1 Overview

Effective January 2008, the Central Bank of Bahrain (CBB) introduced a new Public Disclosure (PD) module in accordance with the Basel-II Pillar 3 guidelines.

This report sets out to outline the qualitative and quantitative public disclosure requirements that SICO adheres to in order to enhance corporate governance and financial transparency through better public disclosure.

Basel II framework is composed of the following 3 pillars:

- Pillar 1: Describes the minimum capital requirements which includes the calculation of the capital adequacy ratio
- Pillar 2: Described supervisory review processes which includes the Internal Capital Adequacy Process
- Pillar 3: Describes Market discipline which includes disclosure of risk management process and capital adequacy information

The information presented herein pertain to Securities and Investment Company BSC (c) ("SICO", or the "Bank") consolidated with its subsidiaries, and in addition to the disclosures set out in the consolidated financial statements for the year ended December 31st. 2009.

This report outlines the description of the Bank's risk management framework, and capital adequacy policies and practices, including detailed information on the capital adequacy measurement process. The information presented herein pertains to Securities and Investment Company BSC (c) consolidated with its subsidiaries (together termed as "SICO" or the "Bank") and should be read in conjunction with the risk and capital management disclosures provided by the Bank in their annual report for the year ended 31 December 2009.

SICO's disclosed tier-1 and total capital adequacy ratios are in full compliance and well within the minimum capital requirements under the CBB's Basel-II framework.

1.1 Basis and Frequency of Disclosures

This disclosure document has been prepared by SICO in accordance with the CBB's requirements of Pillar 3 as set out in its Rulebook Volume 1, PD Module. Unless otherwise stated, all figures are as at 31 December 2009, the financial year-end. Future disclosures will be issued on an annual basis and published as soon as practicable after the publication of the Audited Financial Statements and certain prescribed quantitative disclosures will be made semi-annually on the website.

1.2 Scope

SICO is a wholesale bank incorporated in Bahrain and is regulated by the CBB. The Basel II Framework therefore applies to the Bank and its subsidiary companies (together "the Group"). There is a regulatory requirement to calculate and maintain minimum regulatory capital ratios on both a solo as well as consolidated basis.

The principal subsidiary that is fully consolidated into the financial statements of SICO is SICO Funds Services Company BSC (c) ("SFS"), also incorporated in Bahrain, which provides custody and administration services. There is no restriction on the transfer of funds or regulatory capital within the Group.

1.3 Changes to Capital Structure

During the year ended 31 December 2009, the share capital of the Bank increased by BD 74 thousand pursuant to allocation of 739,104 shares under the Employee Stock Option Plan (ESOP) for the year 2008. The Bank has complied with all externally imposed capital requirements throughout the year. The movement in the issued and fully paid up capital during the year is set out below:

(BHD 000)	2009	2008
Issued and fully paid:-		
At 1 January	42,346	13,921
Bonus shares issued during the year	-	14,115
Rights issue during the year	-	14,116
Issue of shares to the employee share incentive scheme during the year	74	194
At 31 December	**42,420**	**42,346**

2 Approach for Capital requirement

Effective 1 January 2008 the Bank is required to comply with the provisions of the revised Capital Adequacy Module of the CBB (revised based on the Basel II framework) in respect of regulatory capital. The Bank has adopted the standardized approach to credit and market risk management, and the basic indicator approach for the operational risk management.

As at 31 December 2009, the Bank's total risk weighted assets amounted to BD 64,624; Tier 1 Capital amounted to BD 49,945 and total regulatory capital amounted to BD 53,214. Accordingly, Tier 1 and Total Capital Adequacy Ratio was 77.28% and 82.34% respectively. These ratios exceed the minimum capital requirements under the CBB's Basel II framework.

Despite the potential impact on shareholder return, the bank upheld its policy to maintain a strong and stable capital base in order to protect investor, creditor and market confidence and to sustain future development of the business. However, the Bank also recognizes the need to strike a balance between the higher returns that might be possible with greater gearing and the advantages and security afforded by a sound capital position.

2.1 Capital Adequacy (consolidated capital structure)

Tier 1 and Tier 2 Capital as at 31 December were as follows:-

BHD 000's	2009	2008
Tier 1 Capital		
Issued and fully paid ordinary shares	42,420	42,346
Statutory Reserve	3,286	3,286
General Reserve	1,050	1,028
Share Premium	560	546
Retained Earnings Brought forward	3,209	3,229
Gross unrealised loss arising from fair valuing equity securities	(480)	(1,144)
Securitization Exposures subject to deduction	(100)	-

TOTAL TIER 1 capital	**49,945**	**49,291**
Tier 2 Capital		
Current interim profits	3,152	
45% of gross unrealised gains arising from fair valuing equity securities	217	255
Securitization Exposures subject to deduction	(100)	
TOTAL TIER 2 CAPITAL	**3,269**	**255**

The Bank's regulatory capital position was as follows:

Based on year end balances:-

BHD 000's	**2009**	**2008**
Risk weighted exposure		
Credit risk	42,007	37,067
Market risk	8,186	35,875
Operational risk	14,431	17,978
Total risk weighted assets	**64,624**	**90,920**
Tier 1 Capital	49,945	49,291
Tier 2 Capital	3,269	255
Total regulatory capital	53,214	49,546
Tier 1 Capital Adequacy Ratio	77.28%	54.21%
Total Capital adequacy ratio	**82.34%**	**54.49%**

2.2 Regulatory Capital requirements for Market Risk

2009

Asset Categories for Market Risk	Period		Year end	
BHD 000's	**Minimum**	**Maximum**	**Actual Risk Weighted Assets**	Requirement @ 12%
Interest Rate Position Risk	104	786	358	43
Equities Position Risk	75	1,084	75	9
Foreign Exchange Risk	69	3,893	222	27
Total minimum capital for market risk			*655*	*79*
Multiplier			12.5	12.5
Total market risk weighted exposures under the STA			**8,186**	**988**

2008

Asset Categories for Market Risk	Period		Year end	
BHD 000's	**Minimum**	**Maximum**	**Actual Risk Weighted Assets**	Requirement @ 12%
Interest Rate Position Risk	135	786	786	94
Equities Position Risk	246	1,160	246	30
Foreign Exchange Risk	1,838	3,847	1,838	220
Total minimum capital for market risk			*2,870*	*344*
Multiplier			12.5	12.5
Total market risk weighted exposures under the STA			**35,875**	**4,305**

The interest rate risk on the Bank's trading investments is considered minimal and hence no sensitivity analysis has been presented.

- *Equity Positions in the Banking Book*

BHD '000s
2009

Asset Category	Gross exposure	Provision for impairment	Net Risk Weighted assets (RWA)	Regulatory capital requirement @ 12% on RWA
Listed Equities	4,706	-	4,706	565
Unlisted equities	377	-	566	68
Investment in Rated Funds: (ECAI A+ to A-)	961	-	230	28
Investment in unrated funds:				
- Listed	747	-	747	90
- Unlisted	4,692	-	7,038	845
- Unlisted rated (ECAI AAA to A-) funds in Trading portfolio reclassified as banking book	2,355	-	684	82

Total	**13,838**	**-**	**13,971**	**1,678**

2008

Asset Category	Gross exposure	Provision for impairment	Net Risk Weighted assets (RWA)	Regulatory capital requirement @ 12% on RWA
Listed Equities	3,404	1,561	1,843	221
Investment in Rated Funds: (ECAI A+ to A-)	531	-	266	32
Investment in unrated funds:				
- Listed	363	-	363	44
- Unlisted	5,131	612	6,779	813
- Unlisted funds in Trading portfolio reclassified as banking book	2,217	-	3,326	399
Total	**11,646**	**2,173**	**12,577**	**1,509**

BHD 000s	*2009*	*2008*
Realized net gains on sale of available for sale securities	299	1,646
Dividend income on available-for-sale securities	113	445

- Movements in the provision for impairment during the year is as follows:-

BHD 000's	2009	2008
Balance at the beginning of the year	2,173	-
(Write off) / Charge for the year	(2,173)	2,173
Balance at end of the year	-	**2,173**

- As at 1 January 2009, the Bank had an impairment provision of BD 2,173 on its available-for-sale investment securities. During the year 2009, the entire provision was charged off on sale of the respective securities. None of the other exposures as at 31 December 2009 are either past due, impaired or restructured.

- The sectoral and geographical distribution of provision for impairment as at 31 December is as follows:-

Distribution by Sector BHD 000's	2009	2008

Commercial Banks	-	84
Other Banks	-	144
Services	-	669
Managed Funds	-	612
Others	-	664
Total Provision for Impairment	-	**2,173**

Geographical Distribution	2009	BHD 000's
GCC Countries	-	1,424
USA	-	612
Europe	-	136
Total Provision for Impairment	-	2,173

2.3 Regulatory Capital requirement for Credit risk

Standardized Approach

2009

Asset Categories for Credit Risk BHD 000's	Gross exposure		Credit Risk Weighted Assets (RWA)	Capital Requirement (@ 12% of RWA)	*Average gross exposure for the year**
	On-balance sheet (Funded)	**Off-balance sheet (Unfunded)**			
Total Claim on sovereigns	3,040	-	-	-	*2,981*
Claims on Bahraini Public Sector Entities	500	-	-	-	500
Treasury Bills	-	-	-	-	-
Claims on banks	52,510	-	20,829	2,449	*93,533*
Claims on Corporates	4,650	-	4,650	558	*4,794*
Investments in Securities	13,838	1,837	13,970	1,676	*12,467*
Investments in Real Estate Sector	969	-	1,938	233	*450*
Delivery-versus-payment transactions	512	-	7	1	*605*
Other Assets	613	604	613	74	*3,345*
TOTAL credit risk weighted exposures under STA	**76,632**	**2,441**	**42,007**	**4,991**	***118,675***

* Computed based on monthly average

2008

Asset Categories for Credit Risk BHD 000's	Gross exposure	Credit Risk Weighted Assets (RWA)	Capital Requirement (@ 12% of RWA)	*Average gross exposure for the year***
Claims on Bahraini Public Sector Entities	500	-	-	500
Treasury Bills	8,050	-	-	-

Claims on banks	78,782	15,757	1,891	*62,354*
Claims on Corporates	6,227	6,227	747	*1,857*
Investments in Securities	9,473	12,575	1,509	*18,664*
Delivery-versus-payment transactions	434	-	-	*1,464*
Other Assets	2,508	2,508	301	*3,270*
TOTAL credit risk weighted exposures under STA	**105,974**	**37,067**	**4,448**	*88,109*

** Computed based on quarterly average

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

2.4 Regulatory Capital requirement for Operational risk

BHD 000's	Actual Risk weighted Assets	
	2009	2008
Gross Income for the last three years:-		
2005	-	8,707
2006	5,029	5,029
2007	15,029	15,029
2008	3,031	
Average of the three years	7,696	9,588
Alpha coefficient	*15%*	*15%*
K-BIA (3 year average multiplied by alpha)	*1,154*	*1,438*
Operational Risk weighted exposure under BIA (K-BIA * 12.5)	**14,431**	**17,978**
Requirement @ 12% of RWA	**1,732**	**2,157**

2.5 Internal Capital Adequacy Assessment Process (ICAAP)

SICO has a capital management framework in place that is intended to ensure that there is adequate capital to support the financial stability vis-à-vis the risks associated with the various business activities and its capital adequacy ratio is well above the regulatory requirements. There is a comprehensive Internal Capital Adequacy Assessment Process (ICAAP) that includes Board and senior management oversight, monitoring, reporting and internal control reviews, to identify the various risks that are not covered under Pillar 1 risks and to regularly assess the overall capital adequacy considering the pillar 2 risks alongside the planned business strategies. The key pillar 2 risks covered under the ICAAP process include settlement risk, concentration risk, liquidity risk, interest rate risk in the banking book and also other risks that are generally intangible nevertheless significant, such as strategic, reputational, legal and compliance risk, etc., The ICAAP process also includes stress testing on the Bank's capital adequacy to determine capital requirement under extraordinary circumstances and planning to ensure that the Bank is adequately capitalized in line with the overall risk profile.

2.6 Interest Rate Risk in the banking book

The Fixed Income book has increased in 2009 due to adverse conditions of 2008 continuing in 2009 in the equity markets and therefore the interest rate risk has become more relevant and, management monitors this closely as stated above. Investment decisions are driven by careful selection to identify potential opportunities to provide reasonable returns apart from safe deployment of capital. The conservative investment banking business philosophy drives SICO not to deploy customer funds for proprietary investments or lending. Liabilities are always in the shortest maturity bucket to avoid any negative maturity gaps Consequently, Interest Rate Risk in the banking book and liquidity risk are not significant from the asset-liability mismatch perspective. Safeguarding liquidity is a paramount concern for SICO.

A 200 bp increase or decrease in market interest rates would affect the value of the debt instruments in the banking book as follows:-

BHD 000's	**200bp increase**	**200 bp decrease**
As at 31 December 2009	(653)	719
As at 31 December 2008	(188)	202

2.7 Capital allocation

The allocation of capital between specific operations and activities is primarily driven by regulatory requirements. The Bank's capital management policy seeks to maximise return on a risk adjusted basis while satisfying all the regulatory requirements. The Bank's policy on capital allocation is subject to regular review by the Board.