Basel II, Pillar 3 Disclosures

RISK AND CAPITAL MANAGEMENT

FOR THE TWELVE MONTH PERIOD ENDED

31 December 2011

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 **31st December 2011** 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	42,652
Statutory Reserve	3,971
General Reserve	1,737
Share Premium	630
Retained Earnings Brought forward	3,962
Gross unrealised loss arising from fair valuing equity securities	(496)
Securitisation exposures subject to deduction	-
Tier 1 Capital (A)	**52,456**
Tier 2 Capital	
Current Interim Profits (reviewed by External Auditors)	488
45% of gross unrealised gains arising from fair valuing equity securities	227
Securitisation exposures subject to deduction	-
Tier 2 Capital (B)	**715**
Total Available Capital (A) + (B)	**53,171**
Total Tier 1 Deductions	**98**
Total Tier 2 Deductions	**98**
Net Tier 1 Available Capital (C)	**52,358**
Net Tier 2 Available Capital (D)	**617**
Total Eligible Capital (E) = (C) + (D)	**52,975**
Credit risk weighted exposures	42,449
Market risk weighted exposures	19,481
Operational risk weighted exposures	9,854
Total Risk weighted exposures (F)	**71,784**
Tier 1 Capital Adequacy Ratio (A) / (F)	**73.07%**
Total Capital Adequacy Ratio (E) / (F)	**73.80%**

For the twelve month period ended 31 December 2011 BHD '000

2.2 Changes to Capital Structure

During the year 2011, 1,236,542 shares of 100 fils each were issued under the employees share based compensation for the year 2010. These shares were issued at the NAV of 134 fils per share as at 31 December 2010. Accordingly, the share capital increased by BD 124 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.

3. RISK EXPOSURES

3.1 Credit Risk

3.1.1 Gross credit exposures

As at 31 Dec 2011	Gross credit exposure			Credit Risk Weighted Assets	Capital requirement @ 12%
	On-balance sheet (Funded)	Off-balance sheet (Unfunded)	TOTAL		
Cash items	699	-	699	4	-
Claims on Sovereigns	5,206	-	5,206	-	-
Claims on Bahraini Public Sector Entities	500	-	500	-	-
Claims on Banks	20,042	-	20,042	7,797	936
Claims on Corporates	2,362	-	2,362	2,338	281
Investments in Securities	21,276	265	21,541	23,387	2,806
Holdings in Real Estate	1,462	124	1,586	3,172	381
Other Assets	5,444	307	5,751	5,751	690
TOTAL	**56,991**	**696**	**57,687**	**42,449**	**5,094**

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.

For the twelve month period ended 31 December 2011 BHD '000

3.1 Credit Risk (continued)

3.1.2 Large exposure limits

As at 31 December 2011, 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 31 Dec 2011	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	19,964	-	-	-	-	-	19,964
Investments at fair value through profit or loss	8,337	-	196	1,689	6,516	-	16,738
Available-for-sale investments	-	-	-	1,843	25,195	-	27,038
Held-to-maturity investments	-	-	-	-	-	-	-
Other assets	3,337	262	153	3,143	-	-	6,895
Total gross credit exposures	**31,638**	**262**	**349**	**6,675**	**31,711**	**-**	**70,635**
Commitments and contingencies	**-**	**-**	**-**	**1,129***	**-**	**-**	**1,129**

** Kept in this maturity bucket because there is no contractual date/call.*
Note: None of the exposures have a maturity period in excess of ten years.

3.1.4 Sectoral distribution

As at 31 Dec 2011	On-Balance Sheet Exposure	Off-Balance Sheet Exposure	Total Sector Exposure
Financial	25,067	377	25,444
Real Estate / Construction	1,461	-	1,461
Services / Telecom	1,994	-	1,994
Sovereign	5,567	-	5,567
Other	36,546	752	37,298
TOTAL	**70,635**	**1,129**	71,764

BHD '000

3. RISK EXPOSURES (continued)

3.1.5 Geographical distribution

3.1.5 Geographical distribution

As at 31 Dec 2011	On-Balance Sheet Exposure	Off-Balance Sheet Exposure	Total Sector Exposure
Middle East	45,708	377	46,085
North America	8,578	-	8,578
Europe	15,973	599	16,572
Other	376	153	529
TOTAL	**70,635**	**1,129**	**71,764**

3.1.6 Impairment on available-for-sale investment securities

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

Items	Amount in BHD 000'
Impairment on available-for-sale investments	(154)

3.2 Market Risk

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

As at 31 Dec 2011	Market Risk Weighted Assets			Capital Requirement @ 12%
	Minimum	Maximum	Market RWA	
Interest Rate Position Risk	439	867	471	56
Equities Position Risk	151	1,107	974	117
Foreign Exchange Risk	100	269	113	14
Total min capital required for market risk			**1,558**	**187**
Multiplier			12.5	12.5
TOTAL			**19,481**	**2,338**

For the twelve month period ended 31 December 2011 BHD '000

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 Dec 2011	2008	2009	2010
Gross income	3,031	6,068	6,668
Average gross income (A)			5,256
Alpha (B)			15%
(C) = (A) * (B)			788
Risk weighted exposures (D) = ((C) * 12.5)			**9,854**
Capital requirement @ 12% of (D)			**1,183**

The Bank did not have any material legal contingencies during the period ended 31 December 2011.

4 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 31 December 2011	(665,611)	761,207

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

5 EQUITY POSITIONS IN THE BANKING BOOK

As at 31 Dec 2011	Gross Exposure	Risk Weighted Assets	Capital requirement @ 12%
Equity investments			
- Listed	746	746	90
- Unlisted	1,564	2,346	282
Investment in rated funds	5,003	1,038	125
Investment in unrated funds - Listed/Unlisted	14,228	19,257	2311
TOTAL	**21,541**	**23,387**	**2,808**

	Amount in 000'
Realised net gain during the period	1,288
Dividend income during the period	363
Unrealised net gain/loss recognised in equity	167
Gross unrealised losses deducted from Tier 1 capital	(496)
45% of unrealized gains recognised under Tier 2 capital	226

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.

	Amount in 000'
Fee Income	707

	Amount in 000'
Other assets	171
Investments in own funds	3,947
Funds under management	44,432

Transactions with shareholders

	Amount in 000'
Fee & Commission Income	260
Funds under management	37,864
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.