Basel II, Pillar 3 Disclosures

RISK AND CAPITAL MANAGEMENT

FOR THE SIX MONTHS PERIOD

30 June 2014

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 period ended 30 June 2014.

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.

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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 **30 June 2014** 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	2,642
Share Premium	692
Retained Earnings Brought forward	5,148
Gross unrealised loss arising from fair valuing equity securities	(224)
Securitisation exposures subject to deduction	-
Tier 1 Capital (A)	**55,982**
Tier 2 Capital	
Current Interim Profits (reviewed by External Auditors)	5,073
45% of gross unrealised gains arising from fair valuing equity securities	554
Securitisation exposures subject to deduction	-
Tier 2 Capital (B)	**5,627**
Total Available Capital (C) = (A) + (B)	**61,609**
Credit risk weighted exposures	53,300
Market risk weighted exposures	22,415
Operational risk weighted exposures	11,610
Total Risk weighted exposures (D)	**87,325**
Tier 1 Capital Adequacy Ratio (A) / (D)	**64.11%**
Total Capital Adequacy Ratio (C) / (D)	**70.55%**

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2.2 Changes to Share Capital Structure

There has been no change to the capital structure since YE 2013.

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

Subsidiaries	30 June 2014	
	Total Capital Adequacy Ratio	Tier 1 Capital Ratio
SICO Consolidated (Group)	70.55%	64.11%
SICO UAE*	5.99%	5.99%

** 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 30 June 2014	Gross credit exposure			Credit Risk Weighted Assets	Capital requirement @ 12%
	On-balance sheet (Funded)	Off-balance sheet (Unfunded)	TOTAL		
Cash items	3,365	-	3,365	-	-
Claims on Sovereigns	11	-	11	-	-
Claims on Bahraini PSE	500	-	500	-	-
Claims on Banks	47,428	-	47,428	22,307	2,677
Claims on Corporates	879	-	879	1,299	156
Investments in Securities	22,540		22,540	25,346	3,042
Holdings in Real Estate	280	-	280	560	67
Other Assets	3,003	782	3,785	3,785	454
TOTAL	**78,006**	**782**	**78,788**	**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 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 **30 June 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	37,888	-	-	-	-	37,888
Trading Debt Securities	-	-	149	5,898	2,504	8,551
AFS Debt Securities	-	-	786	6,639	1,998	9,423
Other assets	4,094	306	-	512	-	4,912
Total gross credit exposures	**41,982**	**306**	**935**	**13,049**	**4,502**	**60,774**
Commitments and contingencies	**1,443**	**-**	**120**	**-**	**-**	**1,563**

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

3.1.4 Sectoral distribution

As at 30 June 2014	Financial	Real Estate	Services / Telecom	Industrials	Sovereign	Mutual Funds	Other	Total
Cash & bank balances	37,888							**37,888**
Investment at FVTPL	8,733	2,416	1,586	2,861	275	-	126	**15,997**
AFS investments	12,213	1,066	2,084	3,161	-	12,524	10	**31,058**
Other assets							4,912	**4,912**
On-balance sheet	**58,834**	**3,482**	**3,670**	**6,022**	**275**	**12,524**	**5,048**	**89,855**
Off-balance sheet	**-**	**-**	**-**	**-**	**-**	**-**	**1,563**	**1,563**

Note: *The above table excludes prepayments and Furniture & Fixtures.*

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3. Risk Exposures (continued)

3.1 Credit Risk (continued)

3.1.5 Geographical distribution

As at 30 June 2014	GCC	MENA (ex-GCC)	North America	Europe	Other	Total
Cash & bank balances	37,208	112	-	568	-	37,888
Investment at FVTPL	13,331	-	-	1,480	1,186	15,997
AFS investments	15,340	375	3,170	6,016	6,157	31,058
Other assets					4,912	4,912
Total Assets	**65,879**	**487**	**3,170**	**8,064**	**12,255**	**89,855**
Total *Off-balance sheet*	**1,443**	**120**	**-**	**-**	**-**	**1,563**

Note: *The above table excludes prepayments and Furniture & Fixtures*

3.1.6 Impairment on available-for-sale investment securities

During the YTD period, the Bank has not taken any impairment.

3.2 Market Risk

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

As at 30 June 2014	Market Risk Weighted Assets			Capital Requirement @ 12%
	During the 6 months period ended 30 June 2014		As at 30 June 2014	
	Minimum	Maximum		
Interest Rate Position Risk	647	771	771	93
Equities Position Risk	1,002	1,483	1,002	120
Foreign Exchange Risk	21	144	21	2
Total min capital required for market risk			**1,794**	**215**
Multiplier			12.5	12.5
TOTAL			**22,425**	**2,688**

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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 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**

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 fixed rate securities in the available-for-sale portfolio as follows:-

	200 bp increase	**200 bp decrease**
As at 30 June 2014	**-328,650**	**369,414**

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 30 June 2014	Effective Interest rate% p.a.	Within 1 year	Over 1 year	Non-interest sensitive	Total
Cash and Bank balances	-	-	-	14,511	14,511
Call deposits*	-	3,708	-	-	3,708
Placements with banks	1.14%	19,669	-	-	19,669
Investments at fair value through profit or loss	7.13%	149	8,403	7,445	15,997
Available-for-sale securities	5.28%	785	8,638	21,635	31,058
Furniture and equipment	-	-	-	1,318	1,318
Fees receivable	-	-	-	1,668	1,668
Other assets	-	-	-	5,385	5,385
Total Assets		**24,311**	**17,041**	**51,962**	**93,314**
Bank overdrafts	-	-	-	-	-
Short term borrowings	1.00%	3,175	-	-	3,175
Payables to customers	-	-	-	22,396	22,396
Deposits from customers	-	-	-	-	-
Other liabilities	-	-	-	2,539	2,539
Payables to unit Holders	-	-	-	2,281	2,281
Total Liabilities	**-**	**3,175**	**-**	**27,216**	**30,391**
Total Equity	**-**	**-**	**-**	**62,923**	**62,923**
Total Liability and Equity	**-**	**3,175**	**-**	**90,139**	**93,314**
Interest rate sensitivity Gap		*21,136*	*17,041*	*38,177*	
Cumulative Interest rate sensitivity gap		**21,136**	**38,177**	**-**	

5 EQUITY POSITIONS IN THE BANKING BOOK

As at 30 June 2014	Gross Exposure	Capital requirement @ 12%
Quoted Equities	**12,561**	1507
Unquoted Equities	**7,190**	863
TOTAL	**19,751**	**2,370**

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5. *Equity Positions in the Banking Book (continued)*

Realised gain during the year	1,847
Dividend income during the year	666
Unrealised net gain/loss recognised in equity	1,035
Gross unrealised losses deducted from Tier 1 capital	(224)
45% of unrealized gains recognised under Tier 2 capital	554

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	461
Fee receivable	241
Investments in own funds	2,442
Funds under management	53,452

Transactions with shareholders

Fee and commission income	841
Funds under management	74,114

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.