

# TAIB Bank B.S.C (c)

## Pillar 3 - Disclosures

30 June 2010

|             |  |           |
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## **1. Introduction**

The Central Bank of Bahrain's (CBB) Basel II guidelines outlining the capital adequacy framework for banks incorporated in the Kingdom of Bahrain became effective from 1<sup>st</sup> January 2008. This report consists of the semi-annual quantitative information under Basel II -Pillar 3 disclosure requirements in accordance with Public Disclosure Module of the CBB's rulebook.

This report should be read in conjunction with the Bank's interim condensed consolidated financial information for the six months ended 30 June 2010 and the notes thereto. The interim financial information of the Bank comprises of the interim condensed consolidated primary financial statements of the Bank and its subsidiaries (together referred to as "the Group"). The disclosures in this report are in addition to or in some cases serve to supplement the disclosures set out in the interim financial information as at 30 June 2010.

The Bank has adopted the standardized approach for Credit Risk, Market Risk and Operational Risk to determine the capital requirement.

All figures presented in this report are in thousands of United States Dollars as at 30 June 2010 unless otherwise stated.

## 2. Pillar 3 Disclosures

### 2.1 Scope of Application

The Pillar 3 disclosures apply to TAIB Bank B.S.C. (c) and its subsidiaries on a full consolidation basis in accordance with IFRS. The subsidiaries, their place of domicile and the Bank's ownership thereof are as under:

**Table 1 – Group Structure**

| <b>Subsidiary</b>                                  | <b>Domicile</b>      | <b>Ownership</b> |
|--|----------------------|------------------|
| TAIB Yatirim Bank A.S.                             | Turkey               | 100%             |
| TAIB Yatirim A.S.*                                 | Turkey               | 100%             |
| PDF Kurusmal Finasman Danismanlik Hizmetleri A.S.* | Turkey               | 100%             |
| TAIB Kazak Bank                                    | Kazakhstan           | 100%             |
| TAIB Securities W.L.L.                             | Kingdom of Bahrain   | 100%             |
| TAIB Securities LLC **                             | United Arab Emirates | 80%              |
| TAIB Capital Corporation Limited                   | India                | 74%              |
| TAIB Securities (India) Limited*                   | India                | 74%              |
| TAIB Asset Management Company E.C.***              | Kingdom of Bahrain   | 100%             |
| TAIB Securities Mauritius Limited                  | Mauritius            | 100%             |
| TAIB Investments N.V.                              | Netherlands Antilles | 100%             |
| TAM Holdings Inc.                                  | USA                  | 100%             |
| Delray Property Investments Inc.                   | USA                  | 100%             |
| SOSQ Property Investments Inc.                     | USA                  | 100%             |
| TAIB Securities Inc.                               | USA                  | 100%             |
| TAIB Securities Limited                            | United Kingdom       | 100%             |
| TAIB (Suisse) S.A.                                 | Switzerland          | 100%             |
| TAIB Asia Limited                                  | Hong Kong            | 100%             |
| TAIB Invest Inc.                                   | Cayman Islands       | 100%             |
| TAIB GCC Blue Chip Fund                            | Kingdom of Bahrain   | 79%              |
| TAIB Bank Qatar LLC ***                            | Qatar                | 100%             |

\* TAIB Yatirim A.S. is a 100% subsidiary of TAIB Yatirim Bank A.S and PDF Kurusmal Finasman a 100% subsidiary of TAIB Yatirim A.S

\* TAIB Securities (India) Limited is a 100% subsidiary of TAIB Capital Corporation Limited.

\*\*TAIB Securities LLC. is a 80% subsidiary of TAIB Securities W.L.L.

\*\*\* These subsidiaries were liquidated/ are under liquidation during the year.

## 2.2 Risk and Capital

The Bank is exposed to the following types of risks:

- Credit Risk
- Market Risk
- Operational Risk
- Liquidity Risk
- Interest Rate Risk

The composition of the Bank's capital and capital adequacy position are given in the following three tables.

**Table 2 – Capital Structure and Capital Adequacy**

|  | <b>Tier 1</b> | <b>Tier 2</b> | <b>Total</b>   |
|--|---------------|---------------|----------------|
| Share capital  | 106,858       | -             | 106,858        |
| Share premium  | 1,510         | -             | 1,510          |
| Statutory reserve  | 22,432        | -             | 22,432         |
| General reserve  | 7,399         | -             | 7,399          |
| Accumulated losses brought forward   | (47,822)      | -             | (47,822)       |
| Minority interest in consolidated subsidiaries   | 920           | -             | 920            |
| Goodwill on acquisition  | (3,529)       | -             | (3,529)        |
| Current cumulative net losses  | (19,551)      | -             | (19,551)       |
| Unrealised gross losses arising from fair valuing equity securities                      | (211)         | -             | (211)          |
| Asset revaluation reserve - property, plant and equipment                                | -             | 4,095         | 4,095          |
| Unrealised gains arising from fair valuing equities                                      | -             | 540           | 540            |
| <b>Total Available Capital</b>   | <b>68,006</b> | <b>4,635</b>  | <b>72,641</b>  |
| Less: Deduction relating to exposures individually in excess of 15% of available capital | (30,367)      | (4,635)       | (35,002)       |
| <b>Total Eligible Capital</b>  | <b>37,640</b> | <b>-</b>      | <b>37,640</b>  |
| <b>Risk weighted exposures:</b>  |               |               |                |
| - Credit risk  |               |               | 271,283        |
| - Operational risk   |               |               | 46,496         |
| - Market risk  |               |               | 45,232         |
| <b>Total Risk weighted exposure</b>  |               |               | <b>363,010</b> |
| <b>Consolidated Capital Adequacy Ratio (%) : Tier 1 &amp; Total</b>                      |               |               | <b>10.37 %</b> |

The Bank does not have Tier 3 capital as at 30 June 2010. At 30 June 2010, the Bank's capital adequacy ratio (CAR) on a consolidated basis is 10.37% which is below the minimum requirement of 12% as specified by the Central Bank of Bahrain. The Bank is in discussion with the Central Bank of Bahrain regarding a plan to address this shortfall.

**Table 3 – Top Consolidated group in Bahrain**

|   | <b>Tier 1</b> | <b>Tier 2</b> | <b>Total</b>  |
|---|---------------|---------------|---------------|
| Share capital   | 109,345       | -             | 109,345       |
| Share premium   | 1,510         | -             | 1,510         |
| Statutory reserve   | 21,016        | -             | 21,016        |
| General reserve   | 6,043         | -             | 6,043         |
| Accumulated losses brought forward                                  | (57,519)      | -             | (57,519)      |
| Current cumulative net losses                                       | (17,920)      | -             | (17,920)      |
| Unrealised gross losses arising from fair valuing equity securities | (1,798)       | -             | (1,798)       |
| Asset revaluation reserve - property, plant and equipment           | -             | 4,075         | 4,075         |
| Unrealised gains arising from fair valuing equities                 | -             | 593           | 593           |
| <b>Total Available capital</b>                                      | <b>60,677</b> | <b>4,668</b>  | <b>65,345</b> |
| Less: Deductions from Capital                                       |               |               |               |
| - Relating to investment in subsidiaries and funds                  |               |               | (65,678)      |
| <b>Total Eligible Capital</b>                                       |               |               | <b>-</b>      |
| Total Risk Weighted Assets  |               |               | 302,802       |
| <b>Capital Adequacy Ratio (stand alone) (%)</b>                     |               |               | <b>-</b>      |

**Table 4 – Capital Adequacy of the Bank's significant bank subsidiaries.**

|                                     | <b>Subsidiaries</b>                        |  |
|-------------------------------------|--|--|
|                                     | <b>TAIB Kazak Bank JSE,<br/>Kazakhstan</b> | <b>TAIB Yatirim Bank A.S,<br/>Turkey</b> |
| <i>Under Basel II</i>               |  |  |
| Tier 1 – Capital Adequacy Ratio (%) | 39.7                                       | 59.77                                    |
| Total – Capital Adequacy Ratio (%)  | 93.1                                       | 59.77                                    |

## 2.3 Credit Risk

Credit risk is the risk that a customer, counterparty or an issuer of securities or other financial instruments fails to perform under its contractual payment obligations, thus causing the Group to suffer a loss in terms of cash flow or market value. As a private bank, the Bank is not engaged in commercial or retail banking activities in the normal course except for its commercial bank licensed subsidiary in Kazakhstan, and loans for margin trading activities and portfolio investments to selected high net worth clients. The Bank also extends bridge loans under underwriting commitments in respect of real estate investments that are intended to be placed down to the prospective investors within a short period. However, credit risk is the predominant risk type faced by the Group in its banking, investment and treasury activities both on and off balance sheet.

**Table 5 – Capital requirement for credit risk**

| Basel II Asset Classification                                  | Rated          | Unrated        | Total exposure (*) | Average risk weight | RWA            | Capital charge |
|--|----------------|----------------|--------------------|---------------------|----------------|----------------|
| Cash Items   | -              | 894            | 894                | 0%                  | -              | -              |
| Cash items in the process of collection                        | -              | -              | -                  | 0%                  | -              | -              |
| Sovereigns - Relevant Domestic Currency                        | 20,364         | -              | 20,364             | 0%                  | -              | -              |
| Sovereigns - Non Relevant Domestic Currency                    | 15,860         | -              | 15,860             | 50%                 | 7,947          | 954            |
| Preferential Risk Wight on Banks                               | 3,979          | -              | 3,979              | 20%                 | 796            | 95             |
| Short Term Claims on Banks                                     | 4,308          | -              | 4,308              | 20%                 | 862            | 103            |
| Standard Risk Weights on Banks                                 | 101,607        | 16,027         | 117,634            | 47%                 | 55,471         | 6,657          |
| Claims on Corporates   | -              | 31,257         | 31,257             | 100%                | 31,257         | 3,751          |
| Past due exposures   | -              | 5,741          | 5,741              | 150%                | 8,612          | 1,033          |
| Investment in equity portfolio                                 | 288            | 6,530          | 6,818              | 147%                | 10,037         | 1,204          |
| Investment in funds  | -              | 956            | 956                | 150%                | 1,434          | 172            |
| Holding of Real Estate including premises occupied by the bank | -              | 9,973          | 9,973              | 100%                | 9,973          | 1,197          |
| All other holdings of real estate                              | -              | 61,119         | 61,119             | 200%                | 122,235        | 14,668         |
| Others Assets  | -              | 22,659         | 22,659             | 100%                | 22,659         | 2,719          |
| <b>Total Credit Risk under the Standardised Approach</b>       | <b>146,406</b> | <b>155,156</b> | <b>301,562</b>     |                     | <b>271,283</b> | <b>32,553</b>  |

(\*) Exposure post credit risk mitigation and credit conversion.

**Table 6 – Gross credit exposure (\*)**

| Balance sheet Items:                                 | Gross credit exposure | Average gross credit exposure |
|--|-----------------------|-------------------------------|
| Cash and balances with central banks                 | 66,568                | 59,014                        |
| Placements with banks                                | 98,928                | 102,003                       |
| Loans and advances                                   | 22,053                | 23,748                        |
| Available-for-sale financial assets                  | 45,579                | 51,338                        |
| Investment in associate                              | 16,114                | 17,196                        |
| Investment property                                  | 23,006                | 26,187                        |
| Property and equipment                               | 16,730                | 17,618                        |
| Other assets   | 16,243                | 10,185                        |
| <b>Total on balance sheet credit exposure</b>        | <b>305,221</b>        | <b>307,289</b>                |
| Off balance sheet items:                             |                       |                               |
| Direct credit substitutes                            | 17,912                | 17,224                        |
| Notes issuance and revolving underwriting facilities | 408                   | 434                           |
| Derivatives - foreign exchange contracts             | 693                   | 911                           |
| <b>Total off balance sheet credit exposure</b>       | <b>19,013</b>         | <b>18,569</b>                 |
| <b>Total credit exposure</b>                         | <b>324,234</b>        | <b>325,858</b>                |

(\*) Exposure before credit risk mitigation and credit conversion.

The average gross credit exposure is calculated based on balances as at 30 June 2009, 31 December 2009 and 30 June 2010.

**Table 7 – Credit exposure by geographical segments**

| Credit exposure                      | North America | Europe        | Middle East    | Rest of Asia  | Total          |
|--------------------------------------|---------------|---------------|----------------|---------------|----------------|
| Cash and balances with central banks | 976           | 2,303         | 22,409         | 40,880        | 66,568         |
| Placements with banks                | 5,118         | 41,810        | 49,439         | 2,562         | 98,929         |
| Loans and advances                   | -             | 3             | 13,821         | 8,229         | 22,053         |
| Available-for-sale financial assets  | 3,379         | 21,511        | -              | 20,688        | 45,578         |
| Investment in associate              | -             | 10,896        | 5,218          | -             | 16,114         |
| Investment property                  | 17,627        | -             | 4,569          | 810           | 23,006         |
| Property and equipment               | 234           | 2,017         | 12,905         | 1,574         | 16,730         |
| Other assets                         | 2,941         | 459           | 1,082          | 11,761        | 16,243         |
| Off balance sheet items              | -             | 565           | 5,681          | 12,767        | 19,013         |
| <b>Total</b>                         | <b>30,275</b> | <b>79,564</b> | <b>115,124</b> | <b>99,271</b> | <b>324,234</b> |

Exposure to Europe comprises of United Kingdom, France and Turkey  
Exposure to North America comprises United States of America

Exposure to Middle East comprise of Bahrain, UAE, Saudi Arabia, Oman, Kuwait and Qatar.  
Exposure to Rest of Asia comprises of China, India, Kazakhstan and the Far East.

**Table 8 – Credit exposure by sectoral segments**

|                     | Cash, balances<br>with central<br>Banks and<br>placements | Loans<br>and<br>advances | Investment    | Others        | Off-<br>balance<br>sheet<br>items | Total          |
|---------------------|---|--------------------------|---------------|---------------|-----------------------------------|----------------|
| Financial services  | 139,375   | -                        | 2,672         | 425           | 6,142                             | 148,614        |
| Government          | 26,090  | -                        | 11,023        | 334           | 58                                | 37,505         |
| Structured finance  | -   | -                        | 2,112         | 91            | -                                 | 2,203          |
| Trade and transport | -   | 12,161                   | -             | -             | 11,697                            | 23,858         |
| Real estate         | -   | 955                      | 61,119        | 30            | 25                                | 62,129         |
| Equity funds        | -   | -                        | 7,774         | 153           | -                                 | 7,927          |
| Others              | 32  | 8,937                    | -             | 31,938        | 1,091                             | 41,998         |
| <b>Total</b>        | <b>165,497</b>  | <b>22,053</b>            | <b>84,700</b> | <b>32,971</b> | <b>19,013</b>                     | <b>324,234</b> |

**Table 9 – Related party transactions/balances**

|                                      | Associates | Directors and<br>senior<br>management | Total   |
|--------------------------------------|------------|---------------------------------------|---------|
| <b>Balance sheet :</b>               |            |                                       |         |
| Deposits with the banks/companies    | 100,644    | -                                     | 100,644 |
| Deposits received from customers     | -          | 12,809                                | 12,809  |
| <b>Income statement :</b>            |            |                                       |         |
| Interest income                      | -          | -                                     | -       |
| Interest expense                     | 1,953      | 64                                    | 2,017   |
| Reimbursement of Directors' expenses | -          | 61                                    | 61      |
| Key management compensation          | -          | 359                                   | 359     |

The Bank carries out transactions with related parties, defined as shareholders and directors of the Bank and its subsidiaries, and businesses in which shareholders and directors, individually or combined, have control or significant influence, in the normal course of business.

**Table 10 - Discussion on lending to highly leveraged and other high risk counterparties:**

The Group does not have any exposure to highly leveraged and high risk counterparties.

**Table 11 – Credit concentration greater than 15% of individual obligor limit.**

|          | Amount |
|----------|--------|
| Bank     | 74,430 |
| Non bank | 67,690 |

**Table 12 – Counterparty credit risk in derivative transactions**

|  | Notional amount | Credit exposure | Capital requirement |
|--|-----------------|-----------------|---------------------|
| Direct credit substitutes                            | 17,912          | 17,912          | 2,149               |
| Notes issuance and revolving underwriting facilities | 815             | 407             | 49                  |
| Foreign exchange contracts                           | 57,016          | 694             | 83                  |
| <b>Total</b>   | <b>75,743</b>   | <b>19,013</b>   | <b>2,281</b>        |

**Table 13 – Credit exposure by maturity**

| Exposures                            |                |               |                |               |                    | Total          |
|--------------------------------------|----------------|---------------|----------------|---------------|--------------------|----------------|
|                                      | Below 1 month  | 1 to 3 months | 3 to 12 months | 1 to 5 years  | Over 5 to 10 years |                |
| Cash and balances with central banks | 66,568         | -             | -              | -             | -                  | 66,568         |
| Placements with banks                | 90,906         | -             | 7,914          | 108           | -                  | 98,928         |
| Loans and advances                   | 11,410         | 2,464         | 3,777          | 4,402         | -                  | 22,053         |
| Available-for-sale financial assets  | 3,219          | 149           | 11,986         | 28,957        | 1,268              | 45,579         |
| Investment in associate              | -              | -             | -              | -             | 16,114             | 16,114         |
| Investment property                  | -              | -             | 810            | 14,323        | 7,873              | 23,006         |
| Property and equipment               | -              | -             | 127            | 16,603        | -                  | 16,730         |
| Other assets                         | 375            | 11,379        | 1,263          | 3,226         | -                  | 16,243         |
| <b>Total on balance sheet</b>        | <b>172,478</b> | <b>13,992</b> | <b>25,877</b>  | <b>67,619</b> | <b>25,255</b>      | <b>305,221</b> |
| Off balance sheet                    | 799            | 115           | 14,885         | 3,214         | -                  | 19,013         |
| <b>Total</b>                         | <b>173,277</b> | <b>14,107</b> | <b>40,762</b>  | <b>70,833</b> | <b>25,255</b>      | <b>324,234</b> |

**Table 14 – Provision for investments - sectoral segments**

|                        | Available for<br>Sale –<br>Investments | Equity       | Funds        | Total         |
|------------------------|--|--------------|--------------|---------------|
| At 1 January 2010      | 28,624                                 | 8,246        | 2,506        | 39,376        |
| Charge for the year    | 1,506                                  | -            | -            | 1,506         |
| Exchange rate movement | (4)                                    | -            | -            | (4)           |
| <b>At 30 June 2010</b> | <b>30,126</b>                          | <b>8,246</b> | <b>2,506</b> | <b>40,878</b> |

**Table 15 – Provision for investments and related exposures**

|                                  | Gross<br>exposure | Provisions    | Net<br>exposure |
|----------------------------------|-------------------|---------------|-----------------|
| Available for Sale – Investments | 37,041            | 30,126        | 6,915           |
| Equity investments               | 8,246             | 8,246         | -               |
| Funds                            | 2,506             | 2,506         | -               |
| <b>Total</b>                     | <b>47,793</b>     | <b>40,878</b> | <b>6,915</b>    |

**Table 16 – Provision for investments and related exposure - geographical segments**

|                                  | North<br>America | Europe | Middle<br>East | Rest of<br>Asia | Total  |
|----------------------------------|------------------|--------|----------------|-----------------|--------|
| Exposure                         | 22,587           | 21,216 | 355            | 3,635           | 47,793 |
| Specific impairment<br>provision | 22,587           | 14,935 | 355            | 3,001           | 40,878 |

The Bank does not have any significant collective impairment provision at 30 June 2010.

**Table 17 – Provision for loans and advances - sectoral segments**

|                    | Gross Exposure | Specific<br>Provision |
|--------------------|----------------|-----------------------|
| Financial Services | 1,535          | 1,535                 |
| Trade              | 7,814          | 2,866                 |
| Technology         | 567            | 567                   |
| Other Sector       | 8,674          | 7,895                 |
| <b>Total</b>       | <b>18,591</b>  | <b>12,863</b>         |

No provision has been made on an impaired loans amounting to US\$ 5.7 million as the Bank holds cash collateral of US\$ 1.3 million and securities of US\$ 4.4 million. Impaired loans are past due over 3 years.

**Table 18 – Provisions for loans and advances - geographical segments**

|                               | North America | Europe | Middle East | Rest of Asia | Total         |
|-------------------------------|---------------|--------|-------------|--------------|---------------|
| Exposure                      | 1,537         | 4,609  | 16,732      | 12,021       | <b>34,899</b> |
| Specific impairment provision | 1,537         | 4,606  | 2,928       | 3,792        | <b>12,863</b> |

**Table 19 – Provision movement for loans and advances - sectoral segments**

|                            | Financial Institutions | Corporate | Retail | Total         |
|----------------------------|------------------------|-----------|--------|---------------|
| At 1 January 2010          | 4,886                  | 5,176     | 2,910  | <b>12,972</b> |
| Charge for the year        | -                      | 66        | -      | <b>66</b>     |
| Reversals / Other Movement | -                      | (175)     | -      | <b>(175)</b>  |
| At 30 June 2010            | 4,886                  | 5,067     | 2,910  | <b>12,863</b> |

## 2.4 Credit Risk Mitigation

The reduction of the capital requirement attributable to credit risk mitigation is calculated in different ways, depending on the type of credit risk mitigation, as under:

Adjusted exposure amount: The Bank uses the comprehensive method for eligible financial collateral such as cash and equities listed on a recognized stock exchange. The exposure amount and financial collateral, where applicable, are adjusted for market volatility through the use of supervisory haircuts for currency mis-matches, price volatility and maturity-mismatches that are specified by the CBB.

Eligible financial collateral, guarantees and credit derivatives, presented by standard portfolio are as under:

**Table 20 – Eligible financial collateral**

| Basel II Asset Classification           | Gross credit exposure | Eligible Credit Risk Mitigant CRM | Net exposure |
|---|-----------------------|-----------------------------------|--------------|
| Cash items                              | 894                   | -                                 | 894          |
| Cash items in the process of collection | -                     | -                                 | -            |
| Claims on Sovereigns                    | 36,224                | -                                 | 36,224       |
| Claims on Banks                         | 142,030               | 16,108                            | 125,922      |
| Claims on Corporates                    | 37,821                | 6,564                             | 31,257       |

|  |                |               |                |
|--|----------------|---------------|----------------|
| Past Due exposures   | 5,741          | -             | 5,741          |
| Investment in Equity portfolio                                 | 6,818          | -             | 6,818          |
| Investment in Funds  | 956            | -             | 956            |
| Holding of Real Estate including premises occupied by the bank | 71,091         | -             | 71,091         |
| Others Assets  | 22,659         | -             | 22,659         |
| <b>Total Credit Risk under the Standardised Approach</b>       | <b>324,234</b> | <b>22,672</b> | <b>301,562</b> |

## 2.5 Market Risk

Market risk is the possibility of loss arising from changes in the value of a financial instrument as a result of changes in market variables, such as interest rates, exchange rates, credit spreads and other asset prices. The Bank's exposure to market risk is a function of our trading and asset-liability management activities and our role as a financial intermediary in customer-related transactions.

The Bank uses the Standardized Approach for assessing the capital charge for market risk to cover interest rate risk, equity risk and foreign exchange risk. Total risk weighted assets are determined by multiplying the capital charge by 12.5.

The Bank does not have any exposures to commodity risk.

**Table 21 – Capital requirement for components of market risk**

|                             | <b>RWA</b>    | <b>Capital requirement</b> | <b>Maximum value</b> | <b>Minimum value</b> |
|-----------------------------|---------------|----------------------------|----------------------|----------------------|
| Interest rate position risk | 5,180         | 414                        | 7,746                | 5,180                |
| Equities position risk      | 9,514         | 762                        | 10,860               | 9,514                |
| Foreign exchange risk       | 30,376        | 2,430                      | 32,241               | 30,376               |
| Total general market risk   | 45,070        | 3,606                      | 50,847               | 45,070               |
| Total specific market risk  | 163           | 13                         | 550                  | 163                  |
| <b>Total</b>                | <b>45,233</b> | <b>3,619</b>               | <b>51,397</b>        | <b>45,233</b>        |

## 2.6 Operational Risk

Operational risk is the risk of loss resulting from inadequate or failed internal processes, people and systems or from external events.

The Bank constantly strives to minimise operational risks inherent in the Bank's activities, processes and systems by ensuring that a strong control infrastructure is in place throughout the organisation and enhanced where necessary. A rigid internal check system is in place by the separation of front office and back office functions, internal audit and a higher degree of automation of mid-office and back office functions.

The Bank has in place an Operational Risk Management Framework ORMF supported by process for Risk and Control Self-Assessment RCSA and Operational Procedure guidelines.

The various procedures and processes used to manage operational risks are regularly reviewed and updated and implemented through effective staff training, close monitoring of risk limits, segregation of duties, appropriate controls to safeguard assets and records, regular reconciliation of accounts and transactions, and financial management and reporting. In addition, regular internal audit reviews, business continuity planning and arrangements for insurance cover are in place to complement the processes and procedures. An officer within the Risk Management Department is assigned the responsibility for close monitoring and review of operational risk issues on an ongoing basis. Key Risk Indicators (KRIs) are in place to analyse operational risk trends and control.

The Bank uses the standardized approach for calculating operational risk capital charges. In this approach, the Bank's activities are divided into eight business lines according to Basel II guidelines. The capital charge for each business line is calculated by multiplying gross income by a factor denoted by beta assigned to that business line. Total risk weighted assets are determined by multiplying the capital charge by 12.5.

***Table 22 – Capital requirement for Operational Risk***

|   | 2009  | 2008  | 2007          |
|---|-------|-------|---------------|
| Gross income                              | 7,101 | 5,215 | 39,884        |
| Capital charge                            | 1,431 | 3,750 | 5,978         |
| Average of capital charges for 3 years    |       |       | 3,720         |
| <b>Operational Risk Weighted Exposure</b> |       |       | <b>46,496</b> |

## 2.7 Equity Position in Banking Book

The Bank holds certain investments in equity securities with the objective of gaining strategic advantage as well as capital appreciation on sale thereof. All equity positions in the Banking book are classified as "Available-for-Sale". The accounting policies for "Available-for-Sale" instruments are described in detail in the Financial Statements under "Significant Accounting Policies".

***Table 23 – Equity position in banking books***

|              | Gross risk-weighted exposures | Capital requirement |
|--------------|-------------------------------|---------------------|
| Listed       | 378                           | 45                  |
| Unlisted     | 6,440                         | 1,159               |
| <b>Total</b> | <b>6,818</b>                  | <b>1,204</b>        |

**Table 24 – Unrealised gains and losses**

|  | <b>Amount</b> |               |
|--|---------------|---------------|
| Total unrealized gains and losses recognised in the balance sheet but not through the income statement |               |               |
| Fair value reserve net   | 990           |               |
| <b>Unrealised gains and losses included in Tier One and Tier Two capital</b>                           |               |               |
|  | <b>Tier 1</b> | <b>Tier 2</b> |
| Fair value reserve:  |               |               |
| Unrealized gross losses arising from fair valuing equity securities                                    | 211           |               |
| Unrealized gains arising from fair valuing equities  |               | 540           |
| Asset revaluation reserve:   |               |               |
| Property, plant and equipment  |               | 4,095         |

## 2.8 Interest rate risk in Banking book

Interest Rate Risk is measured by the extent to which changes in the market interest rates impact margins, net interest income and the economic value of the Bank's equity. The Bank's asset and liability management process is utilised to manage interest rate risk through the structuring of on-balance sheet and off-balance sheet portfolios. Net interest income will be affected as a result of volatility in interest rates to the extent that the re-pricing structure of interest bearing assets differs from that of liabilities. The Bank's goal is to achieve stable earnings growth through active management of the assets and liabilities mix while, selectively positioning it to benefit from near-term changes in interest rate levels.

**Table 25 – Interest rate risk in banking book**

| <b>Assets</b>   | <b>Less than 3 months</b> | <b>3 months to 1 year</b> | <b>Over 1 year</b> | <b>Non-Interest bearing</b> | <b>Total</b>   |
|---|---------------------------|---------------------------|--------------------|-----------------------------|----------------|
| Cash and balances with central banks                  | -                         | -                         | -                  | 66,563                      | 66,563         |
| Placements with banks                                 | 90,907                    | 7,913                     | 108                | -                           | 98,928         |
| Financial Assets at fair value through profit or loss | 3,174                     | 2,006                     | -                  | 4,757                       | 9,937          |
| Loans and advances                                    | 7,941                     | 3,777                     | 4,402              | 5,916                       | 22,036         |
| Available-for-sale financial assets                   | 3,222                     | 9,758                     | 46,776             | 14,516                      | 74,272         |
| Investment in associate                               | -                         | -                         | -                  | 19,840                      | 19,840         |
| Investment property                                   | -                         | -                         | -                  | 26,310                      | 26,310         |
| Property and equipment                                | -                         | -                         | -                  | 20,481                      | 20,481         |
| Intangible assets                                     | -                         | -                         | -                  | 1,230                       | 1,230          |
| Goodwill  | -                         | -                         | -                  | 3,529                       | 3,529          |
| Other assets  | -                         | -                         | -                  | 5,537                       | 5,537          |
| <b>Total</b>  | <b>105,244</b>            | <b>23,454</b>             | <b>51,286</b>      | <b>168,679</b>              | <b>348,663</b> |

| <b>Liabilities</b>                       |                |               |              |               |                |
|--|----------------|---------------|--------------|---------------|----------------|
| Deposits from banks                      | 24,405         | -             | -            | 1,823         | 26,228         |
| Deposit from customers                   | 144,343        | 21,750        | 1,099        | 42,778        | 209,970        |
| Other liabilities                        | -              | -             | -            | 23,165        | 23,165         |
| Long term debt                           | -              | -             | 7,465        | -             | 7,465          |
| <b>Total</b>                             | <b>168,748</b> | <b>21,750</b> | <b>8,564</b> | <b>67,766</b> | <b>266,828</b> |
| Interest rate sensitivity gap            | (63,504)       | 1,704         | 42,722       |               |                |
| Cumulative Interest rate sensitivity gap | (63,504)       | (61,800)      | (19,078)     |               |                |

There are no interest rate sensitive off-balance sheet exposures at 30 June 2010.

***Table 26 – Sensitivity analysis – Interest rate risk***

| <b>Annualised</b>   | <b>Up to 3 Months</b> | <b>3 Months to 1 Year</b> | <b>Over 1 Year</b> | <b>Total</b> |
|---------------------|-----------------------|---------------------------|--------------------|--------------|
| at 50 bps increase  | (318)                 | 9                         | 214                | (95)         |
| at 100 bps increase | (635)                 | 17                        | 427                | (191)        |
| at 200 bps increase | (1,270)               | 34                        | 854                | (382)        |

**2.9 Discussion on impact of acquisition:**

No acquisition has been made during the period ended 30 June 2010.

**2.10 Discussion on changes in the capital structure:**

There was no change in the capital structure of the Bank during half year 2010.

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