Basel II, Pillar 3 Disclosures

RISK AND CAPITAL MANAGEMENT

FOR THE YEAR ENDED

31 December 2013

These disclosures have been prepared in accordance with the Public Disclosure Module ("PD") of the CBB Rule Book, Volume I for Conventional Banks. These disclosures should be read in conjunction with the notes, in particular the Significant Accounting Policies and Financial Risk Management, in the Bank's Consolidated Financial Statements for the year ended 31 December 2013.

These disclosures have been reviewed by the Bank's external auditors KPMG based on agreed upon procedures as required under Para PD-A.2.4 of the PD Module.

Contents

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 2013** unless otherwise stated.

1. INTRODUCTION

1.1 CBB Rulebook

The Central Bank of Bahrain's (CBB) Basel II guidelines prescribes 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 to the capital adequacy ratio (CAR).
- Pillar 2 - Describes the supervisory review processes, which includes 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.

BASEL II		
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**
Standardized Approach	Standardized Approach	Basic Indicator Approach
Foundation IRB Approach (Internal Ratings Based)	Internal Models Approach (IMA)	Standardized Approach
Advanced IRB Approach (Internal Ratings Based)		Advanced Measurement Approach (AMA)

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

1.2.2 Pillar 2

Pillar 2 sets out the supervisory review & 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 is regulated by the CBB. SICO provides investment banking services on a regional basis with 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 provides custody and fund administration services; and SICO UAE LLC (acquired September 2011), incorporated in Abu Dhabi and provides 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").

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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 of share capital, share premium, retained earnings, unrealized losses arising from fair valuing equity securities classified as available-for-sale and eligible reserves.

The Bank's Tier 2 Capital comprises of interim profits, collective impairment provisions and 45 percent of unrealized 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.

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	4,875
General reserve	2,100
Share premium	692
Retained earnings brought forward	8,892
Gross unrealised loss arising from fair valuing equity securities	(43)
Tier 1 Capital (A)	**59,365**
Tier 2 Capital	
45% of gross unrealised gains arising from fair valuing equity securities	919
Securitisation exposures subject to deduction	-
Tier 2 Capital (B)	**919**
Total Available Capital (C) = (A) + (B)	**60,284**
Credit risk weighted exposures	56,668
Market risk weighted exposures	29,922
Operational risk weighted exposures	10,167
Total Risk Weighted Exposures (D)	**96,757**
Tier 1 Capital Adequacy Ratio (A) / (D)	**61.4%**
Total Capital Adequacy Ratio (C) / (D)	**62.3%**

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2.2 Changes to Share Capital Structure

During the year, the Bank issued 1,228,801 shares of 100 fils each under the employees share incentive scheme for the year 2012 to Volaw Trust & Corp service Ltd. These shares were issued at the 31 December 2012 NAV of 134 fils per share.

Accordingly, the share capital has increased by BD 123 to the extent of the nominal value of the shares of 100 fils each. The share premium of BD 41 relating to the issue of these shares at a premium of 34 fils per share has been credited to the statutory reserve.

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

Subsidiaries	31 December 2013	
	Total Capital Adequacy Ratio	Tier 1 Capital Ratio
SICO Consolidated (Group)	62.31%	61.35%
SICO UAE*	7.99%	7.99%

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

3. RISK EXPOSURES

3.1 Credit Risk

3.1.1 Gross credit exposures

As at 31 December 2013	Gross credit exposure			Credit Risk Weighted Assets	Capital requirement @ 12%
	On-balance sheet (Funded)	Off-balance sheet (Unfunded)	TOTAL		
Cash items	2,469	-	2,469	15	2
Claims on Sovereigns	8	-	8	-	-
Claims on Bahraini Public Sector Entities	500	-	500	-	-
Claims on Banks	41,774	-	41,774	18,883	2,266
Claims on Corporates	1,918	-	1,918	1,923	231
Investments in Securities	25,491	62	25,553	29,406	3,529
Holdings in Real Estate	1,159	-	1,159	2,318	278
Other Assets	3,637	486	4,123	4,123	495
TOTAL	**76,956**	**548**	**77,504**	**56,668**	**6,801**

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 period is not separately disclosed.

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

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3 Risk Exposure (continued)

3.1 Credit Risk (continued)

3.1.2 Large exposure limits

As at 31 December 2013, the following exposures of the Bank are in excess of the 15% large exposure limit as defined in the CM Module of the CBB's rule book.

Counterparty	Country	Amount	Exposure as a % to eligible capital base
Counterparty A	Qatar	11,569	19%
Counterparty B	Bahrain	10,431	17%

These exposures mainly represent cash and short term inter-bank placements. Cash and short term inter-bank placements are exposures with a maturity of less than 90 days and therefore are classified as exempt exposures as per the CBB's CM Module 5.6 under large exposure norms.

3.1.3 Maturity profile of the credit portfolio

As at 31 December 2013	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	32,799	-	-	-	-	32,799
Trading debt securities	-	444	-	6,161	2,557	9,162
Available-for-sale debt securities	-	-	-	4,676	2,655	7,331
Other assets	4,555	153	-	510	-	5,218
Total gross credit exposures	**37,354**	**597**	**-**	**11,347**	**5,212**	**54,510**
Commitments and contingencies	**730**	**607**	**123**	**-**	**-**	**1,460**

Note: None of the exposures have a maturity period in excess of ten years.

3.1.4 Sectoral distribution

As at 31 December 2013	Financial	Real Estate / Construction	Services / Telecom	Sovereign	Mutual Funds	Other	Total
Cash and bank balances	32,799	-	-	-	-	-	**32,799**
Investments at fair value through profit or loss	7,824	248	3,443	-	1,179	6,557	**19,251**
Available-for-sale investments	10,265	1,038	3,743	564	9,796	7,901	**33,307**
Other assets	-	-	-	-	-	5,218	**5,218**
On-balance sheet	**50,888**	**1,286**	**7,186**	**564**	**10,975**	**19,676**	**90,575**
Off-balance sheet	**-**	**-**	**-**	**-**	**-**	**1,460**	**1,460**

Note: The above table excludes prepayments and fixed assets.

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3. Risk Exposures (continued)

3.1.5 Geographical distribution

As at 31 December 2013	GCC	North America	Europe & MENA (ex-GCC)	Total
Cash and bank balances	32,002	-	797	32,799
Investments at fair value through profit or loss	18,332	-	1,483	19,815
Available-for-sale investments	16,392	7,033	9,318	32,743
Other assets	5,170	9	39	5,218
On-balance sheet	**71,896**	**7,042**	**11,637**	**90,575**
Off-balance sheet	**1,337**	**-**	**123**	**1,460**

Note: The above table excludes prepayments and fixed assets.

3.1.6 Impairment on available-for-sale investment securities

During the year, the Bank has provided for the following impairments.

Impairment on available-for-sale investments	(155)

3.2 Market Risk

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

As at 31 December 2013	Market Risk Weighted Assets			Capital Requirement @ 12%
	During the year ended 31 December 2013		As at 31 December 2013	
	Minimum	Maximum		
Interest rate position risk	542	2,172	790	95
Equities position risk	1,440	4,066	1,516	182
Foreign exchange risk	88	194	88	10
Total minimum capital required for market risk			**2,394**	**287**
		Multiplier	12.5	12.5
		TOTAL	**29,925**	**3,591**

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3. Risk Exposures (continued)

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 2013	**2010**	**2011**	**2012**
Gross income	6,668	3,339	6,260
Average gross income (A)			5,422
Alpha (B)			15%
(C) = (A) * (B)			813
Risk weighted exposures (D) = (C) * 12.5)			**10,167**
Capital requirement @ 12% of (D)			**1,220**

4 INTEREST RATE RISK

4.1 Interest Rate Risk in the Banking Book

A 200 bps increase or decrease in market interest rates would affect the value of the fixed income securities in the available-for-sale portfolio as follows:-

	200 bp increase	**200 bp decrease**
As at 31 December 2013	**(531,676)**	**597,342**

Note: 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's invests in securities in BHD and other USD pegged currencies only.

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4. Interest Rate Risk (continued)

4.2 Interest Rate Risk Sensitive Assets and Liabilities

As at 31 December 2013	Effective Interest rate% p.a.	Within 1 year	Over 1 year	Non-interest sensitive	Total
Cash and bank balances	-	-	-	9,584	9,584
Call deposits	-	1,347	-	-	1,347
Placements with banks	1.41%	21,868	-	-	21,868
Investments at fair value through profit or loss	7.01%	444	8,718	10,653	19,815
Available-for-sale investments	5.92%	-	7,332	25,411	32,743
Furniture and equipment	-	-	-	1,812	1,812
Fees receivable	-	-	-	1,980	1,980
Other assets	-	-	-	5,046	5,046
Total assets		**23,659**	**16,050**	**54,486**	**94,195**
Short-term bank borrowings	0.94%	7,094	-	-	7,094
Customer accounts	-	-	-	19,620	19,620
Other liabilities	-	-	-	3,244	3,244
Payable to unit holders	-	-	-	2,373	2,373
Total liabilities		**7,094**	**-**	**25,237**	**32,331**
Total equity	**-**	**-**	**-**	**61,864**	**61,864**
Total liabilities and equity	**-**	**7,094**	**-**	**87,101**	**94,195**
Interest rate sensitivity Gap		*16,565*	*16,050*	*32,615*	
Cumulative Interest rate sensitivity gap		**16,565**	**32,615**	**-**	

5 EQUITY POSITIONS IN THE BANKING BOOK

As at 31 December 2013	Gross Exposure	Capital requirement @ 12%
Quoted Equities	**14,913**	1790
Unquoted Equities	**10,499**	1260
TOTAL	**25,412**	**3,050**

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Realised gain during the year	1,401
Dividend income during the year	393
Unrealised net gain/loss recognised in equity	2,348
Gross unrealised losses deducted from Tier 1 capital	(43)
45% of unrealized gains recognised under Tier 2 capital	919

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	657
Fee receivable	202
Investments in own funds	2,341
Funds under management	53,076

Transactions with shareholders

Fee and commission income	1,597
Fee receivable	1,266
Funds under management	50,541
Borrowings	3,885

The Group has banking relationships, makes deposits and placements and has un-utilized 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 transaction will require approvals as per the delegated authority limits approved by the Board.