

Company number: 1122503

GOLDMAN SACHS INTERNATIONAL BANK

(unlimited company)

DIRECTORS' REPORT AND FINANCIAL STATEMENTS

31 March 1999



GOLDMAN SACHS INTERNATIONAL BANK

(unlimited company)

REPORT OF THE DIRECTORS

The directors present their report and the audited financial statements for the year ended 31 March 1999.

1. Principal activities

The company is engaged in international investment banking business and conducts foreign exchange and derivatives business through a branch in Tokyo. The company is authorised under the Banking Act 1987.

2. Review of business and future developments

The profit and loss account for the year is set out on page 4.

The directors consider that the year end financial position of the company was satisfactory. As a result of regulatory changes in Japan, the foreign exchange and derivatives business in Tokyo is now being undertaken by a fellow subsidiary undertaking and, as a result, the activities of the Tokyo branch have reduced. It is anticipated that the Tokyo branch will be closed in the foreseeable future with no material cost to the company.

3. Year 2000

The company has determined that it will be required to modify or replace portions of its information technology systems, both hardware and software, and its non-information technology systems so that they will properly recognise dates beyond December 31, 1999. The company presently believes that with modifications to existing software, conversions to new software and replacement of some hardware, the Year 2000 issue will be satisfactorily resolved in its own systems worldwide. However, if such modifications are not made or are not completed on a timely basis, the Year 2000 issue could have a material adverse effect on the company. Moreover, even if these changes are successful, failure of third parties to which the company is financially or operationally linked to address their own Year 2000 problems would also have a material adverse effect on the company.

These risks are being addressed as part of a group-wide initiative which is based on a five phase approach : (1) awareness; (2) inventory, assessment and planning; (3) remediation; (4) testing; and (5) implementation. The group is also addressing Year 2000 issues that may exist outside its own technology activities, including its facilities, external service providers and other third parties with which it interfaces. As part of its Year 2000 program, the group has also participated in approximately 130 'external', i.e. industry-wide or point-to-point, tests as of April 30, 1999 including major industry tests in those global markets where the group conducts significant business. Acknowledging that a Year 2000 failure, whether internal or external, could have an adverse effect on the ability to conduct day-to-day business, the group has also organised a comprehensive and group-wide contingency planning effort.

We have not quantified the cost to the company of the year 2000 initiative as a group-wide approach has been adopted.

4. Fixed Assets

The movement in tangible fixed assets is given in note 17 to the financial statements.

5. Dividends

The directors declared and paid interim preference dividends of £5,113,402 (1998: £Nil) during the year. The directors do not recommend the payment of a final ordinary dividend.

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REPORT OF THE DIRECTORS (CONTINUED)

6. Directors

The directors of the company during the year and as at the date of this report, together with dates of appointment and resignation where applicable are:

Name	Appointed	Resigned
F. E. DuBose		
R. J. O'Shea		
B. H. Young, Jr.		November 27, 1998
P. Savitz		April 27, 1998
P.C. Deighton		
G.T. Grant		
P.E. Mulvihill	April 27, 1998	
T.J. O'Neill	September 9, 1999	
S. Davies	September 17, 1999	
E.G. Corrigan (Chairman)		

No director has, or had during the year, any interest requiring note herein.

7. Directors' responsibilities

The directors are required by United Kingdom company law to prepare financial statements for each financial period which give a true and fair view of the state of affairs of the company as at the end of the financial period and of the profit or loss for that period. In preparing the financial statements, appropriate accounting policies have been used and applied consistently, and reasonable and prudent judgements and estimates have been made. Applicable accounting standards have been followed and the financial statements have been prepared on a going concern basis. The directors are responsible for keeping proper accounting records, for taking reasonable steps to safeguard the assets of the company and to prevent and detect fraud and other irregularities.

BY ORDER OF THE BOARD



WILLIAM ELLIOTT
Secretary

23 September 1999

GOLDMAN SACHS INTERNATIONAL BANK
(unlimited company)

Report of the auditors to the members of
GOLDMAN SACHS INTERNATIONAL BANK
(unlimited company)

We have audited the financial statements on pages 4 to 22 which have been prepared under the accounting policies set out on page 7.

Respective responsibilities of directors and auditors

The directors are responsible for preparing the Report of the Directors and, as described on page 2, the financial statements. Our responsibilities, as independent auditors, are established by statute, the Auditing Practices Board and our profession's ethical guidance.

We report to you our opinion as to whether the financial statements give a true and fair view and are properly prepared in accordance with the Companies Act. We also report to you if, in our opinion, the directors' report is not consistent with the financial statements, if the company has not kept proper accounting records, if we have not received all the information and explanations we require for our audit, or if information specified by law regarding directors' remuneration and transactions is not disclosed.


Basis of audit opinion

We conducted our audit in accordance with Auditing Standards issued by the Auditing Practices Board. An audit includes examination, on a test basis, of evidence relevant to the amounts and disclosures in the financial statements. It also includes an assessment of the significant estimates and judgements made by the directors in the preparation of the financial statements, and of whether the accounting policies are appropriate to the company's circumstances, consistently applied and adequately disclosed.

We planned and performed our audit so as to obtain all the information and explanations which we considered necessary in order to provide us with sufficient evidence to give reasonable assurance that the financial statements are free from material misstatement, whether caused by fraud or other irregularity or error. In forming our opinion we also evaluated the overall adequacy of the presentation of information in the financial statements.

Opinion

In our opinion the financial statements give a true and fair view of the state of affairs of the company at 31 March 1999 and of its profit for the year then ended and have been properly prepared in accordance with the Companies Act 1985.


PricewaterhouseCoopers
Chartered Accountants and Registered Auditors
1 Embankment Place
London
WC2N 6NN 24 September 1999

GOLDMAN SACHS INTERNATIONAL BANK
(unlimited company)

PROFIT AND LOSS ACCOUNT
for the year ended 31 March 1999

	Note	1999 £'000	1998 £'000
Interest receivable	4	15,020	11,129
Interest payable	5	(6,747)	(5,903)
Net Interest Income		8,273	5,226
Fees and commissions receivable		9,555	19,082
Fees and commissions payable		(1,136)	-
Dealing profits		4,666	4,918
Other operating income		2,790	2,147
TOTAL OPERATING INCOME		24,148	31,373
Operating expenses:			
Administrative expenses	6	(10,740)	(7,736)
Depreciation and amortisation		(107)	(66)
Other operating charges		(6,551)	(3,081)
Provisions for bad and doubtful debts	14	(1,634)	-
PROFIT ON ORDINARY ACTIVITIES BEFORE TAXATION	8	5,116	20,490
Tax on profit on ordinary activities	9	(2,480)	(9,658)
PROFIT ON ORDINARY ACTIVITIES AFTER TAXATION		2,636	10,832
Dividends paid - preference (non equity)	10	(5,113)	-
(LOSS)/ PROFIT FOR THE FINANCIAL YEAR		(2,477)	10,832

The total operating income of the company is derived entirely from continuing operations.

There is no difference between the profit on ordinary activities before taxation and the loss for the financial year as stated above and their historical cost equivalents.

The notes on pages 7 to 22 form part of these financial statements.
Auditors' report - page 3.

GOLDMAN SACHS INTERNATIONAL BANK
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STATEMENT OF TOTAL RECOGNISED GAINS AND LOSSES
for the year ended 31 March 1999

	Note	<u>1999</u> <u>£'000</u>	<u>1998</u> <u>£'000</u>
Profit on ordinary activities after taxation		2,636	10,832
Other recognised gains	26	<u>1,057</u>	<u>737</u>
Total recognised gains		<u><u>3,693</u></u>	<u><u>11,569</u></u>

RECONCILIATION OF MOVEMENTS IN SHAREHOLDERS' FUNDS
for the year ended 31 March 1999

		<u>1999</u> <u>£'000</u>	<u>1998</u> <u>£'000</u>
Profit on ordinary activities after taxation		2,636	10,832
Dividends paid - on non equity shares	10	<u>(5,113)</u>	<u>-</u>
		(2,477)	10,832
Other recognised gains	26	<u>1,057</u>	<u>737</u>
Net (decrease)/ increase in shareholders' funds		(1,420)	11,569
Opening shareholders' funds		<u>84,171</u>	<u>72,602</u>
Closing shareholders' funds		<u><u>82,751</u></u>	<u><u>84,171</u></u>

The notes on pages 7 to 22 form part of these financial statements.
Auditors' report - page 3.

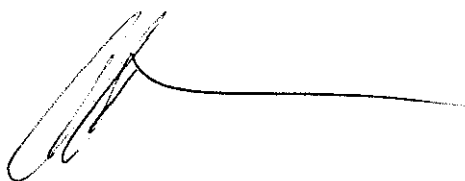
GOLDMAN SACHS INTERNATIONAL BANK
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BALANCE SHEET
as at 31 March 1999

	Note	1999 £'000	1998 £'000
ASSETS			
Cash and balances at central banks	11	1,553	4,225
Loans and advances to banks	12	107,712	164,901
Loans and advances to customers	13	53,381	46,703
Long derivatives inventory	16	310,165	390,402
Tangible fixed assets	17	304	185
Prepayments and accrued income	18	915	1,040
Other assets	19	7,555	9,466
Total assets		481,585	616,922
LIABILITIES			
Deposits by banks	20	29,839	28,839
Customer accounts	21	18,457	22,521
Short derivatives inventory	22	299,468	422,266
Accruals and deferred income	23	1,096	814
Other liabilities	24	14,974	23,311
Subordinated debt	25	35,000	35,000
Called up share capital	27	7,049	7,049
Share premium account	26	61,361	61,361
Translation reserve	26	3,100	2,043
Profit and loss account	26	11,241	13,718
Shareholders' funds		82,751	84,171
Capital resources		117,751	119,171
Total liabilities		481,585	616,922
Equity shareholders' funds		20,751	22,171
Non equity shareholders' funds		62,000	62,000
Shareholders' funds		82,751	84,171
MEMORANDUM ITEMS			
Financial Commitments and Contingencies	28	22,670	41,493

Approved by the Board of Directors on 23 September 1999

Director



The notes on pages 7 to 22 form part of these financial statements.
Auditors' report - page 3.

GOLDMAN SACHS INTERNATIONAL BANK

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NOTES TO THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 MARCH 1999

1. ACCOUNTING POLICIES

The financial statements have been prepared under the historical cost convention and in accordance with the special provisions of Part VII of the Companies Act 1985 relating to banking companies, applicable accounting standards, and Statements of Recommended Accounting Practice issued by the British Bankers Association. The company has not consolidated its subsidiary undertakings as they are not material to the financial statements. The principal accounting policies, which have been consistently applied, were as follows:

(a) Fixed Assets:

- (i) Tangible fixed assets - Tangible fixed assets are stated at cost less accumulated depreciation. Depreciation is calculated so as to write off the cost of the assets, on a reducing line basis, over their estimated useful lives.

The principal annual rates used for this purpose are from 21% to 32%, depending on the nature of the asset.

- (ii) Investments - Investments are carried at cost less amounts written off where there is a permanent diminution in value.

- (b) Derivative financial instruments:** Forward foreign exchange contracts, and other derivative financial instruments are valued, and stated in the balance sheet, at fair value. The gains or losses resulting from the application of this policy are taken to the profit and loss account

- (c) Deferred taxation:** Deferred taxation is provided in respect of all differences in timing between the accounting and tax treatments of income and expenses, to the extent that a liability is expected to crystallise in the foreseeable future. Such taxation is provided at the rate of taxation expected to be ruling when the differences reverse.

- (d) Foreign currencies:** Assets, liabilities and share capital expressed in foreign currencies are translated into Sterling at the rates of exchange ruling at the balance sheet date. Transactions in foreign currencies are translated at the rates of exchange prevailing at the dates the transactions were made. Results of the overseas branch are translated at the average rate for the period. Differences arising on the translation of the opening reserves and fixed assets of the overseas branch are dealt with through reserves. All other gains and losses on exchange are recognised in the profit and loss account.

- (e) Profit recognition:** The operating results for the year include all profits arising from the trading operations of the company. Fees and commissions received in advance are amortised over the life of the advances to which they are applicable.

- (f) Pension costs:** The company participates in the following pension schemes for the benefit of certain employees:

- (i) A defined contribution scheme, for which the costs are charged to the profit and loss account on the basis of the contribution rate determined by the actuary.
- (ii) A funded defined benefit scheme, for which the costs of providing the expected retirement benefits to relevant employees are charged to the profit and loss account in the period to which they relate.

- (g) Advances:** Loans and advances to customers stated in the balance sheet at the lower of cost and net realisable value. Advances are written off when amounts are proven to be irrecoverable.

2. CASHFLOW STATEMENT

During the year ended 31 March 1999, the company was a wholly owned subsidiary of The Goldman Sachs Group, L.P., and is therefore exempt from preparing a cashflow statement as required by FRS1 as the parent undertaking consolidated accounts are publicly available.

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NOTES TO THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 MARCH 1999

3. SEGMENTAL REPORTING

Total operating income arises from the provision of financial services to clients, accordingly the directors are of the opinion that the company's activities constitute a single business. No analysis of results by geographical market is provided on the grounds that the company's clients are located world-wide.

4. INTEREST RECEIVABLE

	1999	1998
	£'000	£'000
Interest receivable comprises:		
Interest receivable on loans to banks and customers	15,020	11,129

5. INTEREST PAYABLE

	1999	1998
	£'000	£'000
Interest payable comprises:		
Interest payable on deposits from banks and customers	3,600	2,791
Interest payable on subordinated debt to parent undertaking	3,147	3,112
	6,747	5,903

6. ADMINISTRATIVE EXPENSES

	1999	1998
	£'000	£'000
Administrative expenses comprise:		
Salaries and wages	5,679	3,628
Social security costs	229	191
Other pension costs	683	516
Staff costs	6,591	4,335
Other expenses	4,149	3,401
	10,740	7,736

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NOTES TO THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 MARCH 1999

7. DIRECTORS' AND EMPLOYEES' EMOLUMENTS

The directors received no emoluments in respect of their services as directors of the company (1998: £Nil). During the year ended 31 March 1999, all of the directors except two were limited partners in The Goldman Sachs Group, L.P., and their remuneration was earned in relation to their activities in the firm as a whole. No part of their remuneration relates to their services as directors of the company. The remuneration of the remaining directors was in respect of their services within business units of The Goldman Sachs Group, L.P., and was not in respect of their services as directors of the company. London staff involved in the company's operations are employed by a fellow subsidiary undertaking. The charges made by this fellow subsidiary undertaking for all services provided to the company are included in the management fee charged by fellow subsidiary undertakings.

The employees in Tokyo were remunerated as disclosed in note 6 above. The average number of employees in Tokyo during the year was 33 (1998:32).

Pension costs relate to pension schemes maintained by the company for the benefit of certain employees, as set out below:

Defined benefit scheme

All employees of the company are members of a defined benefit scheme operated by a fellow subsidiary undertaking. The assets of the scheme are held separately from those of the company. The scheme is funded by contributions determined by an independent qualified actuary on the basis of annual valuations using the discount future obligation method. The most recent actuarial valuation was carried out as at 30 September 1998. The principal actuarial assumptions adopted at that valuation date were that, over the long term, the annual rate of return on investments would be 1% higher than the annual increase in total pensionable remuneration. The benefits provided by the scheme are based on final pensionable pay and the attributable pension costs relating to the scheme are charged to the profit and loss account on the basis of the contribution rate determined by the actuary.

The most recent actuarial valuation of the scheme as at 30 September 1998 showed that the aggregate market value of the scheme's assets was £496,000 and that the actuarial value of those assets represented 64% of the benefits that had accrued to all members, after allowing for expected future increases in earnings. The existing contribution rate takes into account the deficit disclosed by this valuation. The pension charge for the year to 31 March 1999 was £163,000 (1998: £133,000).

Defined contribution scheme

Certain employees are also members of a defined contribution scheme. The pension charge for the year to 31 March 1999 was £520,000 (1998: £383,000).

8. PROFIT ON ORDINARY ACTIVITIES BEFORE TAXATION

	1999 £'000	1998 £'000
Profit on ordinary activities before taxation is stated after charging:		
Auditors' remuneration - audit services	156	242
- other	227	124
Management fees charged by fellow subsidiary undertakings	6,030	3,081
Loss on disposal of fixed assets	-	217
Operating lease rentals - equipment	11	72
- buildings	361	481

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NOTES TO THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 MARCH 1999

9. TAX ON PROFIT ON ORDINARY ACTIVITIES

	1999 £'000	1998 £'000
The taxation charge for the year comprises:		
U.K. corporation tax at 31% (1998:31%)	2,403	2,720
Japanese corporation tax at 58% (1998:58%)	3	6,938
Deferred taxation	74	-
	2,480	9,658

10. DIVIDENDS PAID

	1999 £'000	1998 £'000
Dividend on non equity shares:		
£0.01 fixed rate preference shares	5,113	-

11. CASH AND BALANCES AT CENTRAL BANKS

	1999 £'000	1998 £'000
Cash at banks	1,270	4,109
Balances at central banks	283	116
	1,553	4,225

12. LOANS AND ADVANCES TO BANKS

	1999 £'000	1998 £'000
Repayable:		
On demand	17,882	99,719
In not more than three months	89,830	65,182
	107,712	164,901

13. LOANS AND ADVANCES TO CUSTOMERS

	1999 £'000	1998 £'000
Repayable:		
In not more than three months	34,337	40
In more than three months but not more than one year	1,766	124
In more than one year but not more than five years	12,756	29,806
In more than five years	5,273	16,733
Bad and doubtful debt provision (see note 14)	(751)	-
	53,381	46,703

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NOTES TO THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 MARCH 1999

14. PROVISION FOR BAD AND DOUBTFUL DEBTS

	<u>£'000</u>
At 1 April 1998	-
Charge against profits	1,634
Released on disposal	(883)
At 31 March 1999	<u>751</u>

15. INVESTMENT IN SUBSIDIARY UNDERTAKINGS

The company has investments in the following subsidiary undertakings which are wholly-owned and registered in England and Wales:

	<u>1999</u>	<u>1998</u>
	<u>£</u>	<u>£</u>
Goldman Sachs Leasing Limited (finance lessor)		
- Ordinary shares of £1 at cost	100	100
Restamove Limited (dormant)		
- Ordinary shares of £1 at cost	2	2
	<u>102</u>	<u>102</u>

The directors consider that the value of investments in subsidiary undertakings is not less than their book value

16. LONG DERIVATIVES INVENTORY

	<u>1999</u>	<u>1998</u>
	<u>£'000</u>	<u>£'000</u>
Long derivatives inventory comprise:		
Long positions in foreign exchange options	28,538	67,249
Foreign exchange and interest rate contracts	281,627	323,153
	<u>310,165</u>	<u>390,402</u>

GOLDMAN SACHS INTERNATIONAL BANK
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NOTES TO THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 MARCH 1999

17. TANGIBLE FIXED ASSETS

Tangible fixed assets comprise furniture and equipment. The movement during the year was:

	£'000
Cost	
At 1 April 1998	425
Additions	226
At 31 March 1999	651
Depreciation	
At 1 April 1998	240
Charge for the year	107
At 31 March 1999	347
Net book value	
At 31 March 1999	304
At 31 March 1998	185

18. PREPAYMENTS AND ACCRUED INCOME

	1999 £'000	1998 £'000
Prepayments and accrued income comprise:		
Accrued interest	861	985
Prepayments and accrued income	54	55
	915	1,040

19. OTHER ASSETS

	1999 £'000	1998 £'000
Other assets comprise:		
Amounts due from parent undertaking	4	-
Amounts due from fellow subsidiary undertakings	1,684	5,410
Deferred taxation	-	74
Other assets	5,867	3,982
	7,555	9,466

20. DEPOSITS BY BANKS

	1999 £'000	1998 £'000
Repayable:		
On demand	-	270
In not more than three months	29,839	28,569
	29,839	28,839

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NOTES TO THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 MARCH 1999

21. CUSTOMER ACCOUNTS

	1999 £'000	1998 £'000
Customer accounts comprise:		
Demand deposits	2,157	2,456
Amounts due to parent undertaking	15,384	19,896
Amounts due to subsidiary and fellow subsidiary undertakings	916	169
	<u>18,457</u>	<u>22,521</u>
Repayable:		
On demand	<u>18,457</u>	<u>22,521</u>

22. SHORT DERIVATIVES INVENTORY

	1999 £'000	1998 £'000
Short derivatives inventory comprise:		
Short positions in foreign exchange options	28,538	67,249
Foreign exchange and interest rate contracts	270,930	355,017
	<u>299,468</u>	<u>422,266</u>

23. ACCRUALS AND DEFERRED INCOME

	1999 £'000	1998 £'000
Accruals and deferred income comprise:		
Accrued interest	704	645
Other accruals and deferred income	392	169
	<u>1,096</u>	<u>814</u>

24. OTHER LIABILITIES

	1999 £'000	1998 £'000
Other liabilities comprise:		
Corporation tax	2,934	9,672
Creditors and other liabilities	5,241	4,568
Provisions for liabilities and charges	1,127	486
Amounts due to fellow subsidiary undertakings	2,375	5,344
Amounts due to parent undertaking	3,297	3,241
	<u>14,974</u>	<u>23,311</u>

Provisions for liabilities and charges includes

	Pension Obligations £'000
1 April 1998	486
Charge against profits	520
Exchange differences	121
31 March 1999	<u>1,127</u>

GOLDMAN SACHS INTERNATIONAL BANK
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NOTES TO THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 MARCH 1999

25. SUBORDINATED LIABILITIES

Subordinated liabilities comprise dated loan capital from the ultimate parent undertaking of £35,000,000 (1998: £35,000,000) maturing 29 June 2014. Interest is payable on the loan capital at a margin over LIBOR. The rights of the lender are subordinated to the claims of the senior creditors.

26. SHARE PREMIUM ACCOUNT AND RESERVES

EQUITY	Share Premium Account £'000	Profit and Loss Account £'000	Translation Reserve £'000
1 April 1998	61,361	13,718	2,043
Exchange differences	-	-	1,057
Loss for the year	-	(2,477)	-
31 March 1999	61,361	11,241	3,100

27. SHARE CAPITAL

	No	1999 £'000	No	1998 £'000
<u>Authorised</u>				
Ordinary Shares of £1 each	45,595,600	45,596	45,595,600	45,596
Preference shares of £0.01 each	100,000,000	1,000	100,000,000	1,000
		<u>46,596</u>		<u>46,596</u>
<u>Allotted, called up and fully paid</u>				
Ordinary Shares of £1 each	6,410,256	6,410	6,410,256	6,410
Preference shares of £0.01 each	63,917,526	639	63,917,526	639
		<u>7,049</u>		<u>7,049</u>

The company's preference shares are non-cumulative and carry a fixed non-cumulative preferential dividend at the rate of 8 pence per share per annum.

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NOTES TO THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 MARCH 1999

28. FINANCIAL COMMITMENTS AND CONTINGENCIES

Commitments

	1999 £'000	1998 £'000
Undrawn loan facilities granted	22,670	41,493

Contingencies

Arising from the sale of a loan portfolio in the ordinary course of business, the company has a contingent liability to third party borrowers totalling £916,000. This relates to deposits that the borrowers were required to place with the loan originator as a condition of them being granted a loan and which the company may be required to repay if certain conditions are met by such borrowers.

All costs arising from the contingent liability are fully reimbursable to the company from a related party.

29. RELATED PARTIES

Under the terms of FRS8, "Related Party Disclosures", the company is exempt from disclosing transactions with companies 90% or more controlled within the same group, as the consolidated financial statements in which the company is included are publicly available.

30. ULTIMATE PARENT UNDERTAKING

As at 31 March 1999 the ultimate parent undertaking was The Goldman Sachs Group, L.P., of 85 Broad Street, New York, NY 10004, United States of America. On 7 May 1999, The Goldman Sachs Group, L.P. converted from partnership to corporate form, with The Goldman Sachs Group, Inc. as the successor parent company. At the same time, The Goldman Sachs Group, Inc. completed an initial public offering of its common stock. The immediate parent undertaking is Goldman Sachs Holdings L.L.C., a company incorporated in the United States of America.

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NOTES TO THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 MARCH 1999

31. DERIVATIVES AND OTHER FINANCIAL INSTRUMENTS

Trading Activities

The company's objective is to gain margin value by marketing derivatives to end-users. Products offered by the company include interest rate and currency swaps, and foreign exchange forward and option contracts.

Risk Management

The company seeks to measure, monitor and control its risk exposure through a variety of separate but complementary financial, credit, operational and legal reporting systems.

Interest rate exposure is managed by establishing hedges so as to keep the company's exposure to interest rate and foreign exchange risk within limits set by management. The limit structure also includes exposures to counterparties both on an individual and aggregate basis.

Interest Rate Risk

The table below summarises the company's non-trading book into time bands by reference to the earlier of the next contractual interest rate repricing date and the maturity date. Short term debtors and creditors have been excluded from this and all subsequent analyses.

	Not more than three months	More than three months but not more than six months	More than six months but not more than one year	More than one year but not more than five years	More than five years	Non- interest bearing	Total
	£'000	£'000	£'000	£'000	£'000	£'000	£'000
Assets:							
Cash and balances at central banks	766	-	-	-	-	787	1,553
Loans and advances to banks	17,882	89,830	-	-	-	-	107,712
Loans and advances to customers	22,155	458	895	12,756	5,273	11,844	53,381
	40,803	90,288	895	12,756	5,273	12,631	162,646
Liabilities:							
Deposits by banks	-	(29,839)	-	-	-	-	(29,839)
Customer accounts	(17,607)	-	-	-	-	(850)	(18,457)
Subordinated debt	-	-	-	-	(35,000)	-	(35,000)
Preference shares	-	-	-	-	-	(62,000)	(62,000)
	(17,607)	(29,839)	-	-	(35,000)	(62,850)	(145,296)
Interest sensitivity gap	23,196	60,449	895	12,756	(29,727)	(50,219)	17,350

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NOTES TO THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 MARCH 1999

31. DERIVATIVES AND OTHER FINANCIAL INSTRUMENTS (CONTINUED)

Currency Risk

The company's only overseas operation is its branch in Tokyo. The main functional currencies of operation are therefore sterling and yen. As the currency in which the company prepares its financial statements is sterling, it follows that the company's balance sheet is affected by movements in the exchange rates between the yen and sterling. This currency exposure is referred to as structural currency exposure. Translation gains and losses arising from this exposure are recognised in the statement of total recognised gains and losses.

The table below shows the company's currency exposures in the non-trading book.

Functional currency of operation	Net foreign currency monetary assets / (liabilities) in £'000					Total
	Sterling	US dollar	Yen	Euro	Other	
Sterling	-	(12,732)	1	(1,313)	3,450	(10,594)
Yen	339	(1,818)	-	14	66	(1,399)
Total	339	(14,550)	1	(1,299)	3,516	(11,993)

Fair values of financial assets and liabilities

Set out below is a comparison by category of book values and fair values as at 31 March 1999.

	Book value £'000	Fair value £'000
Primary financial instruments held or issued to finance the company's operations:		
Cash and balances at central banks	1,553	1,553
Financial instruments held or issued for trading:		
Interest rate contracts	-	-
Foreign exchange contracts	10,697	10,697
Equity contracts	-	-

All financial instruments held or issued for trading are carried in the financial statements at fair value. Market values have been used to determine the fair value of all financial instruments.

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NOTES TO THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 MARCH 1999

31. DERIVATIVES AND OTHER FINANCIAL INSTRUMENTS (CONTINUED)

Trading Book

Dealing profits for the year ended 31 March 1999 were £4,666,000. These profits were earned entirely on foreign exchange contracts.

Derivative activity is subject to the same credit approval, limit and monitoring procedures as used for other credit transactions. Total counterparty risk is monitored on an aggregate basis across all activities. Derivative credit exposure to individual counterparties is monitored on a daily basis based on mark-to-market values, and taking into consideration potential future exposure on transactions. To reduce credit risk, the company uses a variety of credit enhancement techniques such as netting and collateralisation, where security is provided against exposure.

Value at Risk ('VaR')

VaR is the potential loss in value of the company's trading positions due to adverse movements in markets over a defined time horizon with a specified confidence level.

For the VaR numbers reported below, a one-day time horizon and a 99.6% confidence level were used. This means that there is a one in 250 chance that daily trading net revenues will fall below the expected daily trading net revenues by an amount at least as large as the reported VaR. Thus, shortfalls from expected trading net revenues on a single trading day greater than the reported VaR would be anticipated to occur, on average, about once a year. Shortfalls on a single day can exceed reported VaR by significant amounts. Shortfalls can also accumulate over a longer time horizon such as a number of consecutive trading days.

VaR methodology, assumptions and limitations

The modeling of the risk characteristics of the company's trading positions involves a number of assumptions and approximations. While management believes that these assumptions and approximations are reasonable, there is no uniform industry methodology for estimating VaR, and different assumptions and/or approximations could produce materially different VaR estimates.

The company uses data for the last five years to estimate its VaR and, given this reliance on historical data, VaR is most effective in estimating risk exposures in markets in which there are no sudden fundamental changes or shifts in market conditions. An inherent limitation of VaR is that past changes in market risk factors may not produce accurate predictions of future market risk. Moreover, VaR calculated for a one-day time horizon does not fully capture the market risk of positions that cannot be liquidated within one day.

The company sets a VaR limit of \$2 million and the VaR for the company's trading book as at 31 March 1999 was \$500,000 (£310,000 equivalent). The average, highest and lowest VaR's, calculated on a daily basis, for the trading book for the year ended 31 March 1999 were \$169,000 (£102,000), \$1,150,000 (£705,000), and \$10,000 (£6,000) respectively.

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NOTES TO THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 MARCH 1999

31. DERIVATIVES AND OTHER FINANCIAL INSTRUMENTS (CONTINUED)

The derivative positions by notional principal amount as at 31 March 1999 were as follows:

Derivatives Positions as of 31 March 1999

	Notional Principal Amounts by Maturity £'000			
	< 1 Year	1-5 Years	>5 Years	Total
Interest Rate Contracts				
With financial institutions	553,265	1,541,043	3,884,951	5,979,259
With others	553,297	646,799	447,076	1,647,172
Total	1,106,562	2,187,842	4,332,027	7,626,431
Foreign Exchange Contracts				
With financial institutions	9,524,315	48,614	776,874	10,349,803
With others	2,849,587	45,004	-	2,894,591
Total	12,373,902	93,618	776,874	13,244,394
Equity Contracts				
With financial institutions	3,887	-	-	3,887
With others	3,887	-	-	3,887
Total	7,774	-	-	7,774
Commodity Contracts				
With financial institutions	-	-	-	-
With others	-	-	-	-
Total	-	-	-	-

The nominal principal amounts above indicate the volume of business outstanding at the balance sheet date, and do not represent amounts at risk. The risk weighted amounts below have been calculated in accordance with guidelines as specified by the Financial Services Authority.

Exchange rate, interest rate, equity and commodity contracts outstanding at 31 March 1999 were:

	Credit Equivalent Amounts £'000	Risk Weighted Amounts £'000
Exchange rate contracts	305,770	63,485
Interest rate contracts	192,198	41,882
Equity Contracts	798	160
Commodity Contracts	-	-

The exchange rate, interest rate and equity contracts are used only for trading purposes.

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NOTES TO THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 MARCH 1999

31. DERIVATIVES AND OTHER FINANCIAL INSTRUMENTS (CONTINUED)

The derivative positions by notional principal amount as at 31 March 1998 were as follows:

Derivatives Positions as of 31 March 1998

	Notional Principal Amounts by Maturity £'000			
	< 1 Year	1-5 Years	>5 Years	Total
Interest Rate Contracts				
With financial institutions	499,651	1,693,953	8,836,822	11,030,426
With others	499,651	861,333	765,164	2,126,148
Total	999,302	2,555,286	9,601,986	13,156,574
Foreign Exchange Contracts				
With financial institutions	14,437,134	9,759	372,387	14,819,280
With others	1,296,570	-	-	1,296,570
Total	15,733,704	9,759	372,387	16,115,850
Equity Contracts				
With financial institutions	22,452	3,348	-	25,800
With others	22,452	3,348	-	25,800
Total	44,904	6,696	-	51,600
Commodity Contracts				
With financial institutions	2,207	-	-	2,207
With others	2,207	-	-	2,207
Total	4,414	-	-	4,414

Exchange rate, interest rate, equity and commodity contracts outstanding at 31 March 1998 were:

	Credit Equivalent Amounts £'000	Risk Weighted Amounts £'000
Exchange rate contracts	403,520	94,542
Interest rate contracts	255,827	63,510
Equity Contracts	5,067	1,896
Commodity Contracts	1,093	480

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NOTES TO THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 MARCH 1999

31. DERIVATIVES AND OTHER FINANCIAL INSTRUMENTS (CONTINUED)

The derivative positions by net replacement cost as at 31 March 1999 were as follows:

Derivatives Positions as of 31 March 1999

	Net Replacement Cost by Residual Maturity £'000			
	< 1 Year	1-5 Years	>5 Years	Total
Interest Rate Contracts				
With financial institutions	-	-	-	-
With others	-	-	-	-
Total	-	-	-	-
Foreign Exchange Contracts				
With financial institutions	8,448	-	-	8,448
With others	2,249	-	-	2,249
Total	10,697	-	-	10,697
Equity Contracts				
With financial institutions	-	-	-	-
With others	-	-	-	-
Total	-	-	-	-
Commodity Contracts				
With financial institutions	-	-	-	-
With others	-	-	-	-
Total	-	-	-	-

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NOTES TO THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 MARCH 1999

31. DERIVATIVES AND OTHER FINANCIAL INSTRUMENTS (CONTINUED)

The derivative positions by net replacement cost as at 31 March 1998 were as follows:

Derivatives Positions as of 31 March 1998

	Net Replacement Cost by Residual Maturity £'000			
	< 1 Year	1-5 Years	>5 Years	Total
Interest Rate Contracts				
With financial institutions	-	-	-	-
With others	-	-	-	-
Total	-	-	-	-
Foreign Exchange Contracts				
With financial institutions	(59,431)	-	-	(59,431)
With others	28,293	-	-	28,293
Total	(31,138)	-	-	(31,138)
Equity Contracts				
With financial institutions	-	-	-	-
With others	-	-	-	-
Total	-	-	-	-
Commodity Contracts				
With financial institutions	-	-	-	-
With others	-	-	-	-
Total	-	-	-	-