بنك استثماري
Investment Bank sico

Basel II, Pillar 3 Disclosures

RISK AND CAPITAL MANAGEMENT

FOR THE YEAR ENDED

31 December 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.

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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 **31 December 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 comes 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

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 comprise of share capital, share premium, retained earnings, unrealized losses arising from fair valuing equity securities and eligible reserves.

The Bank's Tier 2 Capital comprises interim profits, collective impairment provisions and 45 per cent of unrealized gains arising on the re-measurement to fair value of 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

	Amount in 000'
Tier 1 Capital	
Issued and fully paid ordinary shares	42,726
Statutory Reserve	4,334
General Reserve	1,786
Share Premium	650
Retained Earnings Brought forward	6,777
Gross unrealised loss arising from fair valuing equity securities	(220)
Securitisation exposures subject to deduction	-
Total Tier 1 Capital (A)	**56,053**
Tier 2 Capital	
Current Interim Profits (reviewed by External Auditors)	-
45% of gross unrealised gains arising from fair valuing equity securities	206
Securitisation exposures subject to deduction	-
Total Tier 2 Capital (B)	**206**
Total Available Capital (C) = (A) + (B)	**56,259**
Credit risk weighted exposures	43,081
Market risk weighted exposures	19,670
Operational risk weighted exposures	10,047
Total Risk weighted exposures (D)	**72,798**
Tier 1 Capital Adequacy Ratio (A) / (D)	**77.00%**
Total Capital Adequacy Ratio (C) / (D)	**77.28%**

2.2 Changes to Capital Structure

During the year, 738,710 shares of 100 fils each were issued under the employees share incentive scheme 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.

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

Subsidiaries	31 December 2012	
	Total Capital Adequacy Ratio	Tier 1 Capital Ratio
SICO Consolidated (Group)	77.28%	77.00%
SICO UAE*	13.83%	15.05%

** 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 2012	Gross credit exposure			Credit Risk Weighted Assets	Capital requirement @ 12%
	On-balance sheet (Funded)	Off-balance sheet (Unfunded)	TOTAL		
Cash items	3,255	-	3,255	6	0.7
Claims on Sovereigns	23	-	23	-	-
Claims on Bahraini Public Sector Entities	500	-	500	-	-
Claims on Banks	36,512	-	36,512	10,984	1,318
Claims on Corporates	1,588	-	1,588	1,596	192
Investments in Securities	19,470	361	19,831	23,295	2,795
Holdings in Real Estate	1,589	-	1,589	3,178	381
Other Assets	3,749	273	4,022	4,022	483
TOTAL	**66,686**	**634**	**67,320**	**43,081**	**5,170**

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.

3 Risk Exposure (continued)

3.1 Credit Risk (continued)

3.1.2 Large exposure limits

As at **31 December 2012**, 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 *BHD 000's*	Exposure as a % to eligible capital base
Counterparty A	Bahrain	10,724	18.7%

These exposures represent cash, debt instrument, 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

As at 31 December 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	Total
Cash and Bank balances	28,467	4,058	-	-	-	32,525
Investments at fair value through profit or loss	861	-	-	5,828	835	7,524
Available-for-sale investments	-	-	-	2,825	1,499	4,324
Other assets	3,744	160	25	507	-	4,436
Total gross credit exposures	**33,072**	**4,218**	**25**	**9,160**	**2,334**	**48,809**
Commitments and contingencies	**546**	**-**	**613**	**515**	**-**	**1,674**

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

3.1.4 Sectoral distribution

As at 31 December 2012	Financial	Real Estate/construction	services	sovereign	Others	Total
Cash and Bank balances	32,525	-	-	-	-	**32,525**
Investment at FVTPL	2,081	1,854	-	-	3,589	**7,524**
AFS investment	905	1,920	-	-	1,499	**4,324**
Other assets	2,853	-	-	-	1,583	**4,435**
On-balance sheet	**38,364**	**3,774**	**-**	**-**	**6,671**	**48,809**
Off-balance sheet	**377**	**-**	**-**	**-**	**1,297**	**1,674**
TOTAL On & off-balance sheet	**38,741**	**3,774**	**-**	**-**	**7,968**	**50,483**

3. RISK EXPOSURES (continued)

3.1.5 Geographical distribution

As at 31 December 2012	GCC countries	North America	Europe	Total
Assets				
Cash and cash equivalents	28,490	-	4,035	32,525
Investment at FVTPL	7,524	-	-	7,524
Available-for-sale investments	4,324	-	-	4,324
Fees receivable	452	-	-	452
Other assets	3,949	27	8	3,984
Total Assets	**44,739**	**27**	**4,043**	**48,809**
Total *Off-balance sheet*	**377**	**684**	**613**	**1,674**
Total *On & off-balance sheet*	**45,116**	**711**	**4,656**	**50,483**

3.1.6 Impairment on available-for-sale investment securities

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

Items	***12 Month Period***
Impairment on available-for-sale investments	(184)

3.2 Market Risk

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

As at 31 December 2012	Market Risk Weighted Assets			Capital Requirement @ 12%
	During the 12 months period ended 31 December 2012		As at 31 December 2012	
	Minimum	Maximum		
Interest Rate Position Risk	476	1,017	758	91
Equities Position Risk	633	1,132	723	87
Foreign Exchange Risk	71	174	92	11
Total min capital required for market risk			**1,573**	**189**
Multiplier			12.5	12.5
TOTAL			**19,663**	**2,363**

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 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)			**10,050**
Capital requirement @ 12% of (D)			**1,206**

The Bank did not have any material legal contingencies during the period ended 31 December 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 portfolio as follows:-

	200 bp increase	200 bp decrease
As at 31 December 2012	**-342,619**	**384,305**

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

4.2 Interest Rate Risk Sensitive Assets and Liabilities

As at 31 December 2012	**Effective Interest rate% p.a.**	**Within 1 year**	**Over 1 year**	**Non-interest sensitive**	**Total**
Cash and Bank balances	-	-	-	7,811	7,811
Call deposits	-	3,304	-	-	3,304
Placements with banks	1.66%	21,410	-	-	21,410
Investments at fair value through profit or loss	7.60%	862	6,663	7,202	14,727
Available-for-sale securities	6.27%	-	4,324	18,831	23,155
Furniture and equipment	-	-	-	235	235
Fees receivable	-	-	-	452	452
Other assets	-	-	-	7,271	7,271
Total Assets		**25,576**	**10,987**	**41,802**	**78,365**
Short term borrowings	0.95%	4,899	-	-	4,899
Payables to customers	-	-	-	13,416	13,416
Other liabilities	-	-	-	2,757	2,757
Total Liabilities	**-**	***4,899***	**-**	***16,173***	***21,072***
Total Equity	**-**	**-**	**-**	***57,293***	***57,293***
Total Liability and Equity	**-**	**4,899**	**-**	**73,466**	**78,365**
Interest rate sensitivity Gap		*20,677*	*10,987*	*31,664*	
Cumulative Interest rate sensitivity gap		**20,677**	**31,664**	**-**	

5 EQUITY POSITIONS IN THE BANKING BOOK

As at 31 December 2012	Gross Exposure	Risk Weighted Assets	Capital requirement @ 12%
Equity investments			
- Listed	4,464	4,464	536
- Unlisted	1,497	2,246	269
Investment in rated funds	2,927	1,194	143
Investment in unrated funds - Listed/Unlisted	10,943	15,392	1847
TOTAL	**19,831**	**23,296**	**2,795**

	Amount in 000'
Realised net gain during the period	1,321
Dividend income during the period	449
Unrealised net gain/loss recognised in equity	1,714
Gross unrealised losses deducted from Tier 1 capital	(220)
45% of unrealized gains recognised under Tier 2 capital	206

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 & Commission Income	659
Fee receivable	159

	Amount in 000'
Investments in own funds	4,058
Funds under management	43,466

Transactions with shareholders

	Amount in 000'
Fee & Commission Income	301
Fee receivable	24

	Amount in 000'
Funds under management	40,088
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.

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.