Basel II, Pillar 3 Disclosures

RISK AND CAPITAL MANAGEMENT

FOR THE SIX MONTH PERIOD ENDED

30 June 2012

These disclosures have been prepared in accordance with the Public Disclosure Module ("PD"), Section PD-3.1.6, 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 Financial Statements.

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 (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 report encompasses 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 **30th June 2012** 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 come under Volume 1 (Conventional Banks) of the CBB Rulebook. This quantitative disclosure document follow 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.

2 CAPITAL STRUCTURE, RISK WEIGHTED ASSETS AND CAPITAL ADEQUACY

2.1 Capital Structure

	Amount in 000'
Tier 1 Capital	
Issued and fully paid ordinary shares	42,726
Statutory Reserve	4,020
General Reserve	1,786
Share Premium	650
Retained Earnings Brought forward	4,352
Gross unrealised loss arising from fair valuing equity securities	(682)
Securitisation exposures subject to deduction	-
Tier 1 Capital (A)	**52,852**
Tier 2 Capital	
Current Interim Profits (reviewed by External Auditors)	1,059
45% of gross unrealised gains arising from fair valuing equity securities	255
Securitisation exposures subject to deduction	-
Tier 2 Capital (B)	**1,314**
Total Available Capital (A) + (B)	**54,166**
Total Tier 1 Deductions	**100**
Total Tier 2 Deductions	**100**
Net Tier 1 Available Capital (C)	**52,753**
Net Tier 2 Available Capital (D)	**1,215**
Total Eligible Capital (E) = (C) + (D)	**53,967**
Credit risk weighted exposures	58,373
Market risk weighted exposures	18,812
Operational risk weighted exposures	10,047
Total Risk weighted exposures (F)	**87,232**
Tier 1 Capital Adequacy Ratio (A) / (F)	**60.59%**
Total Capital Adequacy Ratio (E) / (F)	**61.87%**

For the Six Month Period ended 30 June 2012 BHD '000

2.2 Changes to Capital Structure

During the period, 738,710 shares of 100 fils each were issued under the employees share based compensation for the year 2011. These shares were issued at the NAV of 127 fils per share as at 31 December 2011. Accordingly, the share capital increased by BD 74 to the extent of the nominal value of the shares of 100 fils each. The share premium of BD 20 relating to the issue of these shares at a premium of 27 fils per share has been credited to the statutory reserve.

3. RISK EXPOSURES

3.1 Credit Risk

3.1.1 Gross credit exposures

As at 30 June 2012	Gross credit exposure			Credit Risk Weighted Assets	Capital requirement @ 12%
	On-balance sheet (Funded)	Off-balance sheet (Unfunded)	TOTAL		
Cash items	427	-	427	40	5
Claims on Sovereigns	1,952	-	1,952	-	-
Claims on Bahraini Public Sector Entities	500	-	500	-	-
Claims on Banks	45,106	-	45,106	17,450	2,094
Claims on Corporates	3,051	-	3,051	1,994	239
Investments in Securities	24,572	262	24,834	28,668	3,440
Holdings in Real Estate	1,436	123	1,559	3,118	374
Other Assets	6,654	449	7,103	7,103	852
TOTAL	**83,698**	**834**	**84,532**	**58,373**	**7,005**

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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3.1 Credit Risk (continued)

3.1.2 Large exposure limits

As at 30 June 2012, there were no exposures in excess of the 15% large exposure limit as defined in the CM Module of the CBB:

3.1.3 Maturity profile

As at 30 June 2012	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	Over 10 years	Total
Cash and Bank balances	33,870	-	-	-	-	-	33,870
Investments at fair value through profit or loss	6,023	199	861	6,136	1,762	-	14,981
Available-for-sale investments	-	-	-	29,836	835	-	30,671
Held-to-maturity investments	-	-	-	-	-	-	-
Other assets	4,142	261	422	3,202	-	-	8,027
Total gross credit exposures	**44,035**	**460**	**1,283**	**39,174**	**2,597**	**-**	**87,549**
Commitments and contingencies	**-**	**-**	**599**	**523**	**-**	**-**	**1,122**

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

3.1.4 Sectoral distribution

As at 30 June 2012	On-Balance Sheet Exposure	Off-Balance Sheet Exposure	Total Sector Exposure
Financial	39,841	377	40,218
Real Estate / Construction	1,436	-	1,436
Services / Telecom	3,377	-	3,377
Sovereign	4,020	-	4,020
Other	38,875	745	39,620
TOTAL *(On & Off-balance sheet)*	**87,549**	**1,122**	88,671

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3. *RISK EXPOSURES (continued)*

3.1.5 Geographical distribution

As at 30 June 2012	On-Balance Sheet Exposure	Off-Balance Sheet Exposure	Total Sector Exposure
Middle East	62,440	377	62,817
North America	8,117	-	8,117
Europe	16,992	599	17,591
Other	-	146	146
TOTAL *(On & Off-balance sheet)*	**87,549**	**1,122**	**88,671**

3.1.6 Impairment on available-for-sale investment securities

During the period, the Bank has taken the following impairments.

Items	*Six Month Period*
Impairment on available-for-sale investments	(148)

3.2 Market Risk

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

As at 30 June 2012	Market Risk Weighted Assets			Capital Requirement @ 12%
	During the 6 months period ended 30 June 2012		As at 30 June 2012	
	Minimum	Maximum		
Interest Rate Position Risk	476	663	598	72
Equities Position Risk	760	1,132	835	100
Foreign Exchange Risk	71	174	72	9
Total min capital required for market risk			**1,505**	**181**
Multiplier			12.5	12.5
TOTAL			**18,812**	**2,257**

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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 30 June 2012	2009	2010	2011
Gross income	6,068	6,668	3,339
Average gross income (A)			5,358
Alpha (B)			15%
(C) = (A) * (B)			804
Risk weighted exposures (D) = ((C) * 12.5)			**10,047**
Capital requirement @ 12% of (D)			**1,206**

The Bank did not have any material legal contingencies during the period ended 30 June 2012.

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 and held-to-maturity portfolios as follows:-

	200 bp increase	200 bp decrease
As at 30 June 2012	**- 409,687**	**453,843**

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

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4.2 Interest Rate Risk Sensitive Assets and Liabilities

As at 30 June 2012	Effective Interest rate% p.a.	Within 1 year	Over 1 year	Non-interest sensitive	Total
Cash and Bank balances	-	-	-	11,327	11,327
Call deposits*	-	877	-	-	877
Placements with banks	0.10%	21,666	-	-	21,666
Investments at fair value through profit or loss	8.01%	1,060	6,120	7,801	14,981
Available-for-sale securities	6.51%	1,112	5,823	23,736	30,671
Furniture and equipment	-	-	-	174	174
Fees receivable	-	-	-	444	444
Other assets	-	-	-	7,409	7,409
Total Assets		**24,715**	**11,943**	**50,891**	**87,549**
Short term borrowings	0.48%	12,879	-	3,012	15,891
Payables to customers	-	-	-	13,837	13,837
Other liabilities	-	-	-	2,602	2,602
Total Liabilities		***12,879***	***-***	***19,451***	***32,330***
Total Equity	***-***	***-***	***-***	***55,219***	***55,219***
Total Liability and Equity	**-**	**12,879**	**-**	**74,670**	**87,549**
Interest rate sensitivity Gap		*11,836*	*11,943*	*23,779*	-
Cumulative Interest rate sensitivity gap		**11,836**	**23,779**	**-**	-

* At 30 June 2012 the effective interest rate on Bahraini Dinar call deposits is 0.225% p.a and on USD call deposits is Nil.

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5 EQUITY POSITIONS IN THE BANKING BOOK

As at 30 June 2012	Gross Exposure	Risk Weighted Assets	Capital requirement @ 12%
Equity investments			
- Listed	2,879	2,879	345
- Unlisted	1,573	2,360	283
Investment in rated funds	5,197	1,635	196
Investment in unrated funds - Listed/Unlisted	15,185	21,795	2615
TOTAL	**24,834**	**28,668**	**3,440**

	Six Month Period
Realised net gain during the period	(386)
Dividend income during the period	306
Unrealised net gain/(loss) recognised in equity	421
Gross unrealised losses deducted from Tier 1 capital	(682)
45% of unrealized gains recognised under Tier 2 capital	255

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.

	Six Month Period
Fee Income	332

	Six Month Period
Other assets	156
Investments in own funds	3,960
Funds under management	43,964

Transactions with shareholders

	Six Month Period
Fee & Commission Income	131
Funds under management	38,387
Borrowing	3,847

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