basis points (8.9 per cent), from 3.49% in 2005 to 3.18% in 2006. The return on average equity increased by 260 basis points (8 per cent), from 30.1% to 32.7%. These ratios are very high compared to international standards.

The '80:20' ratio as at end 2006 was 78.4% compared to 76.9% at end 2005. The Bank has been successfully meeting the '80:20' ratio, despite the substantial growth in its loan portfolio.

BANK RATINGS

Long-term foreign currency ratings	**2006**	2005
Fitch Ratings	**A**	A-
Moody's Investors Service	**Aa3**	A2
Standard & Poor's	**A-**	A-
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.

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 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).

Pillar 1 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 IRB approaches (foundation and advanced) allows banks to calculate the regulatory capital requirement for credit risk based on their own internal assessment.

The Basel II framework also introduces the capital requirement for operational risk, i.e. the risk of losses resulting from operational failures such as inadequate or failed internal process, human behaviour and systems or from external events. As for operational 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 allows 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 has implemented 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 table below details the regulatory capital resources for Gulf Bank as at 31 December 2006 and 31 December 2005.

(KD millions)

	31 Dec 2006	31 Dec 2005
Composition of capital		
Tier 1 capital		
Paid-up share capital	**109.0**	94.8
Reserves	**142.0**	125.9
Retained earnings	**94.9**	69.5
Less: treasury shares	**(33.1)**	(11.4)
Total qualifying tier 1 capital	**312.8**	278.8
Tier 2 capital		
Property revaluation reserve (45%)	**5.3**	3.5
Fair value reserve (45%)	**8.5**	7.7
General provisions (1.25% Of credit rwas)	**25.2**	19.7
Subordinated debt	**86.7**	43.8
Total qualifying tier 2 capital	**125.7**	74.7
Total eligible regulatory capital	**438.5**	353.5

CAPITAL STRUCTURE *(continued)*

Regulatory capital increased by KD85 million (24%) in 2006, from KD353.5 million to KD438.5 million. Qualifying Tier 1 capital increased by KD34 million (12%) to KD312.8 million, reflecting the growth in reserves (KD16.1 million) and retained earnings (KD25.4 million).

Qualifying Tier 2 capital increased by KD51 million (68%) to KD125.7 million, primarily due to inclusion of a portion of general provisions and fresh issue of subordinated debt amounting to USD150 million during the year. 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. KD25.2 million at end 2006.

Tier 2 capital includes subordinated debt, comprising three 10 year US dollar subordinated loans obtained from financial institutions outside of Kuwait: USD50 million due June 2014, USD100 million due December 2014 and USD150 million due in October 2016. All these 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).

Tier 2 capital also includes 45% of the property revaluation reserve and this component increased by KD1.8 million in 2006. Tier 2 capital further includes 45% of the fair value reserve for 'available for sale' investment securities. There was a net increase of KD0.8 million (10%) in this component of Tier 2 capital, from KD7.7 million to KD8.5 million.

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. 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 below details the risk-weighted assets, regulatory capital requirements and regulatory capital ratios for Gulf Bank as at 31 December 2006 and 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.

CAPITAL MANAGEMENT *(continued)*

(KD millions)

	31 Dec 2006	31 Dec 2005
Risk-weighted assets		
Credit risk-weighted assets	**2,013.0**	1,579.2
Less: excess general provisions	**(43.3)**	(36.5)
Net credit risk-weighted exposure	**1,969.7**	1,542.7
Market risk-weighted assets	**23.6**	11.7
Operational risk-weighted exposure	**140.0**	113.7
Total risk-weighted exposure	**2,133.3**	1,668.1
Capital requirements		
Credit risk		
Claims on sovereigns	**0.4**	7.0
Claims on public sector entities	**1.1**	0.1
Claims on banks	**16.5**	13.7
Claims on corporates	**123.0**	89.7
Regulatory retail exposures	**54.0**	44.5
Past due exposures	**2.3**	2.3
Other assets	**44.3**	32.2
Credit risk capital requirement	**241.6**	189.5
Less: excess general provisions (12%)	**(5.2)**	(4.4)
Net credit risk capital requirement	**236.4**	185.1
Market risk		
Interest rate position risk	**1.4**	0.1
Foreign exchange risk	**1.4**	1.3
Capital requirement for market risk	**2.8**	1.4
Capital requirement for operational risk	**16.8**	13.7
Total capital requirement	**256.0**	200.2
Capital adequacy ratios *(per cent)*		
Tier 1 ratio	**14.7%**	16.7%
Total capital adequacy ratio	**20.6%**	21.2%

Total risk-weighted exposure at 31 December 2006 was KD2,133 million, requiring regulatory capital (at 12%) of KD256 million. The capital requirement was substantially lower than Gulf Bank's available regulatory capital (KD438.5 million) and the capital adequacy ratios were consequently well above the CBK minimum total ratio of 12%. The 31 December 2006 total capital adequacy ratio of 20.6% and the Tier 1 ratio of 14.7% leave the Bank strongly capitalised to support the continued expansion of its business activities in 2007. Capital adequacy ratios as on 31 December 2005: total ratio of 21.2% and Tier 1 ratio of 16.7%.

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 direct 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 meet 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.

CREDIT RISK *(continued)*

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) through 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 division and recommended by the MSC.

The international banking division 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 the 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 market 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 and fraud and external threats. It is inherent in every business organisation

OPERATIONAL RISK *(continued)*

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, the 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 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 has implemented a sophisticated grading system, using the Moody's KMV Risk Advisor system. This 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.

CREDIT RISK EXPOSURES *(continued)*

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 undertakes 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 instalments 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). The 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 discussion of 'credit risk mitigation' below).

The summary of Gulf Bank's gross credit risk exposure (before credit risk mitigation) in 2006 and 2005 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 millions)	**2006**	2005
Year-end gross exposure		
Funded gross credit risk exposure	4,099.2	2,642.1
Unfunded gross credit risk exposure	1,487.1	1,126.6
Total year-end gross credit risk exposure	5,586.3	3,768.7
Full year average gross exposure		
Funded gross credit risk exposure	3,333.1	2,395.8
Unfunded gross credit risk exposure	1,224.2	949.8
Total average gross credit risk exposure	4,557.3	3,345.6

CREDIT RISK EXPOSURES *(continued)*

Total year-end gross credit risk exposure increased by KD1.82 billion (48%), from KD3.77 billion at 31 December 2005 to KD5.59 billion at 31 December 2006. Funded (i.e. on-balance sheet) exposure grew by KD1.46 billion (55%), from KD2.64 billion to KD4.10 billion. Unfunded (i.e. off-balance sheet) exposure grew by KD360.5 million (32%), from KD1,126.6 million to KD1,487.1 million: guarantees increased by KD152.6 million (24%) and letters of credit increased by KD207.1 million (57%). The unfunded exposures comprise contingent liabilities and commitments (2006: KD1.41 billion; 2005: KD1.04 billion); and credit default swaps (2006: KD77.8 million; 2005: KD83.2 million). Note 27 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 2006 was KD4.56 billion: funded exposure of KD3.33 billion and unfunded exposure of KD1.23 billion. The full year average amounts are calculated using a 13-point average of the month end figures from 31 December 2005 to 31 December 2006 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 2006 and 31 December 2005 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.

CREDIT RISK EXPOSURES *(continued)*

TOTAL GROSS CREDIT RISK EXPOSURE AS AT **31 DECEMBER 2006**

(KD thousands)	Kuwait	Other Middle East	Western Europe	USA & Canada	Asia Pacific	Rest Of World	Total Gross Exposure
Cash items	27,350	—	—	—	—	—	27,350
Claims on sovereigns	870,575	47,694	—	—	17,348	—	935,617
Claims on PSEs	—	47,174	—	—	—	—	47,174
Claims on banks	67,573	185,786	187,277	15,758	126,138	3,061	585,593
Claims on corporates	2,532,641	282,132	72,233	—	6,144	28,814	2,921,964
Retail exposures	661,618	231	—	—	33	209	662,091
Past due exposures	19,985	—	—	—	—	—	19,985
Other assets	276,957	7,857	940	124	—	100,602	386,480
	4,456,699	570,874	260,450	15,882	149,663	132,686	5,586,254
Percentage of gross exposure by geographical region	79.7%	10.2%	4.7%	0.3%	2.7%	2.4%	100.0%

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%

CREDIT RISK EXPOSURES *(continued)*

FUNDED (ON-BALANCE SHEET) CREDIT FACILITIES AS AT **31 DECEMBER 2006**

(KD thousands)	Kuwait	Other Middle East	Western Europe	USA & Canada	Asia Pacific	Rest Of World	Total Gross Exposure
Cash items	27,350	—	—	—	—	—	27,350
Claims on sovereigns	870,575	—	—	—	—	—	870,575
Claims on PSEs	—	47,174	—	—	—	—	47,174
Claims on banks	58,155	162,788	165,593	12,490	24,795	—	423,821
Claims on corporates	1,615,146	69,539	14,457	—	240	28,814	1,728,196
Retail exposures	640,136	28	—	—	33	209	640,406
Past due exposures	19,240	—	—	—	—	—	19,240
Other assets	232,895	7,857	940	124	—	100,602	342,418
	3,463,497	287,386	180,990	12,614	25,068	129,625	4,099,180
Percentage of gross exposure by geographical region	84.5%	7.0%	4.4%	0.3%	0.6%	3.2%	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%

CREDIT RISK EXPOSURES *(continued)*

UNFUNDED (OFF-BALANCE SHEET) CREDIT FACILITIES AS AT **31 DECEMBER 2006**

(KD thousands)	Kuwait	Other Middle East	Western Europe	USA & Canada	Asia Pacific	Rest Of World	Total Gross Exposure
Claims on sovereigns	—	47,694	—	—	17,348	—	65,042
Claims on banks	9,418	22,998	21,684	3,268	101,343	3,061	161,772
Claims on corporates	917,495	212,593	57,776	—	5,904	—	1,193,768
Retail exposures	21,482	203	—	—	—	—	21,685
Past due exposures	745	—	—	—	—	—	745
Other assets	44,062	—	—	—	—	—	44,062
	993,202	283,488	79,460	3,268	124,595	3,061	1,487,074
Percentage of gross exposure by geographical region	66.8%	19.1%	5.3%	0.2%	8.4%	0.2%	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%

The bulk of the Bank's credit exposure is in Kuwait: KD4.46 billion (79.7% of total gross credit exposure) at 31 December 2006, compared with KD3.03 billion (80.5% of total gross credit exposure) at 31 December 2005. The credit exposure mix by standard portfolio remained broadly unchanged in 2006, being mainly concentrated in claims on corporates: 52.3% of total gross exposure at 31 December 2006 (2005: 48.7%); retail exposures: 11.9% of gross exposure at 31 December 2006 (2005: 14.3%); and claims on banks: 10.5% of gross exposure at 31 December 2006 (2005: 11.4%). The significant exposure in Kuwait against claims on sovereigns (KD870.6 million at end 2006) reflects the Bank's holdings of Kuwait Government treasury bills and bonds and CBK bonds, and current account/deposit balances with CBK.

CREDIT RISK EXPOSURES *(continued)*

The average gross credit risk exposure for 2006 and 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 **(2006 AVERAGE)**

(KD thousands)	Kuwait	Other Middle East	Western Europe	USA & Canada	Asia Pacific	Rest Of World	Total Gross Exposure
Cash items	20,680	—	—	—	—	—	20,680
Claims on sovereigns	677,186	36,862	—	—	17,348	—	731,396
Claims on PSEs	—	19,064	—	—	—	—	19,064
Claims on banks	84,702	113,419	137,294	9,894	105,116	2,318	452,743
Claims on corporates	2,038,656	256,523	43,275	133	5,028	27,488	2,371,103
Retail exposures	601,298	97	6	—	1,869	102	603,372
Past due exposures	29,701	7,247	22	—	—	1,063	38,033
Other assets	228,819	6,310	701	101	—	84,969	320,900
	3,681,042	439,522	181,298	10,128	129,361	115,940	4,557,291
Percentage of gross exposure by geographical region	80.8%	9.6%	4.0%	0.2%	2.8%	2.6%	100.0%

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%

CREDIT RISK EXPOSURES *(continued)*

FUNDED (ON-BALANCE SHEET) CREDIT FACILITIES **(2006 AVERAGE)**

(KD thousands)	Kuwait	Other Middle East	Western Europe	USA & Canada	Asia Pacific	Rest Of World	Total Gross Exposure
Cash items	20,680	—	—	—	—	—	20,680
Claims on sovereigns	677,186	—	—	—	—	—	677,186
Claims on PSEs	—	19,064	—	—	—	—	19,064
Claims on banks	77,508	91,345	119,017	7,398	14,365	2	309,635
Claims on corporates	1,295,049	56,265	3,022	120	629	27,488	1,382,573
Retail exposures	585,915	29	—	—	1,869	102	587,915
Past due exposures	28,841	7,247	22	—	—	1,063	37,173
Other assets	206,771	6,308	701	101	—	84,969	298,850
	2,891,950	180,258	122,762	7,619	16,863	113,624	3,333,076
Percentage of gross exposure by geographical region	86.8%	5.4%	3.7%	0.2%	0.5%	3.4%	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%

CREDIT RISK EXPOSURES *(continued)*

UNFUNDED (OFF-BALANCE SHEET) CREDIT FACILITIES AS AT **(2006 AVERAGE)**

(KD thousands)	Kuwait	Other Middle East	Western Europe	USA & Canada	Asia Pacific	Rest Of World	Total Gross Exposure
Claims on sovereigns	—	36,862	—	—	17,348	—	54,210
Claims on banks	7,194	22,074	18,277	2,496	90,751	2,316	143,108
Claims on corporates	743,607	200,258	40,253	13	4,399	—	988,530
Retail exposures	15,383	68	6	—	—	—	15,457
Past due exposures	860	—	—	—	—	—	860
Other assets	22,048	2	—	—	—	—	22,050
	789,092	259,264	58,536	2,509	112,498	2,316	1,224,215
Percentage of gross exposure by geographical region	64.4%	21.2%	4.8%	0.2%	9.2%	0.2%	100.0%

UNFUNDED (OFF-BALANCE SHEET) CREDIT FACILITIES AS AT (2005 AVERAGE)

(KD thousands)	Kuwait	Other Middle East	Western Europe	USA & Canada	Asia Pacific	Rest Of World	Total Gross Exposure
Cash items	—	—	—	—	33,800	14,600	48,400
Claims on sovereigns	—	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 2006 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: KD3.68 billion (80.8% of total gross credit exposure) (2005:KD2.71 billion – 80.9% of total exposure), comprising funded (on-balance-sheet) facilities of KD2.89 billion (86.8% of total funded exposure) and unfunded (off-balance-sheet) facilities of KD789.1 million (64.4% of total unfunded exposure). The 2006 average mix by standard portfolio was similarly concentrated in claims on corporates (52.0%); retail exposures (13.2%); and claims on banks (9.93%).

CREDIT RISK EXPOSURES *(continued)*

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 2006 and 31 December 2005 is shown below.

TOTAL GROSS CREDIT RISK EXPOSURE AS AT **31 DECEMBER 2006**

(KD thousands)	Personal	Financial	Trade & Commerce	Crude oil & Gas	Const-ruction	Manu-facturing	Real Estate	Other	Total Gross Exposure
Cash items	—	—	—	—	—	—	—	27,350	27,350
Claims on sovereigns	—	—	—	—	—	—	—	935,617	935,617
Claims on PSEs	—	47,174	—	—	—	—	—	—	47,174
Claims on banks	—	585,593	—	—	—	—	—	—	585,593
Claims on corporates	144,332	380,606	487,738	15,979	822,183	217,205	403,825	450,096	2,921,964
Retail exposures	615,221	2	13,026	163	10,009	4,736	5,881	13,053	662,091
Past due exposures	3,640	—	8,234	—	165	627	2,234	5,085	19,985
Other assets	881	—	10,541	—	18,398	1,494	139,002	216,164	386,480
	764,074	1,013,375	519,539	16,142	850,755	224,062	550,942	1,647,365	5,586,254
Percentage of gross exposure by industry segment	13.7%	18.1%	9.3%	0.3%	15.2%	4.0%	9.9%	29.5%	100.0%

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%

CREDIT RISK EXPOSURES *(continued)*

FUNDED (ON-BALANCE SHEET) CREDIT FACILITIES AS AT **31 DECEMBER 2006**

(KD Thousands)	Personal	Financial	Trade & Commerce	Crude Oil & Gas	Const-ruction	Manu-facturing	Real Estate	Other	Total Gross Exposure
Cash items	—	—	—	—	—	—	—	27,350	27,350
Claims on sovereigns	—	—	—	—	—	—	—	870,575	870,575
Claims on PSEs	—	47,174	—	—	—	—	—	—	47,174
Claims on banks	—	423,821	—	—	—	—	—	—	423,821
Claims on corporates	137,764	331,733	245,594	13,769	427,767	81,930	366,229	123,410	1,728,196
Retail exposures	614,708	2	9,639	133	1,603	2,182	5,682	6,457	640,406
Past due exposures	3,640	—	8,234	—	85	625	2,164	4,492	19,240
Other assets	826	—	5,118	—	3,230	1,062	136,427	195,755	342,418
	756,938	802,730	268,585	13,902	432,685	85,799	510,502	1,228,039	4,099,180
Percentage of gross exposure by industry segment	18.3%	19.6%	6.6%	0.3%	10.6%	2.1%	12.5%	30.0%	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%

UNFUNDED (OFF-BALANCE SHEET) CREDIT FACILITIES AS AT **31 DECEMBER 2006**

(KD thousands)	Personal	Financial	Trade & Commerce	Crude Oil & Gas	Const-ruction	Manu-facturing	Real Estate	Other	Total Gross Exposure
Claims on sovereigns	—	—	—	—	—	—	—	65,042	65,042
Claims on banks	—	161,772	—	—	—	—	—	—	161,772
Claims on corporates	6,568	48,873	242,144	2,210	394,416	135,275	37,596	326,686	1,193,768
Retail exposures	513	—	3,387	30	8,406	2,554	199	6,596	21,685
Past due exposures	—	—	—	—	80	2	70	593	745
Other assets	55	—	5,423	—	15,168	432	2,575	20,409	44,062
	7,136	210,645	250,954	2,240	418,070	138,263	40,440	419,326	1,487,074
Percentage of gross exposure by industry segment	0.5%	14.2%	16.9%	0.2%	28.1%	9.3%	2.7%	28.1%	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%

Credit facilities are well spread across the various industrial sectors. Funded (on-balance sheet) facilities increased by KD1.46 billion (55%) in 2006, from KD2.64 billion to KD4.09 billion. Personal facilities comprised 18.5% of total funded facilities at end 2006 (2005: 22.3%).

CREDIT RISK EXPOSURES *(continued)*

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 2006 and 31 December 2005 is shown below.

TOTAL GROSS CREDIT RISK EXPOSURE AS AT **31 DECEMBER 2006**

(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	27,350	—	—	—	—	—	27,350
Claims on sovereigns	525,062	121,906	51,154	60,194	65,999	111,302	935,617
Claims on PSEs	—	—	—	—	47,174	—	47,174
Claims on banks	267,192	115,476	41,797	57,634	80,725	22,769	585,593
Claims on corporates	469,080	578,468	677,899	455,105	418,118	323,294	2,921,964
Retail exposures	34,623	11,470	11,560	17,109	26,885	560,444	662,091
Past due exposures	8,318	299	347	555	1,114	9,352	19,985
Other assets	29,784	16,706	11,317	64,910	23,670	240,093	386,480
	1,361,409	844,325	794,074	655,507	663,685	1,267,254	5,586,254
Percentage of gross exposure by residual contract maturity	24.4%	15.1%	14.2%	11.7%	11.9%	22.7%	100.0%

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%

CREDIT RISK EXPOSURES *(continued)*

FUNDED (ON-BALANCE SHEET) CREDIT FACILITIES AS AT **31 DECEMBER 2006**

(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	27,350	—	—	—	—	—	27,350
Claims on sovereigns	525,062	121,906	51,154	60,194	65,999	46,260	870,575
Claims on PSEs	—	—	—	—	47,174	—	47,174
Claims on banks	245,876	83,851	25,712	42,504	18,794	7,084	423,821
Claims on corporates	237,693	307,174	475,407	198,298	247,376	262,248	1,728,196
Retail exposures	30,934	5,447	8,231	11,661	24,024	560,109	640,406
Past due exposures	8,074	237	107	356	1,114	9,352	19,240
Other assets	28,198	11,005	8,695	40,260	14,905	239,355	342,418
	1,103,187	529,620	569,306	353,273	419,386	1,124,408	4,099,180
Percentage of gross exposure by residual contract maturity	26.9%	12.9%	13.9%	8.6%	10.2%	27.5%	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%

CREDIT RISK EXPOSURES *(continued)*

UNFUNDED (OFF-BALANCE SHEET) CREDIT FACILITIES AS AT **31 DECEMBER 2006**

(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	—	—	—	—	—	65,042	65,042
Claims on banks	21,316	31,625	16,085	15,130	61,931	15,685	161,772
Claims on corporates	231,387	271,294	202,492	256,807	170,742	61,046	1,193,768
Retail exposures	3,689	6,023	3,329	5,448	2,861	335	21,685
Past due exposures	244	62	240	199	—	—	745
Other assets	1,586	5,701	2,622	24,650	8,765	738	44,062
	258,222	314,705	224,768	302,234	244,299	142,846	1,487,074
Percentage of gross exposure by residual contract maturity	17.4%	21.2%	15.1%	20.3%	16.4%	9.6%	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%

CREDIT RISK EXPOSURES *(continued)*

Funded (on-balance sheet) credit facilities with a residual contract maturity in excess of 3 years increased in 2006, from KD687.7 million (26% of total exposure) at 31 December 2005 to KD1,124.4 million (27.4% of total exposure) at 31 December 2006.

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 2006 and 31 December 2005 is shown below.

IMPAIRED LOANS AND PROVISIONS (BY INDUSTRY SEGMENT) AS AT **31 DECEMBER 2006**

	Impaired Loans (NPLs)		Balance Sheet Provisions			Specific Provisions
(KD thousands)	Past Due Portion	Balance Outstanding	Specific	General	Total	Cover
Personal	3,640	12,482	8,842	14,091	22,933	70.8%
Financial	—	6,223	6,223	12,298	18,521	208.8%
Trade & commerce	8,234	8,756	532	8,131	8,663	4.7%
Crude oil & gas	—	413	413	261	674	100%
Construction	85	2,570	2,485	12,823	15,308	79.0%
Manufacturing	625	916	291	6,069	6,360	31.8%
Real estate	2,164	2,476	312	8,973	9,285	12.6%
Government	—	1,290	1,290	1,501	2,791	100.0%
Other	4,492	7,824	3,332	4,266	7,598	42.6%
TOTAL	19,240	42,950	23,720	68,413	92,133	55.2%

IMPAIRED LOANS AND PROVISIONS (BY INDUSTRY SEGMENT) AS AT 31 DECEMBER 2005

	Impaired Loans (NPLs)		Balance Sheet Provisions			Specific Provisions
(KD thousands)	Past Due Portion	Balance Outstanding	Specific	General	Total	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%

CREDIT RISK EXPOSURES *(continued)*

The industry segment split of the provision charges and write-offs in 2006 is shown below.

PROVISION CHARGES AND WRITE-OFFS DURING **2006** (BY INDUSTRY SEGMENT)

	Charge/(Release) For Impairment Provisions			
(KD thousands)	Specific Charge	General Charge	Total Charge	Write-offs
Personal	3,099	2,749	5,848	67
Financial	(56)	2,295	2,239	
Trade & Commerce	(48)	259	211	
Crude Oil & Gas	(4)	14	10	
Construction	(218)	2,990	2,772	
Manufacturing	143	727	870	
Real Estate	(97)	3,815	3,718	
Government	82	(364)	(282)	
Other	351	(338)	13	
TOTAL	3,252	12,147	15,399	67

PROVISION CHARGES AND WRITE-OFFS DURING 2005(BY INDUSTRY SEGMENT)

	Charge/(Release) For Impairment Provisions			
(KD thousands)	Specific Charge	General Charge	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) increased by KD4.6 million (12%) in 2006, from KD38.4 million at 31 December 2005 to KD42.95 million at 31 December 2006. Personal NPLs increased by KD5.8 million, from KD6.7 million at end 2005 (17.5% of total NPLs) to KD12.5 million (29.1% of total NPLs) at 31 December 2006. There were total write-offs of KD11million in 2005, mainly in personal (KD8 million) and other (KD2.5 million) credit facilities, which resulted in a reduction in overall levels of NPLs as on 31

December 2005. Specific provisions cover have increased from 50.8% of NPLs in 2005 to 55.2% of NPLs at 31 December 2006; and total provisions cover (including general provisions), improved from 197.4% to 214.5%.

The total net provisions charge in 2006 of KD15.4 million comprised specific provisions of KD3.3 million and general provisions of KD12.1 million. Provisions for personal credit facilities represented over 38% of the 2006 charge and comprised: specific provisions of KD3.1 million (approximately 95% of the total specific provision charge) and general provisions of KD2.7 million (over 23% 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 requires a minimum general provision of 2% on all credit facilities, net of certain restricted categories of collateral, that are not subject to specific provision.

The geographical split of impaired (i.e. non-performing) loans and the associated provisions cover as at 31 December 2006 and 31 December 2005 is shown below.

IMPAIRED LOANS AND PROVISIONS (BY GEOGRAPHICAL REGION) AS AT **31 DECEMBER 2006**

	Impaired Loans (NPLs)					Specific
	Past Due	Balance	Balance Sheet Provisions			Provisions
(KD thousands)	Portion	Outstanding	Specific	General	Total	Cover
Kuwait	19,240	30,134	10,904	60,961	71,865	36.2%
Other Middle East	—	11,503	11,503	5,658	17,161	100.0%
Western Europe	—	23	23	1,206	1,229	100.0%
Asia Pacific	—	—	—	103	103	0.0%
Rest of World	—	1,290	1,290	485	1,775	100.0%
TOTAL	19,240	42,950	23,720	68,413	92,133	55.2%

IMPAIRED LOANS AND PROVISIONS (BY GEOGRAPHICAL REGION) AS AT 31 DECEMBER 2005

	Impaired Loans (NPLs)					Specific
	Past Due	Balance	Balance Sheet Provisions			Provisions
(KD thousands)	Portion	Outstanding	Specific	General	Total	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 World	—	1,208	1,208	432	1,640	100.0%
TOTAL	18,829	38,365	19,484	56,266	75,750	50.8%

CREDIT RISK EXPOSURES *(continued)*

The geographical split of provision charges and write-offs in 2006 is shown below.

PROVISION CHARGES AND WRITE-OFFS DURING **2006** (BY GEOGRAPHICAL REGION)

	Charge/(Release) For Impairment Provisions			
(KD thousands)	Specific Charge	General Charge	Total Charge	Write-Offs
Kuwait	3,246	16,422	19,668	67
Other Middle East	(78)	(1,007)	(1,085)	—
Western Europe	2	(580)	(578)	—
USA & Canada	—	(452)	(452)	—
Asia Pacific	—	(2,289)	(2,289)	—
Rest of World	82	53	135	—
TOTAL	3,252	12,147	15,399	67

PROVISION CHARGES AND WRITE-OFFS DURING 2005 (BY GEOGRAPHICAL REGION)

	Charge/(Release) For Impairment Provisions			
(KD thousands)	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 World	(207)	178	(29)	—
TOTAL	4,454	16,280	20,734	11,007

The bulk of the Bank's non-performing loans (70.2% of the total as at 31 December 2006), and the bulk of the provisions (78% of the total at end 2006) 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 2005 and 31 December 2006 are shown below.

PROVISION MOVEMENTS DURING **2006**

	Charge/(Release) For Impairment Provisions		
(KD thousands)	Specific Charge	General Charge	Total Charge
At 1 January 2006			
Funded (on-balance sheet)	19,469	41,531	61,000
Unfunded (off-balance sheet)	15	14,735	14,750
Total at 1 January	19,484	56,266	75,750
Exchange adjustments	4	—	4
Recoveries	1,039	—	1,039
Amounts written off	(67)	—	(67)
Amounts provided for pre-invasion debts not purchased by Central Bank of Kuwait	8	—	8
Income statement charge/(release):			
Funded (on-balance sheet)	3,257	7,276	10,533
Unfunded (off-balance sheet)	(5)	4,871	4,866
Total income statement charge	3,252	12,147	15,399
At 31 December 2006	23,720	68,413	92,133

PROVISION MOVEMENTS DURING 2005

	Charge/(Release) For Impairment Provisions		
(KD thousands)	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 provided for pre-invasion debts not purchased by Central Bank of Kuwait	(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

CREDIT RISK EXPOSURES *(continued)*

The total credit exposure before credit risk mitigation (CRM) as at 31 December 2006, broken down by standard credit risk portfolio, is shown below.

GROSS CREDIT RISK EXPOSURE BEFORE CRM AS AT **31 DECEMBER 2006**

	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	27,350	—	27,350	27,350	—	—	27,350
Claims on sovereigns	870,575	65,042	935,617	870,575	65,042	—	935,617
Claims on PSEs	47,174	—	47,174	47,174	—	—	47,174
Claims on banks	423,821	161,772	585,593	423,821	79,761	2,958	506,540
Claims on corporates	1,728,196	1,193,768	2,921,964	1,728,196	460,000	2,614	2,190,810
Retail exposures	640,406	21,685	662,091	640,406	8,777	—	649,183
Past due exposures	19,240	745	19,985	19,240	373	—	19,613
Other assets	342,418	44,062	386,480	342,418	28,140	—	370,558
TOTAL	4,099,180	1,487,074	5,586,254	4,099,180	642,093	5,572	4,746,845

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 total credit exposure before CRM was KD4.75 billion at 31 December 2006, comprising: funded gross credit risk exposure of KD4.10 billion; unfunded off-balance sheet credit facilities, after applying the relevant Basel II standardised approach credit conversation factors (CCF), of KD642.0 million; and foreign exchange contracts after CCF of KD5.6 million.

The exposure after CRM, as at 31 December 2006, 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 (RWA) AS AT **31 DECEMBER 2006**

	Credit Exposure/CRM			Risk-Weighted Assets		
(KD thousands)	Exposure Before CRM	CRM	Exposure After CRM	Rated	Unrated	Total
Cash items	27,350	—	27,350	—	—	—
Claims on sovereigns	935,617	—	935,617	3,470	—	3,470
Claims on PSEs	47,174	—	47,174	—	9,435	9,435
Claims on banks	506,540	54,173	452,367	137,104	—	137,104
Claims on corporates	2,190,810	1,165,462	1,025,348	—	1,025,348	1,025,348
Retail exposures	649,183	49,466	599,717	—	449,788	449,788
Past due exposures	19,613	—	19,613	—	19,526	19,526
Other assets	370,558	2,222	368,336	—	368,336	368,336
TOTAL	4,746,845	1,271,323	3,475,522	140,574	1,872,433	2,013,007

CREDIT RISK EXPOSURE AFTER CRM; RISK-WEIGHTED ASSETS (RWA) 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 EXPOSURES *(continued)*

Credit risk-weighted assets of KD2.01 billion at 31 December 2006 were mainly concentrated in claims on corporates: KD1.03 billion (50.9% of credit RWAs); retail exposures: KD449.8 million (22.3% of credit RWAs); and claims on banks: KD137.1 million (6.8% 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 KD140.6 million (7.0% 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 have 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 techniques 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 2006, approximately 47% (2005: 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 requested 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 55% at 31 December 2006. The proportion of 'quick liquidity' collateral (i.e. fixed deposits, bank guarantees and shares) has similarly improved from 45.9% in 2000 to 76% in 2006.

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', The Bank's total credit exposure before CRM at 31 December 2006 was KD4.75 billion. Eligible CRM of KD1.27 billion reduced this to net credit exposure after CRM of KD3.48 billion. The amount of CRM eligible financial collateral and eligible guarantees for each standard portfolio as at 31 December 2006 is shown below.

CREDIT RISK MITIGATION (CRM) AS AT **31 DECEMBER 2006**

(KD thousands)	Total Exposure Before CRM	Eligible Financial Collateral	Eligible Guarantees	Total CRM	Total Exposure After CRM
Cash items	27,350	—	—	—	27,350
Claims on sovereigns	935,617	—	—	—	935,617
Claims on PSEs	47,174	—	—	—	47,174
Claims on banks	506,540	54,173	—	54,173	452,367
Claims on corporates	2,190,810	1,160,159	5,303	1,165,462	1,025,348
Retail exposures	649,183	49,249	217	49,466	599,717
Past due exposures	19,613	—	—	—	19,613
Other assets	370,558	2,222	—	2,222	368,336
TOTAL	4,746,845	1,265,803	5,520	1,271,323	3,475,522

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

CREDIT RISK MITIGATION *(continued)*

Most of the CRM (KD1.27 billion, or 99.6% 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 2006 of KD2.19 billion was reduced by KD1.17 billion (53.2%) as a result of eligible CRM techniques (financial collateral and guarantees), to give a net corporate credit exposure after CRM of KD1.03 billion. Gross retail exposures of KD649.2 million were reduced by total CRM of KD49.5 million (7.6%) to give a net retail exposure of KD599.7 million. Gross claims on banks of KD506.5 million were reduced by total CRM of KD54.2 million (10.7%) to give net bank credit exposure of KD452.4 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 2006 and 31 December 2005 are shown in the following table.

(KD thousands)	**31 Dec 2006**	31 Dec 2005
Interest rate position risk	1,462	129
Equity position risk	—	—
Foreign exchange risk	1,370	1,277
Commodities risk	—	—
Options	—	—
Total capital requirement for market risk	2,832	1,406
Market risk-weighted assets	23,589	11,715

The 31 December 2006 total market risk capital charge of KD2.83 million was equivalent to market risk-weighted assets of KD23.59 million. Market risk-weighted assets were KD11.87 million (101%) higher than 2005 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.

OPERATIONAL RISK *(continued)*

The details of the operational risk capital charge for Gulf Bank as at 31 December 2006 and 31 December 2005 are shown in the following tables.

AS AT **31 DECEMBER 2006**

(KD thousands)	3 Year Average Gross Income	Beta Factor	Operational Risk Capital Charge
Trading and sales	26,170	18%	4,711
Commercial banking	44,250	15%	6,637
Retail banking	45,491	12%	5,459
Total	115,911		16,807
Operational risk-weighted exposure			140,003

AS AT 31 DECEMBER 2005

(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 2006 total operational risk capital charge of KD16.8 million was equivalent to operational risk-weighted exposure of KD140 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.

EQUITY RISK IN THE BANKING BOOK *(continued)*

The fair value of the investment securities held at 31 December 2006 is shown below, 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 2006 is also shown.

KD thousands	Publicly Traded	Privately Held	Total Investment Securities
Balance sheet details 2006			
Fair value of investment securities:			
Debt securities	2,255	716	2,971
Equity securities	2,363	154,050	156,413
Total fair value of investment securities	4,618	154,766	159,384
Unrealised gains in equity	918	18,014	18, 932
Latent revaluation gains	—	—	—
Regulatory capital details			
Unrealised gains in tier 2 capital (45%)	413	8,106	8,519
Regulatory capital requirement	505	17,599	18,104
Income statement details			
Income from disposal of investment securities	1,258	11,298	12,556

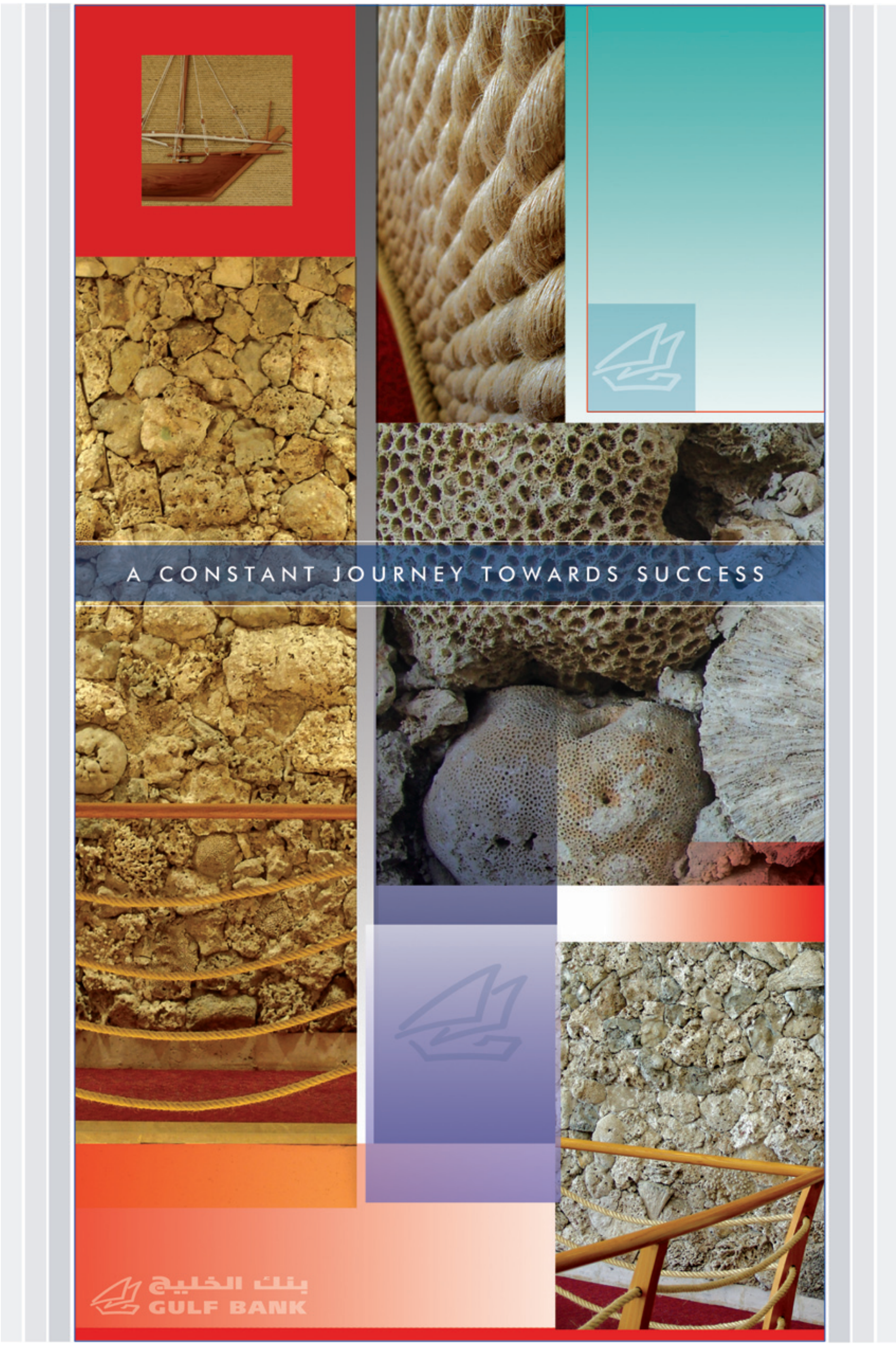
KD thousands	Publicly Traded	Privately Held	Total Investment Securities
Balance sheet details 2005			
Fair value of investment securities:			
Debit securities	2,278	984	3,262
Equity securities	10,843	91,761	102,604
Total fair value of investment securities	13,121	92,745	105,866
Unrealised gains in equity	4,384	12,703	17,087
Latent revaluation gains	—	—	—
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 2007 by approximately KD8.6 million while a hypothetical 100 basis points rise in all yield curves would increase net interest income by approximately KD9.4 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% (2005: 86%) of total loans and advances to customers reprice immediately, while foreign currency loans to customers reprice with a 3 month lag; 86% (2005: 60%) of current account balances are non-interest bearing and the remaining 40% (2005: 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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بنك الخليج
GULF BANK

FINANCIAL STATEMENTS

ANNUAL REPORT

2006

FINANCIAL STATEMENTS

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INDEPENDENT AUDITORS' REPORT TO THE SHAREHOLDERS

We have audited the accompanying financial statements of Gulf Bank K.S.C ('the Bank'), which comprise the balance sheet as at 31 December 2006 and the income statement, statement of changes in equity and cash flow statement for the year then ended, and a summary of significant accounting policies and other explanatory notes.

Management's Responsibility for the Financial Statements

Management is responsible for the preparation and fair presentation of these financial statements in accordance with International Financial Reporting Standards as adopted for use by the State of Kuwait. This responsibility includes: designing, implementing and maintaining internal control relevant to the preparation and fair presentation of financial statements that are free from material misstatement, whether due to fraud or error; selecting and applying appropriate accounting policies; and making accounting estimates that are reasonable in the circumstances.

Auditors' Responsibility

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 comply with ethical requirements and plan and perform the audit to obtain reasonable assurance whether the financial statements are free from material misstatement.

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

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

Opinion

In our opinion, the financial statements present fairly, in all material respects, the financial position of the Bank as of 31 December 2006 and of its financial performance and its cash flows for the year when then ended in accordance with International Financial Reporting Standards as adopted for use by the State of Kuwait.

Report on Other Legal and Regulatory Requirements

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 Capital Adequacy Regulations issued by Central Bank of Kuwait as stipulated in CBK Circular number 2/BS/184/2005 dated 21 December 2005, 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 Capital Adequacy Regulations issued by Central Bank of Kuwait as stipulated in CBK Circular number 2/BS/184/2005 dated 21 December 2005, Commercial Companies Law of 1960, as amended, or of the Articles of Association have occurred during the year ended 31 December 2006 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 2006.

Bader A. Al-Wazzan
Licence No. 62A
PricewaterhouseCoopers

Waleed A. Al Osaimi
Licence No. 68A
Ernst & Young
Al Aiban, Al Osaimi & Partners

9 January 2007
Kuwait

INCOME STATEMENT

YEAR ENDED **31 DECEMBER 2006**

	Notes	**2006 KD 000's**	2005 KD 000's
Interest income	3	235,899	136,261
Interest expense	4	(127,358)	(54,717)
Net interest income		108,541	81,544
Dividend income		453	1,855
Net fees and commissions		26,077	25,324
Net gains from dealing in foreign currencies and derivatives		6,177	5,449
Income from disposal of investment securities		12,556	18,833
Other income	5	379	150
Operating income		154,183	133,155
Staff expenses		17,912	13,747
Occupancy costs		1,359	1,198
Depreciation		1,683	1,149
Other expenses		8,025	8,003
Operating expenses		28,979	24,097
Operating profit before provisions		125,204	109,058
Provisions for impairment - specific		3,252	4,454
- general		12,147	16,280
		15,399	20,734
Operating profit		109,805	88,324
Contribution to Kuwait Foundation for the Advancement of Sciences		1,098	883
Directors' emoluments	22	108	108
National Labour Support Tax		2,716	1,963
Profit for the year		105,883	85,370
Earnings per share (fils)	6	114.514	92.508

BALANCE SHEET

AS AT **31 DECEMBER 2006**

	Notes	**2006 KD 000's**	2005 KD 000's
Assets			
Cash and short term funds	7	**708,288**	347,647
Treasury bonds	8	**315,513**	396,299
Central Bank of Kuwait bonds	9	**119,165**	59,798
Deposits with banks and other financial institutions	10	**129,874**	17,370
Loans and advances to banks	11	**48,071**	63,473
Loans and advances to customers	11	**2,538,303**	1,578,565
Investment securities	12	**159,384**	105,866
Other assets	13	**22,061**	25,291
Premises and equipment		**19,292**	13,932
Total Assets		**4,059,951**	2,608,241
Liabilities and Equity			
Liabilities			
Due to banks	14	**229,029**	65,844
Deposits from financial institutions	14	**372,516**	205,783
Customer deposits	15	**2,838,780**	1,829,001
Floating rate notes	16	**57,828**	58,400
Subordinated loans	17	**86,742**	43,800
Other liabilities	18	**76,205**	50,728
Total liabilities		**3,661,100**	2,253,556
Equity			
Share capital	19	**94,809**	86,190
Proposed bonus shares	22	**14,221**	8,619
Statutory reserve	20	**75,905**	64,924
General reserve	20	**2,356**	2,356
Share premium	20	**46,044**	46,044
Property revaluation reserve	20	**11,781**	7,669
Treasury share reserve		**17,710**	12,587
Fair valuation reserve		**18,932**	17,087
Retained earnings		**94,893**	69,510
		376,651	314,986
Treasury shares	21	**(33,186)**	(11,396)
		343,465	303,590
Proposed dividend	22	**55,386**	51,095
		398,851	354,685
Total liabilities and equity		**4,059,951**	2,608,241

These financial statements have been approved for issue by the Board of Directors on 9 January 2007 and signed on its behalf by:

Salah Khaled Al-Fulaij
Deputy Chairman

Sana Jumah
Acting Chief General Manager

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

CASH FLOW STATEMENT

YEAR ENDED **31 DECEMBER 2006**

	Notes	**2006 KD 000's**	2005 KD 000's
Cash flows from operating activities			
Profit for the year		105,883	85,370
Adjustments:			
Dividend income		(453)	(1,855)
Income from disposal of investment securities		(12,556)	(18,833)
Depreciation		1,683	1,149
Provisions for impairment		15,399	20,734
Operating profit before changes in operating assets and liabilities		109,956	86,565
(Increase) decrease in operating assets:			
Treasury bonds		80,786	88,060
Central Bank of Kuwait bonds		(59,367)	(59,798)
Deposits with banks and other financial institutions		(112,504)	(17,370)
Loans and advances to banks		15,402	52,832
Loans and advances to customers		(970,271)	(255,898)
Other assets		3,230	(12,455)
Increase (decrease) in operating liabilities:			
Due to banks		163,185	(42,364)
Medium term loans from banks		-	(154,205)
Deposits from financial institutions		166,733	37,816
Customer deposits		1,009,779	435,263
Floating rate notes		(572)	(540)
Subordinated loans		42,942	(405)
Other liabilities		20,611	7,273
Net cash from operating activities		469,910	164,774
Cash flows from investing activities			
Purchase of investment securities		(92,947)	(65,979)
Proceeds from sale of investment securities		53,830	57,959
Purchase of premises and equipment		(2,931)	(2,729)
Dividends received		453	1,855
Net cash (used in) investing activities		(41,595)	(8,894)
Cash flows from financing activities			
Dividends paid		(51,007)	(55,580)
Purchase of treasury shares		(44,004)	(12,795)
Sale of treasury shares		27,337	25,530
Net cash used in financing activities		(67,674)	(42,845)
Net increase in cash and short term funds		360,641	113,035
Cash and short term funds at 1 January		347,647	234,612
Cash and short term funds at 31 December	7	708,288	347,647

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

STATEMENT OF CHANGES IN EQUITY

YEAR ENDED **31 DECEMBER 2006**

	Share Capital KD 000's	Proposed Bonus Shares KD 000's	RESERVES 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
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
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)
Profit on sale of treasury shares	—	—	—	—	—	—	3,194	—	—	3,194	—	—	3,194
Surplus on revaluation of properties	—	—	—	—	—	173	—	—	—	173	—	—	173
Income and expense directly recognised in equity	—	—	—	—	—	173	3,194	(8,449)	—	(5,082)	—	—	(5,082)
Profit for the year	—	—	—	—	—	—	—	—	85,370	85,370	—	—	85,370
Total recognised income and expense for the year	—	—	—	—	—	173	3,194	(8,449)	85,370	80,288	—	—	80,288
Issue of capital	4,104	(4,104)	—	—	—	—	—	—	—	—	—	—	—
Purchase of treasury shares	—	—	—	—	—	—	—	—	—	—	(12,795)	—	(12,795)
Sale of treasury shares	—	—	—	—	—	—	—	—	—	—	22,336	—	22,336
Transfers from profit	—	—	8,832	—	—	—	—	—	(8,832)	—	—	—	—
Proposed bonus shares	—	8,619	—	—	—	—	—	—	(8,619)	(8,619)	—	—	—
Proposed dividend	—	—	—	—	—	—	—	—	(51,095)	(51,095)	—	51,095	—
Dividend paid	—	—	—	—	—	—	—	—	536	536	—	(56,116)	(55,580)
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
Effect of changes in fair values of "available for sale" financial assets	—	—	—	—	—	—	—	11,805	—	11,805	—	—	11,805
Net realised gains during the year	—	—	—	—	—	—	—	(9,960)	—	(9,960)	—	—	(9,960)
Profit on sale of treasury shares	—	—	—	—	—	—	5,123	—	—	5,123	—	—	5,123
Surplus on revaluation of properties	—	—	—	—	—	4,112	—	—	—	4,112	—	—	4,112
Income and expense directly recognised in equity	—	—	—	—	—	4,112	5,123	1,845	—	11,080	—	—	11,080
Profit for the year	—	—	—	—	—	—	—	—	105,883	105,883	—	—	105,883
Total recognised income and expense for the year	—	—	—	—	—	4,112	5,123	1,845	105,883	116,963	—	—	116,963
Issue of capital	8,619	(8,619)	—	—	—	—	—	—	—	—	—	—	—
Purchase of treasury shares	—	—	—	—	—	—	—	—	—	—	(44,004)	—	(44,004)
Sale of treasury shares	—	—	—	—	—	—	—	—	—	—	22,214	—	22,214
Transfer from profit	—	—	10,981	—	—	—	—	—	(10,981)	—	—	—	—
Proposed bonus shares	—	14,221	—	—	—	—	—	—	(14,221)	(14,221)	—	—	—
Proposed dividend	—	—	—	—	—	—	—	—	(55,386)	(55,386)	—	55,386	—
Dividend paid	—	—	—	—	—	—	—	—	88	88	—	(51,095)	(51,007)
At 31 December 2006	**94,809**	**14,221**	**75,905**	**2,356**	**46,044**	**11,781**	**17,710**	**18,932**	**94,893**	**267,621**	**(33,186)**	**55,386**	**398,851**

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

NOTES TO THE FINANCIAL STATEMENTS

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 2006 was 1,136 (2005: 914).

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 are consistent with those used in the previous year.

The financial statements have been presented in Kuwaiti Dinars rounded off to the nearest thousand. These financial statements are subject to the approval of the shareholders at the Annual General Meeting.

The following IASB Standards and Interpretations have been issued but are not yet mandatory, and have not yet been adopted by the Bank:

IFRS 7 Financial Instruments: Disclosures

IFRIC Interpretation 8 Scope of IFRS 2

IFRIC Interpretation 9 Reassessment of Embedded Derivatives

IFRIC Interpretation 10 Interim Financial Reporting and Impairment

IFRIC Interpretation 11 IFRS 2 – Group and Treasury Share Transactions

The application of IFRS 7, which will be effective for the year ending 31 December 2007, will result in amended and additional disclosures relating to financial instruments and associated risks. The application of IFRIC 8, 9, 10 and 11, which will be effective for the year ending 31 December 2007, is not expected to have a material impact on the financial statements of the Bank.

b. 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 they are managed and their performance is evaluated and reported internally on a fair value basis in accordance with a documented investment strategy. 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.

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 receive cash flows from the financial asset has expired or the Bank has transferred substantially all risks and rewards of ownership and has not retained control. If the Bank has retained control, it shall continue to recognise the financial asset to the extent of its continuing involvement in the financial asset.

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.

2. SIGNIFICANT ACCOUNTING POLICIES *(continued)*

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 less any provision for impairment. 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 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 less impairment loss, if any. '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 previously recognised in equity 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 based on net asset values provided by the fund managers or 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 the difference between the carrying value and the present value at the 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, less any impairment loss previously recognised in the income statement;

c) for financial assets carried at cost, impairment is the difference between the carrying value 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 offset and the net amounts reported in the balance sheet only 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.

c. Derivative financial instruments and hedging

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

2. SIGNIFICANT ACCOUNTING POLICIES *(continued)*

For hedges, which do not qualify for hedge accounting, 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.)

d. 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.

e. 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.

f. 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.

g. Revenue recognition

Revenue is recognised to the extent that it is probable that the economic benefits will flow to the Bank and the revenue can be reliably measured.

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.

h. 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.

i. Foreign currencies

Foreign currency transactions are recorded at rates of exchange ruling at the dates of the transactions. Monetary assets and liabilities denominated in foreign currencies at year end are translated into Kuwaiti Dinars at the 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 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.

j. 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.

k. Significant accounting judgments and estimates

Judgments

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 financial instruments

Management has to decide on acquisition of a financial instrument whether it should be classified as carried at fair value through income statement, available for sale or as loans and advances. In making that judgment the Bank considers the primary purpose for which it is acquired and how it intends to manage and report its performance. Such judgment determines whether it is subsequently measured at cost or at fair value and if the changes in fair value of instruments are reported in the income statement or directly in equity.

Evidence of impairment in 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 judgment 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

	2006 KD 000's	2005 KD 000's
Treasury bonds, Central Bank of Kuwait bonds, and other investments	24,314	13,561
Placements with banks	17,941	7,724
Loans and advances to banks and customers	193,644	114,976
	235,899	136,261

4. INTEREST EXPENSE

	2006 KD 000's	2005 KD 000's
Call accounts	3,309	2,919
Savings accounts	2,892	1,777
Time deposits	108,492	42,566
Bank borrowings	12,665	7,455
	127,358	54,717

5. OTHER INCOME

	2006 KD 000's	2005 KD 000's
Customer portfolio management fee	110	117
Sundry income	269	33
	379	150

6. EARNINGS PER SHARE

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

	2006 KD 000's	2005 KD 000's
Profit for the year	105,883	85,370
	Shares	Shares
Bank's issued and paid up shares	948,091,631	948,091,631
Less: weighted average number of treasury shares	(23,463,888)	(25,254,206)
	924,627,743	922,837,425
	Fils	Fils
Earnings per share	114.514	92.508

Earnings per share reported for the year ended 31 December 2005 was 101.759 fils before retroactive adjustment relating to the issue of bonus share at 10% of the paid up capital approved by the shareholders in the General Assembly Meeting dated 11 March 2006.

The issued and paid up shares for 2005 have been adjusted for the bonus shares issued in 2006.

7. CASH AND SHORT TERM FUNDS

	2006 KD 000's	2005 KD 000's
Balances with the Central Bank of Kuwait	435,062	125,387
Cash on hand and in current accounts with other banks	49,722	43,491
Money at call and short notice	—	5,000
Deposits with banks and other financial institutions maturing within one month	223,504	173,769
	708,288	347,647

8. TREASURY BONDS

The Central Bank of Kuwait on behalf of the Ministry of Finance issues these financial instruments.

	2006 KD 000's	2005 KD 000's
Maturing within one year	203,254	396,299
Maturing after one year	112,259	—
	315,513	396,299

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.

	2006 KD 000's	2005 KD 000's
Central Bank of Kuwait Bonds	119,165	59,798

1 0. DEPOSITS WITH BANKS AND OTHER FINANCIAL INSTITUTIONS

	2006 KD 000's	2005 KD 000's
Time deposits	129,874	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 2006:

Loans And Advances To Customers

	Kuwait KD 000's	Other Middle East KD 000's	Western Europe KD 000's	Asia Pacific KD 000's	Rest of World KD 000's	Total KD 000's
Personal	747,264	—	—	—	—	747,264
Financial	318,585	6,087	—	—	—	324,672
Trade and commerce	260,975	818	—	—	—	261,793
Crude oil and gas	13,856	413	—	—	—	14,269
Construction	379,932	49,024	—	—	—	428,956
Government	—	47,174	—	—	29,144	76,318
Others	154,026	3,231	14,480	—	—	171,737
Manufacturing	67,272	17,068	—	—	—	84,340
Real estate	501,471	—	—	—	—	501,471
	2,443,381	123,815	14,480	—	29,144	2,610,820
Less: provision for impairment						(72,517)
						2,538,303
Loans and advances to banks	6,361	20,963	20,747	—	—	48,071

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

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 Pacific 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

Movement In Provisions For Impairment

	2006 KD 000's Specific	**General**	**Total**	2005 KD 000's Specific	General	Total
At 1 January	**19,469**	**41,531**	**61,000**	25,405	29,961	55,366
Exchange adjustments	**4**	—	**4**	73	—	73
Recoveries	**1,039**	—	**1,039**	122	—	122
Amounts written off	**(67)**	—	**(67)**	(11,007)	—	(11,007)
Amount to be ceded to Central Bank of Kuwait (note 23)	—	—	—	(284)	—	(284)
Amount provided for pre invasion debts not purchased by Central Bank of Kuwait	**8**	—	**8**	—	—	—
Income statement	**3,257**	**7,276**	**10,533**	4,458	11,570	16,028
Transfer to provision for "assets sold"	—	—	—	702	—	702
At 31 December	**23,710**	**48,807**	**72,517**	19,469	41,531	61,000

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

The provision charge for the year on non-cash facilities is KD 4,866,000 (2005: KD 4,706,000), net of release of specific provisions of KD 5,000 (2005: KD 4,000). The available provision on non-cash facilities of KD 19,616,000 (2005: KD 14,750,000) is included in other liabilities (Note 18).

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% 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 2006, non-performing loans and advances amounted to KD 42,950,000 (2005: KD 38,365,000) split between facilities granted pre-invasion and post-liberation as follows:

	2006		2005	
	Loans & Advances KD 000's	**Provisions KD 000's**	Loans & Advances KD 000's	Provisions KD 000's
Pre-invasion	**12,911**	**12,911**	12,903	12,903
Post-liberation	**30,039**	**10,799**	25,462	6,566
Total	**42,950**	**23,710**	38,365	19,469

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

	2006 KD 000's	2005 KD 000's
Available for sale		
Debt securities		
Quoted	**2,255**	2,278
Unquoted	**716**	984
	2,971	3,262
Equity securities		
Quoted	**2,363**	10,843
Unquoted	**154,050**	91,761
	156,413	102,604
Total	**159,384**	105,866

During the year, the Bank recognised KD 11,805,000 (2005: KD 7,811,000) in equity as the net gain arising from changes in fair value of investment securities and re-cycled a profit of KD 9,960,000 (2005: KD 16,260,000) 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 certain investments where this estimation cannot be reliably determined, and as a result investments with a carrying amount of KD 15,316,000 (2005: KD 9,221,000) are carried at cost. Certain investments amounting to KD 16,247,000 (2005: KD 13,085,000) are carried at cost as the acquisition price of these investments is determined to be the fair value as these securities are recently acquired.

13. OTHER ASSETS

	2006 KD 000's	2005 KD 000's
Accrued interest receivable	17,794	16,529
Sundry debtors and others	3,915	8,450
Net positive fair value of derivatives (note 30)	352	312
	22,061	25,291

14. DUE TO BANKS AND DEPOSITS FROM FINANCIAL INSTITUTIONS

	2006 KD 000's	2005 KD 000's
Due to banks		
Current accounts and demand deposits	11,110	5,251
Time deposits	217,919	60,593
	229,029	65,844
Deposits from financial institutions		
Current accounts and demand deposits	78,043	69,430
Time deposits	294,473	136,353
	372,516	205,783

15. CUSTOMER DEPOSITS

	2006 KD 000's	2005 KD 000's
Current accounts	358,843	387,143
Savings accounts	204,387	202,581
Time deposits	2,275,550	1,239,277
	2,838,780	1,829,001

16. FLOATING RATE NOTES

On 22 October 2003, the Bank issued five year floating rate notes (due October 2008), with a principal amount of USD 200 million 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 arrears. The notes are in bearer form in the denomination of USD 100,000 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 2006 is USD 201,000,000 (2005: USD 201,220,000), equivalent to KD 58,117,000 (2005: KD 58,756,000).

17. SUBORDINATED LOANS

As at 31 December 2006, Gulf Bank has subordinated borrowings of USD 300 million (equivalent to KD 86,742,000). The borrowings comprise of three 10 year subordinated loans: USD 50 million due in June 2014, USD 100 million due in December 2014, and USD 150 million due in October 2016. 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.

18. OTHER LIABILITIES

	2006 KD 000's	2005 KD 000's
Interest payable	**32,103**	18,083
Deferred income	**8,195**	3,065
Provisions for non-cash facilities	**19,616**	14,750
Provisions to be ceded to the Central Bank of Kuwait (note 23)	**—**	284
Contribution to Kuwait Foundation for the Advancement of Sciences	**1,098**	883
Staff related provisions	**3,225**	3,417
National Labour Support Tax	**2,716**	1,963
Other	**9,252**	8,283
	76,205	50,728

19. SHARE CAPITAL

	2006 KD 000's	2005 KD 000's
Authorised, issued and fully paid ordinary shares	**94,809**	86,190

The number of authorised, issued and fully paid ordinary shares of KD 0.100 each as at 31 December 2006 is 948,091,631 (2005: 861,901,485). Bonus share of 10% on the outstanding shares proposed as at 31 December 2005 was approved at the 2005 Annual General Meeting and was issued in 2006 following that approval (Note 22).

20. 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 the premises and equipment 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.

21. TREASURY SHARES

	2006 KD 000's	2005 KD 000's
Number of treasury shares	**24,994,216**	10,317,697
Percentage of treasury shares	**2.64%**	1.20%
Cost of treasury shares (KD 000's)	**33,186**	11,396
Market value of treasury shares (KD 000's)	**42,990**	13,619

22. PROPOSED DIVIDEND, BONUS SHARES AND DIRECTORS' REMUNERATION

At 31 December 2006, the following dividend has been proposed and will be submitted for formal approval at the Annual General Meeting: cash dividend of KD 0.060 per share (totalling KD 55,386,000) payable to the shareholders registered in the Bank's records as of the date of the Annual General Meeting; and bonus shares of 15% on the outstanding shares as at 31 December 2006.

A cash dividend of KD 0.060 per share (totalling KD 51,095,000) and bonus shares of 10% on the outstanding shares proposed as of 31 December 2005, was approved at the 2005 Annual General Meeting and was paid in 2006 following that approval.

Directors' remuneration of KD 108,000 (2005: KD 108,000) is within the amount permissible under local regulations and is subject to approval by the Annual General Meeting.

23. PROVISION TO BE RECOVERED/CEDED TO THE CENTRAL BANK OF KUWAIT

As at 31 December 2006, provisions to be ceded to the Central Bank of Kuwait is KD Nil (2005: to be ceded KD 284,000). The identification of provisions no longer required was made in the same manner as adopted at the end of 2005 and in accordance with Central Bank of Kuwait instructions. Bank has provided KD 8,000 for the shortfall of provision on pre invasion debts not purchased by the Central Bank of Kuwait.

24. RELATED PARTY TRANSACTIONS

Certain related parties (directors and officers of the Bank, their families and companies of which their 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.

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

	No. Of Board Members And Executive Management Members	No. Of Related Parties	Value KD 000's
2006			
Board members			
Loans	4	1	10,229
Deposits	8	—	321
Guarantees issued	3	1	148
Executive management			
Loans	8	—	2,794
Deposits	1	—	4
Guarantees issued	2	—	2
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

The loans issued to directors and key management personnel are repayable within 3 years and have interest rates of 6% to 8% (2005: 6% to 8%). The loans advanced to directors during the year are collateralised by equities. The fair value of these equities as of 31 December 2006 was KD 17,470,000 (2005: KD 18,959,000).

The transactions included in the income statement are as follows:

	2006 KD 000's	2005 KD 000's
Directors and key management personnel		
Interest income earned	**865**	740
Interest expense on deposits	**14**	10
Key management compensation:		
Salaries and other short-term benefits	**1,629**	1,331
End of service/termination benefits	**70**	52

25. 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 geographic 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 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.

25. FINANCIAL INSTRUMENTS
A. CREDIT RISK *(continued)*

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 2006:

	Kuwait KD 000's	Other Middle East KD 000's	Western Europe KD 000's	USA and Canada KD 000's	Asia Pacific KD 000's	Rest of World KD 000's	Total KD 000's
Assets:							
Cash and short term funds	494,205	104,237	72,561	12,490	24,795	—	708,288
Treasury bonds	315,513	—	—	—	—	—	315,513
Central Bank of Kuwait bonds	119,165	—	—	—	—	—	119,165
Deposits with banks and financial institutions	20,000	37,588	72,286	—	—	—	129,874
Loans and advances to banks	6,361	20,963	20,747	—	—	—	48,071
Loans and advances to customers	2,383,657	112,312	14,480	—	—	27,854	2,538,303
Investment securities	41,468	8,026	898	130	—	108,862	159,384
Other assets	22,061	—	—	—	—	—	22,061
Premises and equipment	19,292	—	—	—	—	—	19,292
	3,421,722	283,126	180,972	12,620	24,795	136,716	4,059,951
Liabilities:							
Due to banks	125,351	80,947	16,213	4,814	406	1,298	229,029
Deposits from financial institutions	351,796	20,720	—	—	—	—	372,516
Customer deposits	2,560,869	138,583	127,195	245	515	11,373	2,838,780
Floating rate notes	—	—	57,828	—	—	—	57,828
Subordinated loans	—	86,742	—	—	—	—	86,742
Other liabilities	76,205	—	—	—	—	—	76,205
	3,114,221	326,992	201,236	5,059	921	12,671	3,661,100
Commitments and contingent liabilities	993,210	227,410	79,461	3,268	102,910	3,061	1,409,320

25. FINANCIAL INSTRUMENTS
A. CREDIT RISK *(continued)*

At 31 December 2005:

	Kuwait KD 000's	Other Middle East KD 000's	Western Europe KD 000's	USA and Canada KD 000's	Asia Pacific KD 000's	Rest of World KD 000's	Total KD 000's
Assets:							
Cash and short term funds	185,995	90,032	39,794	18,345	13,478	3	347,647
Treasury 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:							
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

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 27.

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 30.

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 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.

25. FINANCIAL INSTRUMENTS
B. INTEREST RATE RISK *(continued)*

The Bank's interest sensitivity position was as follows:

At 31 December 2006:

	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
Assets:						
Cash and short term funds	708,288	—	—	—	—	708,288
Treasury bonds	50,000	41,906	111,348	112,259	—	315,513
Central Bank of Kuwait bonds	39,724	79,441	—	—	—	119,165
Deposits with banks and other financial institutions	—	80,959	48,915	—	—	129,874
Loans and advances to banks	18,216	9,686	20,169	—	—	48,071
Loans and advances to customers	413,397	362,703	756,475	1,078,245	(72,517)	2,538,303
Investment securities	—	716	2,255	—	156,413	159,384
Other assets	—	—	—	—	22,061	22,061
Premises and equipment	—	—	—	—	19,292	19,292
	1,229,625	575,411	939,162	1,190,504	125,249	4,059,951
Liabilities and equity:						
Due to banks	195,628	18,529	14,872	—	—	229,029
Deposits from financial institutions	213,126	108,952	50,438	—	—	372,516
Customer deposits	1,553,474	652,413	574,036	58,857	—	2,838,780
Floating rate notes	—	57,828	—	—	—	57,828
Subordinated loans	—	57,828	28,914	—	—	86,742
Other liabilities	—	—	—	—	76,205	76,205
Equity	—	—	—	—	398,851	398,851
Total liabilities and equity	1,962,228	895,550	668,260	58,857	475,056	4,059,951
On-balance sheet gap	(732,603)	(320,139)	270,902	1,131,647	(349,807)	—
Off-balance sheet gap	—	58,423	—	(58,423)	—	—
Total interest rate sensitive gap	(732,603)	(261,716)	270,902	1,073,224	(349,807)	—
Cumulative interest rate sensitive gap	(732,603)	(994,319)	(723,417)	349,807	—	—

25. FINANCIAL INSTRUMENTS
B. INTEREST RATE RISK *(continued)*

At 31 December 2005

	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
Assets:						
Cash and short term funds	330,299	—	—	—	17,348	347,647
Treasury bonds	—	44,750	351,549	—	—	396,299
Central Bank of Kuwait bonds	59,798	—	—	—	—	59,798
Deposits with banks and other 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
Total liabilities and equity	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	—	—

25. FINANCIAL INSTRUMENTS
B. INTEREST RATE RISK *(continued)*

Effective interest rates

At 31 December 2006:

	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
Assets:						
Cash and short term funds	24,754	653,504	—	2,680	27,350	708,288
Treasury bonds	—	143,060	172,453	—	—	315,513
Central Bank of Kuwait bonds	—	119,165	—	—	—	119,165
Deposits with banks and other financial institutions	—	119,874	10,000	—	—	129,874
Loans and advances to banks	—	32,891	15,180	—	—	48,071
Loans and advances to customers	56,676	69,736	1,557,318	927,090	(72,517)	2,538,303
Investment securities	—	2,255	716	—	156,413	159,384
Other assets	—	—	—	—	22,061	22,061
Premises and equipment	—	—	—	—	19,292	19,292
	81,430	1,140,485	1,755,667	929,770	152,599	4,059,951
Liabilities and equity:						
Due to banks	11,045	217,984	—	—	—	229,029
Deposits from financial institutions	77,096	23,600	271,820	—	—	372,516
Customer deposits	552,283	629,880	1,656,294	323	—	2,838,780
Floating rate notes	—	—	57,828	—	—	57,828
Subordinated loans	—	—	86,742	—	—	86,742
Other liabilities	—	—	—	—	76,205	76,205
Equity	—	—	—	—	398,851	398,851
	640,424	871,464	2,072,684	323	475,056	4,059,951

25. FINANCIAL INSTRUMENTS
B. INTEREST RATE RISK *(continued)*

At 31 December 2005:

	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
Assets:						
Cash and short term funds	99,410	230,889	—	—	17,348	347,647
Treasury bonds	—	396,299	—	—	—	396,299
Central Bank of Kuwait bonds	—	59,798	—	—	—	59,798
Deposits with banks and other 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:						
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

25. FINANCIAL INSTRUMENTS *(continued)*

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 of 31 December:

	2006 KD 000's	2005 KD 000's
Net assets (liabilities):		
US Dollars	**52,954**	48,059
Euros	**8,175**	5,158
Swiss Francs	**18,475**	17,243
Sterling Pounds	**(13,062)**	(8,189)
Japanese Yen	**4,819**	5,523
Australian Dollars	**(31)**	(3)
Canadian Dollars	**(6)**	(14)
Saudi Riyals	**3,309**	435
Others	**128**	778
	74,761	68,990

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 2006

	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
Assets:							
Cash and short term funds	708,288	—	—	—	—	—	708,288
Treasury bonds	50,000	41,906	51,154	60,194	65,999	46,260	315,513
Central Bank of Kuwait bonds	39,724	79,441	—	—	—	—	119,165
Deposits with banks and other financial institutions	—	80,959	20,000	28,915	—	—	129,874
Loans and advances to banks	—	2,891	5,712	13,590	18,794	7,084	48,071
Loans and advances to customers	267,147	334,514	499,218	272,577	338,040	826,807	2,538,303
Investment securities	—	716	—	2,255	—	156,413	159,384
Other assets	22,061	—	—	—	—	—	22,061
Premises and equipment	—	—	—	—	—	19,292	19,292
Total assets	1,087,220	540,427	576,084	377,531	422,833	1,055,856	4,059,951
Liabilities and equity:							
Due to banks	195,628	18,529	14,872	—	—	—	229,029
Deposits from financial institutions	213,126	108,952	29,104	21,334	—	—	372,516
Customer deposits	1,553,474	652,413	349,720	224,316	58,475	382	2,838,780
Floating rate notes	—	—	—	—	57,828	—	57,828
Subordinated loans	—	—	—	—	—	86,742	86,742
Other liabilities	76,205	—	—	—	—	—	76,205
Equity	—	55,386	—	—	—	343,465	398,851
Total liabilities	2,038,433	835,280	393,696	245,650	116,303	430,589	4,059,951
Net liquidity gap	(951,213)	(294,853)	182,388	131,881	306,530	625,267	—

25. FINANCIAL INSTRUMENTS
D. LIQUIDITY RISK *(continued)*

At 31 December 2005

	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
Assets:							
Cash and short term funds	347,647	—	—	—	—	—	347,647
Treasury bonds	—	44,750	58,755	292,794	—	—	396,299
Central Bank of Kuwait bonds	59,798	—	—	—	—	—	59,798
Deposits with banks and other financial institutions	—	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	—	723	—	2,278	261	102,604	105,866
Other assets	25,291	—	—	—	—	—	25,291
Premises and equipment	—	—	—	—	—	13,932	13,932
Total assets	533,873	224,426	436,795	536,655	184,349	692,143	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
Total liabilities and equity	1,434,424	418,581	170,548	150,034	87,003	347,651	2,608,241
Net liquidity gap	(900,551)	(194,155)	266,247	386,621	97,346	344,492	—

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.

F. PRICE RISK

This is a 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.

26. 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 willing 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 KD 15,316,000 (2005: KD 9,221,000) for which fair value cannot be reliably determined.

27. CONTINGENT LIABILITIES AND COMMITMENTS

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

	2006 KD 000's	2005 KD 000's
Guarantees:		
Contract	399,326	321,196
Tender	77,818	60,841
Syndicated	88,019	70,742
Other	221,034	180,773
	786,197	633,552
Letters of credit:		
Sight	346,244	219,382
Syndicated	23,745	21,586
Acceptance	196,963	120,455
Confirmed	3,863	2,329
	570,815	363,752
Irrevocable commitments to extend credit:		
Original term to maturity of one year or less	52,141	45,046
Original term to maturity of more than one year	167	999
	52,308	46,045
	1,409,320	1,043,349

28. 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.

28. SEGMENTAL ANALYSIS *(continued)*

At 31 December 2006

	Treasury & International KD 000's	Domestic Banking KD 000's	Total KD 000's
Income statement:			
Interest income from external sources	57,045	178,854	235,899
Profit for the year	7,423	98,460	105,883
Balance sheet:			
Assets	1,467,726	2,592,225	4,059,951
Liabilities:			
Deposits	1,188,586	2,396,309	3,584,895
Other liabilities	14,965	61,240	76,205
Central treasury	(134,676)	134,676	—
	1,068,875	2,592,225	3,661,100
Capital expenditure	41	2,890	2,931
Depreciation	4	1,679	1,683

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
Profit for the year	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

28. 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 25 A.

29. FIDUCIARY ASSETS

The aggregate value of assets held in a fiduciary capacity by the Bank at 31 December 2006 amounted to KD 299,000 (2005: KD 310,000).

30. 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.

30. DERIVATIVES *(continued)*

At 31 December 2006:

				Notional Amounts By Term To Maturity		
	Positive Fair Value KD 000's	Negative Fair Value KD 000's	Notional Amount Total KD 000's	Within 3 Months KD 000's	3 - 12 Months KD 000's	1 - 5 Years KD 000's
Derivatives instruments held as:						
Trading (and non qualifying hedges)						
Interest rate swaps	110	(90)	58,423	—	11,382	47,041
Forward foreign exchange contracts	562	(1)	396,422	329,980	66,442	—
Credit default swaps	5	(234)	77,764	4,337	2,891	70,536
	677	(325)	532,609	334,317	80,715	117,577

At 31 December 2005:

				Notional Amounts By Term To Maturity		
	Positive Fair Value KD 000's	Negative Fair Value KD 000's	Notional Amount Total KD 000's	Within 3 Months KD 000's	3 - 12 Months KD 000's	1 - 5 Years KD 000's
Derivatives instruments held as:						
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	421	(423)	83,220	32,120	29,200	21,900
	787	(475)	283,717	191,744	59,784	32,189

30. 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 or to transfer third party credit risk based on an agreed principal and related outstanding interest. For interest rate swaps, counter parties 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. For credit default swaps, fee is earned based on the amount of credit risk swapped.

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.

31. CAPITAL ADEQUACY

The disclosures relating to the Capital Adequacy Regulations issued by Central Bank of Kuwait as stipulated in CBK Circular number 2/BS/184/ 2005 dated 21 December 2005, are included under the 'Capital Management and Allocation' section of the annual report.


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ANNUAL REPORT

2006

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Fahaheel (Alghanim Electronics)	Tel: 3916866
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Hadiya	Tel: 3969221/3/8
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Jahra	Tel: 4564235
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Mansouriyah	Tel: 2555271
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