

# TAIB Bank B.S.C (c)

## Pillar 3 - Disclosures

30 June 2009

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## **1. Introduction**

The Central Bank of Bahrain's (CBB) Basel 2 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 Basel Committee's Pillar 3 disclosure requirements in accordance with Public Disclosure Module of the CBB's rule book. The objective of Pillar 3 is to improve market discipline through effective public disclosures.

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

As at 30th June 2009, the Group's total risk weighted assets amounted to US\$ 431.4 million and total regulatory capital amounted to US\$ 85.7 million. Accordingly, total Capital Adequacy Ratio on a consolidated basis for the group was 19.87%. The ratio exceeds the minimum capital requirements under the CBB's Basel II framework. The Bank intends to maintain a minimum total capital adequacy ratio of 15% on a consolidated basis while complying with the capital adequacy requirement.

The Bank views the Basel II Pillar 3 disclosures as an important means of increased transparency and accordingly has provided extensive disclosures in this report that is appropriate and relevant to the Bank's stakeholders and market participants.

All figures presented in this report are in thousands of United States Dollars as at 30 June 2009 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 Holding 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 Investment Company Ltd	Mauritius	100%

## 2.2 Risk and Capital Management

The Bank is exposed to the following types of risks:

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

### **Risk Management Framework**

The Bank maintains prudent and disciplined approach to risk taking by upholding a comprehensive set of risk management policies, procedures and limits, employing professionally qualified people with appropriate skills, investing in technology and training, and actively monitoring a culture of sound risk management at all levels. TAIB adopts an enterprise-wide proactive approach based on five fundamental principles to identify and mitigate the risks viz. 1) Strong corporate governance and board oversight exercised through approval of policies and authority limits, periodic review of exposures and performance measurement (2) Low financial leverage to maintain strong capital adequacy ratio, (3) Balanced asset allocation to avoid over concentration, (4) Emphasis on asset quality by thorough pre investment due diligence and (5) continuous post investment monitoring.

The Board of Directors has overall responsibility for establishing the Group's approach to risk and ensuring that an effective risk management framework is in place. The Risk Management Committee (RMC) of the executive management of the bank is responsible for implementing risk management policies, procedures and limits, and for ensuring that monitoring processes are in place. RMC oversees the risk management functions through the independent risk management department of the Bank. The Asset and Liability Committee (ALCO) of the senior management has overall responsibility for managing the Bank's liquidity and interest rate risks, while the day-to-day management of liquidity and interest rate risk is vested with the treasury department under the overall guidance and direction of ALCO. Risk Management Department, together with Internal Audit, provides independent assurance that all types of risks are being measured and managed in accordance with the policies and guidelines set by the Board. Internal Audit reports to the Audit Committee of the Board. The Board of Directors approves the overall business plans, policies and budgets of the Bank. Additionally, in order to streamline the decision making process and to strengthen the corporate governance process with ongoing involvement of the Board of Directors in administering and managing the affairs of the Bank, the Board has established the following Board Committees:

- Executive Committee
- Audit Committee
- Insider Trading Committee
- Nomination Committee
- Human Resources and Remuneration Committee

TAIB diversifies its portfolios to avoid over concentration in any single area, whether geographic, currency, asset class or investment type. At its core, asset allocation methodology entails specific exposure limits and concentration limits for various asset classes viz. real estate, private equity, fixed income, funds, inter bank placements, trading securities, etc. Limits are combined with a variety of oversight, measurement and monitoring procedures to ensure adherence to such limits.

TAIB Group constantly strives to maintain and build quality asset portfolios. To this end, it has strong in-house pre-investment due diligence and post investment monitoring processes in place. It carefully chooses investment exposures and minimises, manages, caps and hedges risks, wherever possible. TAIB believes that a prerequisite of successful risk management is the

ability to identify, measure and control risks right from the very beginning of the investment process. In order to ensure quality exposure and minimise risks, the following due diligence measures are followed in the pre-investment stage with regard to all exposures:

- In depth examination of known and potential risks by the deal sourcing product divisions (viz. real estate, private equity, asset management and brokerage divisions) corroborated by independent third party due diligence reports on technical, financial, legal, structuring and valuation.
- Critical review and appraisal of the proposals by the bank's risk management department
- Review and approval by the Risk Management Committee and Executive Committee of the Board, as appropriate under delegated Approval Authority Structure.
- Review by the Board of Directors.

TAIB continuously monitors the performance of its trading assets and long-term investments in real estate, private equity, funds and other assets. Exposures are continuously monitored by originating product divisions as well as RMD at post investment stage for necessary corrective action to mitigate risks on an ongoing basis.

### **Capital Management**

The Bank's policy is to maintain sufficient capital to sustain investor, creditor and market confidence and to support future development of the business. The impact of the level of capital on return on shareholders' equity is also considered while maintaining a balance between the higher return that might be possible with leveraging and security afforded by sound capital position to absorb risks. The bank's capital management framework is intended to ensure that there is sufficient capital to support the underlying risks of the Bank's business activities and to maintain a well-capitalised status under regulatory requirements. The Bank has Internal Capital Allocation Assessment Process (ICAAP) with the supporting risk management framework and risk management policies and procedures to identify and measure the various risks that are not covered under Pillar 1 risks and to regularly assess the overall capital adequacy considering the risks and the Bank's planned business strategies. The non Pillar 1 risks covered under the ICAAP process include strategic risk, reputation and legal risk, concentration risk, liquidity risk, interest rate risk in the banking book etc. The ICAAP also keeps in perspective the Bank's strategic plans and credit growth expectations and the impact of all these on maintaining adequate capital levels. The Bank ensures that the capital adequacy requirements are met on a consolidated basis as well as on stand alone basis and also with local regulator's requirements, if any, in countries in which the Bank's subsidiaries operate. The Bank has complied with regulatory capital requirements throughout the period.

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, eligible reserves and retained earnings. The eligible reserves in Tier 1 exclude gains arising on asset revaluation reserve and re-measurement to fair value of available-for-sale financial assets. Further, the following items are adjusted from Tier 1 capital as per CBB guidelines:

- Unrealized losses on available-for-sale financial assets and goodwill are deducted.
- Losses for the period 2009 pursuant to review of the consolidated financial information are also deducted.

The Bank's Tier 2 capital comprises 45% of asset revaluation reserve and unrealised gains arising on the re-measurement to fair value of available-for-sale financial assets.

Deductions relating to exposures in excess of 15% threshold of available capital have also been made from the Tier 1 and Tier 2 capital of the Bank as required by the CBB guidelines. The Bank does not have Tier 3 capital as at 30 June 2009.

The Bank has neither any subsidiary engaged in insurance business nor investments in insurance companies.

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

	<b>Tier 1</b>	<b>Tier 2</b>	<b>Total</b>
Share capital	107,833	-	107,833
Share premium	3,196	-	3,196
Statutory reserve	22,423	-	22,423
General reserve	7,463	-	7,463
Retained profit brought forward	(22,043)	-	(22,043)
Minority interest in consolidated subsidiaries	891	-	891
Goodwill on acquisition	(3,642)	-	(3,642)
Current cumulative net losses	(6,052)	-	(6,052)
Unrealised gross losses arising from fair valuing equity securities	(2,058)	-	(2,058)
Asset revaluation reserve - property, plant and equipment	-	4,483	4,483
Unrealised gains arising from fair valuing equities	-	121	121
<b>Total Available Capital</b>	<b>108,011</b>	<b>4,604</b>	<b>112,615</b>
Less: Deduction relating to exposures individually in excess of 15% of available capital	(22,270)	(4,604)	(26,874)
<b>Total Eligible Capital</b>	<b>85,741</b>	<b>-</b>	<b>85,741</b>
<b>Risk weighted exposures:</b>			
- Credit risk			312,750
- Operational risk			62,176
- Market risk			56,509
<b>Total Risk weighted exposure</b>			<b>431,434</b>
<b>Consolidated Capital Adequacy Ratio (%) : Tier 1 &amp; Total</b>			<b>19.87</b>

The Bank does not have Tier 3 capital as at 30 June 2009.

**Table 3 – Capital Adequacy of the Bank’s significant bank subsidiaries.**

	Subsidiaries	
<i>Under Basel II</i>	<b>TAIB Kazak Bank JSE, Kazakhstan</b>	<b>TAIB Yatirim Bank A.S, Turkey</b>
Tier 1 – Capital Adequacy Ratio (%)	65.6	91.66
Total – Capital Adequacy Ratio (%)	85.8	91.66

## 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.

The Bank has a diversified on and off balance sheet credit portfolio, which are divided into counter party exposure classes in line with the CBB’s Basel II capital adequacy framework for the standardised approach for credit risk. A high-level description of the counter party exposure classes and the risk weights used to derive the Risk Weighted Assets (“RWA”) are as follows:

### **Sovereigns**

The sovereign portfolio comprises exposures to governments and their respective central banks. The risk weights are zero per cent for exposures in the relevant domestic currency of the sovereign, or for any exposures to GCC governments. Foreign currency claims on other sovereigns are risk weighted based on their external credit ratings. Certain multilateral development banks as determined by the CBB may be included in the sovereign portfolio and treated as exposures with a zero per cent risk weighting.

### **Banks**

Claims on banks are risk weighted based on their external credit ratings. A preferential risk weight treatment is available for qualifying short-term exposures to banks in their country of incorporation. Short-term exposures are defined as exposures with an original tenor of three months or less and denominated and funded in the respective domestic currency. The preferential risk weight for short-term claims is allowed on exposures in Bahraini Dinar/US Dollar in the case of Bahraini incorporated banks.

### **Corporates**

Claims on corporates are risk weighted based on their external credit ratings. A 100 % risk weight is assigned to exposures to unrated corporates. A preferential risk weight treatment is available for certain corporates owned by the Government of Bahrain, as determined by the CBB, which are assigned a zero per cent risk weight.

### **Equities Investments**

The equities portfolio comprises equity investments in the banking book, i.e. the available-for-sale financial assets portfolio. The credit (specific) risk for equities in the trading book is included in market risk RWAs for regulatory capital adequacy calculation purposes.

A 100 % risk weight is assigned to listed equities and funds. Unlisted equities and funds are risk weighted at 150 %. Investments in rated funds are risk weighted according to the external credit rating.

### **Real Estates Investments**

Holdings of real estates, owned directly or indirectly by the Bank other than own premises, are risk weighted at 200% and premises occupied by the Bank are risk weighted at 100% as per CBB guidelines.

### **In addition to the standard portfolios, other exposures are risk weighted as under:**

#### **Past due exposures**

In accordance with the Bank's policy and CBB guidelines, loans on which payment of interest or repayment of principal are 90 days past due are defined as non-performing. All past due loan exposures, irrespective of the categorisation of the exposure, are classified separately under the past due exposures asset class. A risk weighting of either 100 % or 150 % is applied depending on the level of specific provision maintained against the exposure.

**Other assets** are risk weighted at 100 %.

### **External Credit Assessment Institutions (ECAI)**

The Bank uses ratings issued by Fitch to derive the risk weightings under the CBB's Basel II capital adequacy framework.

The following are gross credit risk exposures considered for Capital Adequacy Ratio calculations comprising of banking book exposures.

**Table 4 – Capital requirement for credit risk**

<b>Basel II Asset Classification</b>	<b>Rated</b>	<b>Unrated</b>	<b>Total exposure (*)</b>	<b>Average risk weight</b>	<b>RWA</b>	<b>Capital charge</b>
Cash Items	-	1,627	1,627	0%	-	-
Cash items in the process of collection		101	101	20%	20	2
Claims on sovereigns	10,609	-	10,609	0%	-	-
Claims on banks	71,628	42,474	114,102	42%	47,615	5,714
Claims on corporates	817	47,652	48,469	100%	47,892	5,747
Past due exposures	-	3,841	3,841	150%	5,762	691
Investment in equity portfolio	298	6,675	6,974	146%	10,180	1,222
Investment in funds	-	1,162	1,162	150%	1,743	209
Holding of Real Estate including premises occupied by the bank	-	97,160	97,160	150%	183,612	22,033
Others Assets	-	15,926	15,926	100%	15,926	1,911
<b>Total Credit Risk under the Standardised Approach</b>	<b>83,352</b>	<b>216,618</b>	<b>299,970</b>	<b>104%</b>	<b>312,750</b>	<b>37,530</b>

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

**Table 5 – Gross credit exposure (\*)**

<b>Balance sheet Items:</b>	<b>Gross credit exposure</b>	<b>Average gross credit exposure</b>
Cash and balances with central banks	42,141	48,771
Placements with banks	114,453	139,736
Loans and advances	23,806	22,379
Available-for-sale financial assets	57,524	91,308
Investment in associate	16,024	13,129
Investment property	29,277	39,451
Property and equipment	18,254	19,394
Other assets	8,595	11,385
<b>Total on balance sheet credit exposure</b>	<b>310,074</b>	<b>385,553</b>
<b>Off balance sheet items:</b>		
Direct credit substitutes	14,360	14,182
Notes issuance and revolving underwriting facilities	656	6,309
Derivatives - foreign exchange contracts	1,562	918
<b>Total off balance sheet credit exposure</b>	<b>16,578</b>	<b>21,409</b>
<b>Total credit exposure</b>	<b>326,652</b>	<b>406,962</b>

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

The average gross credit exposure is calculated based on balances as at 31 March 2008, 30 June 2008, 31 December 2008 and 30 June 2009.

**Table 6 – Credit exposure by geographical segments**

<b>Credit exposure</b>	<b>North America</b>	<b>Europe</b>	<b>Middle East</b>	<b>Rest of Asia</b>	<b>Total</b>
Cash and balances with central banks	1,845	2,352	13,652	24,292	42,141
Placements with banks	16,861	27,340	64,334	5,918	114,453
Loans and advances	-	519	15,848	7,439	23,806
Available-for-sale financial assets	10,282	38,544	177	8,521	57,524
Investment in associate	-	11,024	5,000	-	16,024
Investment property	20,157	-	8,335	785	29,277
Property and equipment	276	2,458	14,489	1,031	18,254
Other assets	2,650	964	1,492	3,489	8,595
Off balance sheet items	-	1,564	13,616	1,398	16,578
<b>Total</b>	<b>52,071</b>	<b>84,765</b>	<b>136,943</b>	<b>52,873</b>	<b>326,652</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 7 – Credit exposure by sectoral segments**

	Cash, balances with central Banks and placements	Loans and advances	Investment	Others	Off- balance sheet items	Total
Financial services	156,541	-	1,841	2,620	15,178	176,180
Government	53	-	3,557	231	-	3,841
Structured finance	-	-	2,839	-	-	2,839
Trade and transport	-	4,203	-	495	1,400	6,098
Real estate	-	298	86,453	481	-	87,232
Equity funds	-	-	8,135	498	-	8,633
Others	-	19,305	-	22,524	-	41,829
<b>Total</b>	<b>156,594</b>	<b>23,806</b>	<b>102,825</b>	<b>26,849</b>	<b>16,578</b>	<b>326,652</b>

**Table 8 – Related party transaction**

	Associates	Directors and senior management	Total
<b>Balance sheet :</b>			
Deposits with the banks	-	20,000	20,000
Loans and advances extended	-	626	626
Deposits received from Customers	81,018	5,638	86,656
<b>Income statement :</b>			
Interest income	-	727	727
Interest expense	1,598	88	1,686
Fee & commission income	750	-	750
Reimbursement of Directors expenses	-	141	141
Key management compensation	-	477	477

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, at arms length, in the normal course of business.

**Table 9 - 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 10 – Credit concentration greater than 15% of individual obligor limit.**

	<b>Amount</b>
Bank	20,000
Non bank	40,650

**Table 11 – Counterparty credit risk in derivative transaction**

	<b>Notional amount</b>	<b>Credit exposure</b>	<b>Capital requirement</b>
Direct credit substitutes	15,082	14,360	1,723
Notes issuance and revolving underwriting facilities	1,312	656	79
Foreign exchange contracts	153,883	1,562	187
<b>Total</b>	<b>170,277</b>	<b>16,578</b>	<b>1,989</b>

**Table 12 – Credit exposure by maturity**

	<b>Below 1 month</b>	<b>1 to 3 months</b>	<b>3 to 12 months</b>	<b>1 to 5 years</b>	<b>Over 5 to 10 years</b>	<b>Total</b>
<b>Exposures</b>						
Cash and balances with central banks	42,141	-	-	-	-	42,141
Placements with banks	108,531	1,836	4,086	-	-	114,453
Loans and advances	10,156	1,432	5,907	6,311	-	23,806
Available-for-sale financial assets	931	1,447	29,755	25,391	-	57,524
Investment in associate	-	-	-	-	16,024	16,024
Investment property	-	-	20,942	-	8,335	29,277
Property and equipment	-	-	10	-	18,244	18,254
Other assets	78	2,153	3,018	3,320	26	8,595
<b>Total on balance sheet</b>	<b>161,837</b>	<b>6,868</b>	<b>63,718</b>	<b>35,022</b>	<b>42,629</b>	<b>310,074</b>
Off balance sheet	1,583	707	2	14,286	-	16,578
<b>Total</b>	<b>163,420</b>	<b>7,575</b>	<b>63,720</b>	<b>49,308</b>	<b>42,629</b>	<b>326,652</b>

**Table 13 – Provision for investments - sectoral segments**

	Property interest held for sale – Equity	Equity	Funds	Total
At 1 January 2009	22,014	8,892	2,500	33,406
Charge for the year	-	31	-	31
Exchange rate movement	-	7		7
<b>At 30 June 2009</b>	<b>22,014</b>	<b>8,930</b>	<b>2,500</b>	<b>33,444</b>

**Table 14 – Provision for investments and related exposures**

	Gross exposure	Provisions	Net exposure
Property interests held for sale - equity	27,314	22,014	5,300
Equity investments	8,979	8,930	49
Funds	2,500	2,500	0
<b>Total</b>	<b>38,793</b>	<b>33,444</b>	<b>5,349</b>

**Table 15 – Provision for investments and related exposure - geographical segments**

	North America	Europe	Middle East	Rest of Asia	Total
Exposure	27,887	8,319	622	1,965	38,793
Specific impairment provision	22,586	8,319	574	1,965	33,444

The Bank does not have any significant collective impairment provision at 30 June 2009.

**Table 16 – Provision for loans and advances - sectoral segments**

	Gross Exposure	Specific Provision
Financial Services	6,633	4,634
Trade	1,924	97
Technology	39	39
Other Sector	8,865	8,567
<b>Total</b>	<b>17,461</b>	<b>13,337</b>

No provision has been made on an impaired loans amounting to US\$ 3.3 million as the Bank holds cash collateral of US\$ 1.3 million and securities of US\$ 2 million. Impaired loans are past due over 3 years.

**Table 17 – Provisions for loans and advances - geographical segments**

	North America	Europe	Middle East	Rest of Asia	Total
Exposure	1,725	4,825	6,898	4,013	17,461
Specific impairment provision	1,725	4,526	3,613	3,473	13,337

**Table 18 – Provision movement for loans and advances - sectoral segments**

	Financial Institutions	Corporate	Retail	Total
At 1 January 2009	4,886	5,221	2,910	13,017
Charge for the year	-	345	7	352
Reversals / Other Movement	-	(32)	-	(32)
At 30 June 2009	4,886	5,534	2,917	13,337

## 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.

### Collateral and valuations principles

The main collaterals taken for risk mitigation on credit exposures are deposits held by customers, pledge of quoted shares, residential/commercial property mortgage, investment securities, counter-guarantees from other banks, etc. Other risk mitigants considered in one of the subsidiaries (Kazakhstan) include salary and end of service benefits assignment for personal loans, personal guarantees of promoters etc. However, for purposes of capital adequacy computation, only eligible collaterals recognized under Basel II are taken into consideration and there are no significant concentrations in such eligible collaterals taken for credit risk mitigation.

The Bank's credit policy defines the types of acceptable collateral, margin requirements and the loan-to-value ratio. The Bank has a system of independent valuation of collateral. In the case of real estate, valuation is done by independent valuer as stipulated in the Bank's credit policy. In respect of quoted shares and other securities, the valuation is done based on the closing price on the stock exchange. The market value of the collateral is actively monitored on a regular basis and requests are made for additional collateral in accordance with the terms of the underlying agreements. In general, lending is based on the credit worthiness and financial standing and not the collateral value. However, collateral is considered as a secondary alternative to fall back on in the event of default.

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

**Table 19 – Eligible financial collateral**

<b>Basel II Asset Classification</b>	<b>Gross credit exposure</b>	<b>Eligible Credit Risk Mitigant (CRM)</b>	<b>Net exposure</b>
Cash items	1,627	-	1,627
Cash items in the process of collection	101		101
Claims on sovereigns	10,609	-	10,609
Claims on banks	129,292	15,190	114,102
Claims on corporates	59,961	11,492	48,469
Past due exposures	3,841	-	3,841
Investment in equity portfolio	6,974	-	6,974
Investment in funds	1,162	-	1,162
Holding of Real Estate including premises occupied by the bank	97,160	-	97,160
Others Assets	15,925	-	15,925
<b>Total Credit Risk under the Standardised Approach</b>	<b>326,652</b>	<b>26,682</b>	<b>299,970</b>

**On and off-balance sheet netting:**

The legal documents that the Bank obtains from customers include clauses that permit the Bank to offset the customer's dues to the Bank against the Bank's dues. In case of certain counter party banks, the Bank has entered into specific netting agreements that provide for netting on and off-balance sheet exposures.

**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 objective of market risk management is to minimize the impact of losses on earnings and equity capital due to market risk.

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 has documented policies and procedures for the management of the trading portfolio. The Group seeks to manage the market risks it faces through diversification of exposures across dissimilar markets and the establishment of hedges in related securities, wherever necessary. To manage the Group's exposures, in addition to exercising business judgment and management experience, the Group utilises limit structures, including those relating to positions, portfolios, maturities and maximum allowable stop loss and book profit limits.

The back office in the Corporate Services Division, which is independent of the front office, is responsible for valuation which is done on an ongoing basis, based on quoted market prices from stock exchanges, independent third parties or amounts derived from cash flow models as appropriate.

The Bank does not have any exposures to commodity risk.

**Table 20 – 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	1,915	153	509	153
Equities position risk	10,904	872	872	629
Foreign exchange risk	43,577	3,486	3,631	3,486
Total general market risk	56,396	4,512	4,656	4,624
Total specific market risk	113	9	69	9
<b>Total</b>	<b>56,509</b>	<b>4,521</b>	<b>4,725</b>	<b>4,633</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.

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 21 – Capital requirement for Operational Risk**

	2008	2007	2006
Gross income	5,215	39,884	35,409
Capital charge	3,750	5,978	5,194
Average of capital charges for 3 years			4,974
<b>Operational Risk Weighted Exposure</b>			<b>62,176</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 22 – Equity position in banking books**

	Gross risk-weighted exposures	Capital requirement
Listed	561	47
Unlisted	6,413	534
<b>Total</b>	<b>6,974</b>	<b>581</b>

**Table 23 – Unrealised gains and losses**

	Amount	
Total unrealized gains and losses recognised in the balance sheet but not through the income statement		
Fair value reserve (net)		(1,790)
Unrealised gains and losses included in Tier One and Tier Two capital		
	Tier 1	Tier 2
Fair value reserve:		
Unrealized gross losses arising from fair valuing equity securities	2,058	
Unrealized gains arising from fair valuing equities		121
Asset revaluation reserve:		
Property, plant and equipment		4,483

## 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. Overall non-trading interest rate risk positions are managed by the Treasury division, which uses investment securities, placements with banks, deposits from banks and derivative instruments to manage the overall position arising from the Bank's non-trading activities. Reports on overall position and risks are submitted to senior management for review and positions are adjusted if deemed necessary. In addition, Asset Liability Committee ("ALCO") regularly reviews the interest rate sensitivity profile and its impact on earnings. Strategic decisions are made with the objective of producing a strong and stable interest income stream over time.

Deposits without a fixed maturity are considered as repayable on demand and are accordingly included in the overnight maturity bucket.

**Table 24 – 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	41,584	-	-	-	41,584
Placements with banks	113,482	4,087	-	-	117,569
Financial Assets at fair value through profit or loss	651	4,846	-	1,869	7,366
Loans and advances	10,311	5,907	6,311	-	22,529
Available-for-sale financial assets	1,114	4,518	8,853	66,945	81,430
Investment in associate	-	-	-	16,024	16,024
Investment property	-	-	-	29,277	29,277
Property and equipment	-	-	-	21,924	21,924
Intangible assets	-	-	-	1,786	1,786
Goodwill	-	-	-	3,642	3,642
Other assets	-	-	-	8,555	8,555
<b>Total</b>	<b>167,142</b>	<b>19,358</b>	<b>15,164</b>	<b>150,022</b>	<b>351,686</b>
<b>Liabilities</b>					
Deposits from banks	25,000	2,000	-	146	27,146
Deposit from customers	99,834	26,788	1,122	53,156	180,900
Other liabilities	-	-	-	13,400	13,400
Long term debt	-	-	7,566	-	7,566
<b>Total</b>	<b>124,834</b>	<b>28,788</b>	<b>8,688</b>	<b>66,702</b>	<b>229,012</b>
Interest rate sensitivity gap	42,308	(9,430)	6,476		
Cumulative Interest rate sensitivity gap	42,308	32,878	39,354		

There are no interest rate sensitive off-balance sheet exposures at 30 June 2009.

***Table 25 – 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	212	(47)	32	197
at 100 bps increase	423	(94)	65	394
at 200 bps increase	846	(189)	130	787

## **2.9 Discussion on impact of acquisition:**

No acquisition has been made during the period ended 30 June 2009.

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

The shareholders of the Bank and the regulatory authorities have accorded approval for an increase in the paid up capital of the Bank to US\$ 250 million. The processes for such increase are under internal examination and review.