BASEL II PILLAR 3 DISCLOSURES

BAHRAINI DINARS '000

EXECUTIVE SUMMARY

Securities & Investment Company BSC(c) (SICO) is a conventional wholesale bank licensed by the Central Bank of Bahrain (CBB). SICO provides innovative products and investment banking services that include Asset Management, Corporate Finance, Brokerage and Market Making.

This Risk and Capital Management Disclosures encompass the Basel II Pillar 3 disclosure requirements prescribed by the CBB based on the Basel Committee's Pillar 3 guidelines. The report contains a description of SICO's risk management and capital adequacy practices, including detailed information on the capital adequacy process.

The information presented herein pertains to Securities and Investment Company BSC (c) consolidated with its subsidiaries (together termed as "SICO" or the "Bank").

All figures presented in this report are as at 31 December 2014 unless otherwise stated.

1. INTRODUCTION

1.1 CBB Rulebook

The Central Bank of Bahrain's (CBB) Basel II guidelines prescribe the capital adequacy framework for banks incorporated in the Kingdom of Bahrain. During January 2008, the CBB introduced these guidelines, and all banks in Bahrain were requested to comply with them.

This disclosure document has been prepared in accordance with the CBB requirements outlined in the Public Disclosure Module ("PD") which comes under Volume 1 (Conventional Banks) of the CBB Rulebook. This quantitative disclosure document follows the requirements of Basel II Pillar 3.

1.2 BASEL II Framework

Basel II is the second of the Basel Accords, which was issued by the Basel Committee on Banking Supervision. The Basel II framework consists of the following 3 pillars:

- Pillar 1 - Describes the minimum capital requirements by applying risk-based methodology in the calculation of the risk-weighted assets (RWAs) and capital requirement for the major asset classes to derive the capital adequacy ratio (CAR).
- Pillar 2 - Describes the supervisory review processes, which include the Internal Capital Adequacy Assessment Process (ICAAP).
- Pillar 3 - Describes market discipline, which includes disclosure of risk management process and capital adequacy requirements and guidelines.

PILLAR 1	PILLAR 2	PILLAR 3
Minimum Capital Requirements	**Supervisory Review Process**	**Market Discipline**
Risk based capital requirements for: - Credit Risk - Market Risk - Operational Risk	Regulatory Framework for Banks: Internal Capital Adequacy Assessment Process (ICAAP) Supervisory Framework: Supervisory Review & Evaluation Process	Disclosure requirement for banks: - Specific quantitative and qualitative disclosures - Transparency for market participants concerning the bank's risk position (scope of application, risk management etc.) - Enhanced comparability of banks

1.2.1 Pillar 1

Pillar 1 lays down the basis for the calculation of the regulatory Capital Adequacy Ratio (CAR). Pillar 1 sets out the definition and calculations of the RWAs, and the derivation of the regulatory capital base. The capital adequacy ratio is calculated by dividing the regulatory capital base by the total RWAs.

Below are the approaches used for deriving the CAR:

Approaches for determining regulatory capital requirements		
Credit Risk	Market Risk	Operational Risk
Standardised Approach	Standardised Approach	Basic Indicator Approach
Foundation IRB Approach (Internal Ratings Based)	Internal Models Approach (IMA)	Standardised Approach
Advanced IRB Approach (Internal Ratings Based)	-	Advanced Measurement Approach (AMA)

SICO has adopted the Standardised Approach for Credit Risk and Market Risk, and follows the Basic Indicator Approach for Operational Risk to determine its capital requirements.

1. INTRODUCTION CONTD

1.2.2 Pillar 2

Pillar 2 sets out the supervisory review and evaluation process of an institution's risk management framework, and accordingly its capital adequacy through ICAAP.

The supervisory review and evaluation process represents the CBB's review of the Bank's capital management and an assessment of internal controls and corporate governance. The process is designed to ensure that institutions identify their material risks and allocate adequate capital, and employ sufficient management processes to support such risks. The process also encourages institutions to develop and apply enhanced risk management techniques for the measurement and monitoring of risks in addition to the credit, market and operational risks addressed in the core Pillar 1 framework.

Other risk types which are not covered by the minimum capital requirements in Pillar 1 include liquidity risk, interest rate risk in the banking book, business risk and concentration risk. These are covered either by capital, or risk management and mitigation processes under Pillar 2.

Pillar 2 also comprises an Internal Capital Adequacy Assessment Process (ICAAP). The ICAAP incorporates a review and evaluation of risk management and capital relative to the risks to which the Bank is exposed. The ICAAP addresses all components of the Bank's risk management, from the daily management of more material risks to the strategic capital management of the Bank. The brief and final ICAAP will be based on the Bank's economic capital framework, which is designed to ensure that the Bank has sufficient capital resources available to meet regulatory and internal capital requirements, even during periods of economic or financial stress.

1.2.3 Pillar 3

The third pillar as per the CBB's Rulebook, describes the level of qualitative and quantitative information that should be disclosed about an institution's risk management and capital adequacy practices.

Under the current regulations, partial disclosure consisting mainly of quantitative analysis is required during half-year reporting, whereas full disclosure is required to coincide with the financial year-end reporting.

1.3 Scope of Application

SICO is a conventional wholesale bank incorporated in Bahrain and regulated by the CBB. SICO provides investment banking services on a regional basis with a principal focus on the GCC. There is a regulatory requirement to calculate and maintain minimum regulatory capital ratios on both a solo as well as consolidated basis.

The principal subsidiaries that are fully consolidated into the financial statements of SICO are SICO Funds Services Company BSC (c) ("SFS"), incorporated in Bahrain and providing custody and fund administration services; and SICO UAE LLC (acquired September 2011), incorporated in Abu Dhabi and providing brokerage services in the UAE.

The adoption of IFRS 10 resulted in the Group also consolidating SICO Kingdom Equity Fund ("SKEF") and SICO Fixed Income Fund ("SFIF").

2. CAPITAL STRUCTURE, RISK WEIGHTED ASSETS AND CAPITAL ADEQUACY

The Bank's paid up capital consists only of ordinary shares which have proportionate voting rights. The Bank does not have any other type of capital instruments.

The Bank's Tier 1 capital comprises share capital, share premium, retained earnings, and unrealised losses arising from fair valuing equity securities classified as available-for-sale and eligible reserves.

The Bank's Tier 2 Capital comprises interim profits, collective impairment provisions and 45 percent of unrealised gains arising from fair valuing equity securities classified as available-for-sale.

In accordance with the CBB's Basel II capital adequacy framework, certain assets are required to be deducted from regulatory capital rather than included in RWAs. These deductions are applied 50 per cent from tier one and 50 per cent from tier two capital.

The Bank has no subsidiaries and/or investments in insurance companies exceeding 20% of the Bank's capital or the invested company's capital that is required to be deducted from capital.

BAHRAINI DINARS '000

The Bank has no restrictions on the transfer of funds or regulatory capital within the Group other than restrictions over transfers to ensure minimum regulatory capital requirements are met for subsidiary companies.

2.1 Capital Structure

Tier 1 Capital	
Issued and fully paid ordinary shares	**42,849**
Statutory Reserve	**5,450**
General Reserve	**2,642**
Share Premium	**692**
Retained Earnings brought forward	**9,946**
Gross unrealised loss arising from fair valuing equity securities	**(438)**
Securitisation exposures subject to deduction	**-**
Tier 1 Capital (A)	**61,141**
Tier & Capital	
Current Interim Profits	**0**
45% of gross unrealised gains arising from fair valuing equity securities	**484**
Securitisation exposures subject to deduction	**-**
Tier 2 Capital (B)	**484**
Total Available Capital (C) = (A) + (B)	**61,625**
Credit risk weighted exposures	**61,031**
Market risk weighted exposures	**24,184**
Operational risk weighted exposures	**11,610**
Total Risk weighted exposures (D)	**96,825**
Tier 1 Capital Adequacy Ratio (A) / (D)	**63.15%**
Total Capital Adequacy Ratio (C) / (D)	**63.65%**

2.2 Changes to Share Capital Structure

There has been no change to the capital structure during the year.

2.3 Capital Ratios - Consolidated & Subsidiaries above 5% of Group capital:

Subsidiaries	31 December 2014	
	Total Capital Adequacy Ratio	Tier 1 Capital Ratio
SICO Consolidated (Group)	63.65%	63.15%
SICO UAE*	8.41%	4.35%

* SICO UAE CAR has been computed using capital charges as outlined in Emirates Securities and Commodities Authority regulations.

BAHRAINI DINARS '000

3. RISK EXPOSURES

3.1 Credit Risk

3.1.1 Gross credit exposures

As at 31 December 2014	Gross Credit Exposure			Credit Risk Weighted Assets	Capital Requirement @ 12%
	On-balance Sheet (Funded)	Off-balance Sheet (Unfunded)	TOTAL		
Cash items	4,221	-	**4,221**	-	-
Claims on Sovereigns	12,206	-	**12,206**	-	-
Claims on Bahraini PSE	500	-	**500**	-	-
Claims on Banks	73,023	-	**73,023**	22,307	2,677
Claims on Corporates	1,077	-	**1,077**	1,299	156
Investments in Securities	21,090		**21,090**	25,346	3,042
Holdings in Real Estate	203	-	**203**	560	67
Other Assets	3,513	765	**4,278**	3,785	454
TOTAL	**115,833**	**765**	**116,598**	**53,297**	**6,396**

The on-balance sheet and off-balance sheet gross exposures have been risk weighted using the applicable risk weights and CCF's (credit conversion factors).

The balances above are representative of the position during the period; hence the average balances for the year is not separately disclosed.

The exposures are not backed by collaterals, and hence no benefit for credit risk mitigation is applicable.

3.1.2 Large exposure limits

As at 31 December 2014, there were no exposures in excess of the 15% large exposure limit as defined in the CM Module of the CBB's rule book.

3.1.3 Maturity profile of the credit portfolio

As at	Less than 3 months	Over 3 months to 6 months	Over 6 months to 1 year	Over 1 year to 5 years	Over 5 years to 10 years	Total
Cash and Bank Balances	61,426				-	61,426
Trading Debt Securities			903	5,992	3,394	10,289
AFS Debt Securities			-	5,593	3,112	8,705
Other Assets	5,622	217		546	-	6,385
Total gross credit exposures	67,048	217	903	12,132	6,506	86,806
Commitments and contingencies	1,415		115	0	0	1,530

Note: None of the exposures have a maturity period in excess of ten years.The above table excludes Prepayments and Furniture & Fixtures.

BAHRAINI DINARS '000

3.1.4 Sectoral distribution

As at 31 December 2014	Financial	Real Estate	Services / Telecom	Industrials	Sovereign	Mutual Funds	Other	Total
Cash & bank balances	61,427							**61,427**
Investment at FVTPL	6,759	3,619	2,232	772	1,684	1,186	1,089	**17,340**
AFS investments	12,654	587	3,086	-	179	11,864	441	**28,811**
Other assets							6,388	**6,388**
ON-BALANCE SHEET	**80,840**	**4,205**	**5,318**	**772**	**1,863**	**13,050**	**7,918**	**113,966**
Off-balance sheet	-	-	-	-	-	-	1,530	**1,530**

Note: The above table excludes Prepayments and Furniture & Fixtures.

3.1.5 Geographical distribution

As at 31 December 2014	GCC	MENA (ex-GCC)	North America	Europe	Other	Total
Cash & bank balances	58,472	33	-	2,922		61,427
Investment at FVTPL	15,815	-	-	1,526	0	17,341
AFS investments	13,881	-	4,089	6,172	4,669	28,811
Other assets					6,388	6,388
Total Assets	88,167	33	4,089	10,621	11,057	113,967
Total Off-balance sheet	1,415	115	-	-	-	1,530

Note: The above table excludes Prepayments and Furniture & Fixtures

3.1.6 Impairment on available-for-sale investment securities
During the year, the Bank has taken a specific impairment provision of BHD 366 on one of its AFS investments.

3. RISK EXPOSURES CONTD BAHRAINI DINARS '000

3.2 Market Risk

The market risk weighted assets and the capital requirement are computed as follows:

As at 31 December 2014	Market Risk Weighted Assets			Capital Requirement @ 12%
	During the 12 months period ended 31 December 2014		As at 31 December 2014	
	Minimum	Maximum		
Interest Rate Position Risk	647	898	771	93
Equities Position Risk	939	1,483	1,002	120
Foreign Exchange Risk	21	144	21	2
Total min capital required for market risk			**1,793**	**215**
Multiplier			12.5	12.5
TOTAL			**22,415**	**2,690**

3.3 Operational Risk

The operational risk weighted assets are computed as per the guidelines of the CBB, which are as follows:

Average gross income for the past 3 years

(Excluding extraordinary and exceptional income)

As at 31 December 2014	2011	2012	2013
Gross income	3,339	6,252	8,985
Average gross income (A)			6,192
Alpha (B)			15%
(C) = (A) * (B)			929
Risk weighted exposures (D) = (C) * 12.5)			**11,610**
Capital requirement @ 12% of (D)			**1,393**

BAHRAINI DINARS '000

4. INTEREST RATE RISK

4.1 Interest Rate Risk in the Banking Book

A 100 bps and 50 bps increase and decrease in market interest rates would affect the value of the fixed rate debt instruments in the available-for-sale portfolio as follows:-

As at 31 December 2014	100 bps increase	50 bps increase	100 bps decrease	50 bps decrease
	-171,351	**-87,083**	**-**	**-**

Note: Only interest rate increase impact has been disclosed as interest rates are currently at the lowest point.

The interest rate risk on the Bank's placements and short-term borrowings is considered minimal, and hence no sensitivity analysis has been presented. There has been no currency sensitivity analysis provided since the Bank invests in securities in BHD and other USD pegged currencies only.

4.2 Interest Rate Risk Sensitive Assets and Liabilities

As at 31 December 2014	Effective Interest Rate% p.a.	Within 1 year	Over 1 year	Non-interest Sensitive	Total
Cash and Bank balances	-	-	-	20,263	20,263
Call deposits*	-	1,267	-	-	1,267
Placements with banks	1.04%	39,897	-	-	39,897
Investments at fair value through profit or loss	7.03%	903	9,386	7,050	17,340
Available-for-sale securities	4.91%	307	8,398	20,106	28,811
Furniture and equipment		-	-	1,500	
Fees receivable	-	-	-	1,192	1,192
Other assets	-	-	-	6,998	6,998
Total Assets		**42,374**	**17,785**	**57,109**	**117,268**
Bank overdrafts	-	-	-	-	-
Short-term borrowings	0.84%	16,220	-	-	16,220
Payables to customers	-	-	-	32,878	32,878
Deposits from customers	-	-	-	3,301	3,301
Other liabilities	-	-	-	2,172	
Payables to unit holders		16,220	-	38,351	54,571
Total Liabilities				62,697	62,697
Total Equity	-	-	-	-	-
Total Liability and Equity	**-**	**16,220**	**-**	**101,048**	**117,268**
Interest rate sensitivity gap		26,154	7,785	43,939	
Cumulative Interest rate sensitivity gap		**26,154**	**43,939**	**(0)**	

BAHRAINI DINARS '000

5. EQUITY POSITIONS IN THE BANKING BOOK

As at 31 December 2014	Gross Exposure	Capital Requirement @ 12%
Quoted Equities	20,507	2461
Unquoted Equities	6,650	798
TOTAL	**27,157**	**3,259**

Realised gain during the year	2,122
Dividend income during the year	1,055
Unrealised net gain/loss recognised in equity	764
Gross unrealised losses deducted from Tier 1 capital	(438)
45% of unrealised gains recognised under Tier 2 capital	484

6. RELATED PARTY TRANSACTIONS

The following are the related party transactions during the period. All these transactions are in the ordinary course of business and on normal commercial terms.

Transactions with funds owned by the subsidiary companies, namely SICO Funds Company BSC (c), SICO Funds Company II BSC (c), SICO Funds Company III BSC (c), SICO Funds Company IV BSC (c), SICO Funds Company V BSC (c), SICO Funds Company VI BSC (c), SICO Funds Company VII BSC (c) and SICO Ventures Company SPC.

Fee and commission income	884
Fee receivable	255
Investments in own funds	2,420
Funds under management	47,422
Transactions with shareholders	
Fee and commission income	1,393
Funds under management	74,002

The Group has banking relationships, makes deposits and placements, and has un-utilised credit facilities with certain of its shareholders that are local banks.

Approval process for related parties transactions
The Bank has a due process for dealing with transactions involving Directors and related parties. Any such transactions will require approvals as per the delegated authority limits approved by the Board.