

BASEL II

PILLAR 3 DISCLOSURE AS AT 30 JUNE 10

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 January 2008. These disclosures have been prepared in accordance with the CBB requirements outlined in the Public Disclosure Module (PD), Chapter 1.3 of the CBB Rule Book, Volume II for Islamic Banks. These disclosures follow the requirements of Basel II - Pillar 3 and the Islamic Financial Services Board's (IFSB) recommended disclosures for Islamic banks, and should be read in conjunction with the detailed Risk and Capital Management Disclosures made in the Bank's Annual Report for the year ended 31 December 2009.

Pillar 3 disclosure requirements are designed to promote market discipline and disclosure by providing information on a firm's risk exposures and risk management processes.

The Bank has adopted the Standardised Approach for Credit Risk and Market Risk and follows the Basic Indicator Approach for Operational Risk to determine its capital requirements.

As at 30 June 2010, the Bank's total risk weighted assets amounted to US\$ 670 m and Tier 1 Capital and total regulatory capital amounted to US\$ 304 m. Accordingly, total Capital Adequacy Ratio was 45.39%. These ratios exceed the minimum capital requirements under the CBB's Basel 2 framework.

Group structure:

The Bank has the following operational subsidiaries, which are fully consolidated in its financial statements .

Subsidiary	Country	Capital	Percentage interest
The Lounge Serviced Offices Co. WLL	Bahrain	BHD 20,000	100%
Gulf Projects Company WLL	Bahrain	BHD 1,000,000	100%
The Lime Restaurants Management & Catering Services Co. WLL	Bahrain	BHD 20,000	100%

2 Details of eligible capital base

	USD '000	
	Tier 1	Tier 2
Share capital	250,000	
Less: Unvested shares of ESOP	(22,764)	
Share premium	28,429	
Statutory reserve	10,415	
Prior year retained earnings b/fwd	14,012	
Discount on unrealized gains reported in retained earnings (55%)	7,101-	
Minority Interest of MENA SME Fund 1 consolidated for capital adequacy purpose	60,892	
Less: deductions:		
Goodwill	(3,232)	
Current Interim cumulative net losses	(6,973)	
Total Tier 1 capital	<u>323,678</u>	
ESOP equity reserve		4,779
Unrealized AFS fair value gains (45%)		527
Total Tier 2 capital		<u>5,306</u>
Excess amount over maximum permitted large exposure limit	(12,479)	12,479-
Deduction to absorb deficiency in Tier 2	(7,173)	7,173
Net Available Capital	<u>304,026</u>	-
Total eligible capital (Tier 1 + Tier 2)	<u>304,026</u>	

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Credit risk:

The credit risk exposures faced by VCBank are in respect of its own short term liquidity related to placements with other financial institutions, and in respect of investment related funding made to projects. The investment related funding exposures arise in the ordinary course of its investment banking activities and are generally transacted without contractual due dates, collateral or other credit risk mitigants. All such exposures are however reviewed periodically for recoverability and provision made where necessary having regard to the nature of the item and the assessment of probability of collection. Due to the nature of the Bank's credit exposures, this is considered more appropriate than a collective impairment provision.

3 Details of exposures and capital requirement

USD '000

Credit risk:	Gross exposures	Risk weighted exposures	
		Risk weighted exposures	Capital charge
Exposures to banks	20,314	4,154	499
Exposures to corporates	96,937	96,937	11,632
Investments in listed equities in banking book	4,863	4,863	583
Investments in unlisted equities in banking book	142,976	214,464	25,736
Investments in real estate	112,280	224,560	26,947
Other exposures	14,330	14,330	1,720
Total credit risk exposure under standardized approach	391,700	559,308	67,117
Market risk:			
Equities position	1,115	2,230	268
Foreign exchange position	2,755	2,755	330
Total market risk under standardized approach	3,870	4,985	598
Operational risk under Basic Indicator Approach (ref. below)		105,574	12,669
Total		669,867	80,384
Total eligible capital - (Tier 1 + Tier 2)		304,026	
Total eligible capital - Tier 1		304,026	
Total Capital Adequacy Ratio (Tier 1 + Tier 2)		45.4%	
Tier 1 Capital Adequacy Ratio		45.4%	

Capital requirement for Operational Risk (Basic Indicator Approach)

USD '000

	2009	2008	2007
Gross income for prior three years	32,473	82,047	54,398
Average of past 3 years gross income	56,306		
Capital requirement for Operational Risk (15%)	8,446		
Risk weighted exposure for Operational Risk	105,574		

Total unrealized fair value gains / (losses):

Unrealized fair value gains/(losses) recognized in income	-
Unrealized fair value gains/(losses) recognized in equity	1,170

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The maximum and minimum values of each category of market risk exposure during the year are detailed in the table below:

Particulars	30-Jun-10	Maximum	US\$ '000
			Minimum
Market risk exposures			
Listed equities held for trading	1,115	1,314	1,089
Foreign currency exposure	2,755	2,755	2,087
Market risk charge			
Listed equities held for trading	179	179	179
Foreign currency exposure	220	220	220
Total market risk charge	399	399	399
Market risk weighted exposure			
Listed equities held for trading	2,230	2,230	2,230
Foreign currency exposure	2,755	2,755	2,755
Total market risk weighted exposure	4,985	4,985	4,985

4 Credit risk mitigants

The bank is not involved in extending credit facilities in the normal course of its activities. The credit risk exposures faced by the Bank are primarily in respect of its own short term liquidity related placements with other financial institutions, and in respect of investments related funding made to projects. These exposures arise in the ordinary course of its investment banking activities and are generally entered into without any collateral, guarantees or other credit risk mitigants. As at 30 June 2010, there were no credit risk mitigants and, accordingly, the gross credit exposure detailed above represents the total credit risk exposure of the Bank.

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5 Concentration Risk

The quantitative details of the bank credit risk exposures are depicted in the following tables, which are representative of the position during the period:

5.a Distribution of bank's exposures by industry sector

Industry sector	Trading & Manufacturing	Banks & financial Inst.	Real estate related	Oil and Gas	Health Care	Technology	Shipping	Others	Total USD'000
On balance sheet									
Cash and balances with banks	-	4,457	-	-	-	-	-	-	4,457
Placements with financial institutions	-	18,425	-	-	-	-	-	-	18,425
Investment securities	12,705	984	59,608	19,656	9,950	2,073	17,304	15,865	138,145
Investment in associates and joint ventures	-	-	23,782	-	2,907	3,926	-	6,184	36,799
Investment properties	-	-	9,130	-	-	-	-	-	9,130
Receivable from investment banking services	270	3,637	4,920	-	2,183	237	375	682	12,304
Short term financing to project companies	2,040	-	8,219	-	6,290	4,699	-	-	21,248
Other assets	7,789	2,977	116	-	897	174	3	23,198	35,154
Property and equipment	-	13,139	-	-	-	-	-	-	13,139
Total on balance sheet	22,804	43,619	105,775	19,656	22,227	11,109	17,682	45,929	288,801
Off balance sheet exposures									
Restricted investment accounts	-	3,293	13,492	-	-	-	-	369	17,154
Contingent items	-	-	17,502	-	-	-	-	61,316	78,818
Total gross credit exposure	22,804	46,912	136,769	19,656	22,227	11,109	17,682	107,614	384,773
Percentage of gross exposure by sector	6%	12%	36%	5%	6%	3%	5%	28%	100%

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5.b **Distribution of bank's exposures by geographic sector**

USD '000

Geographic sector	GCC countries	Other MENA countries	Global	Cayman / Americas	Total USD'000
Assets					
Cash and balances with banks	4,457	-	-	-	4,457
Placements with financial institutions	18,425	-	-	-	18,425
Investment securities	91,806	30,111	16,228	-	138,145
Investment in associates and joint ventures	35,072	1,727	-	-	36,799
Investment properties	9,130	-	-	-	9,130
Receivable from investment banking services	8,037	270	375	3,622	12,304
Short term financing to project companies	19,208	2,040	-	-	21,248
Other assets	34,969	180	3	2	35,153
Property and equipment	13,139	-	-	-	13,139
Total Assets	234,243	34,328	16,606	3,624	288,801
Off balance sheet assets					
Restricted investment accounts	17,154	-	-	-	17,154
Contingent items	69,762	9,056	-	-	78,818
	321,159	43,384	16,606	3,624	384,773

Percentage exposure by geographic sector

83%	11%	4%	0.9%	100%
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5.c **Credit exposure by maturity**

USD '000

	Up to 3 months	3 to 6 months	6 months to 1 year	1 to 3 years	Over 3 to 5 years	Total USD'000
Assets						
Cash and balances with banks	4,457	-	-	-	-	4,457
Placements with financial institutions	18,425	-	-	-	-	18,425
Investment securities	-	-	6,572	43,164	88,409	138,145
Inv in associates and joint ventures	-	-	-	-	36,799	36,799
Investment property	-	-	-	9,130	-	9,130
Receivable from investment banking services	2,061	4,077	812	5,354	-	12,304
Short-term financing to project companies	-	6,291	5,309	9,649	-	21,248
Other assets	1,282	30,235	3,040	596	-	35,154
Equipment	-	-	-	-	13,139	13,139
Total assets	26,225	40,603	15,733	67,893	138,347	288,801
Off-balance sheet items						
Restricted investment accounts	196	696	12,000	4,262	-	17,154
Contingent items	-	17,502	9,056	52,260	-	78,818
	26,421	58,801	36,789	124,415	138,347	384,773

Note: There are no dues which are expected to be of longer duration than 5 years.

6 Related party transactions

USD '000

Income statement	Associates and joint ventures	Others	Total
Income from investment banking services	203	758	961
Share of profit/ (loss) of associates and joint ventures	-1,496		-1,496
Impairment allowance	-400		-400
Total related party	-1,693	758	-935

USD '000

Balance sheet	Associates and joint ventures	Others	Total
Investment securities	28,672	22,907	51,579
Investments in associates and joint ventures	36,800	0	36,800
Receivable from investment banking services	439	5,894	6,333
Short term funding to project companies	5,863	6,290	12,154
Other assets	20	22,979	22,999
Total related party	71,794	58,070	129,864

7 Impairment provisions

USD '000

Particulars (USD '000)	Impairment booked in 2010	Impairment booked in prior years	Total impairment recognized	Carrying value
Listed securities in the GCC classified as available for sale (AFS)	0	9,914	9,914	14,170
Investment projects of VC Bank	2,319	6,218	8,538	10,700
Total	2,319	16,132	18,452	24,870

The Bank follows a prudent policy of regularly reviewing all assets for impairment.

Impairment is recognized and charged to the income statement when circumstances indicate that the recoverability of

the asset is in doubt with consequent impairment. The bank does not currently have any collective impairment provision and does not have a significant receivable which are past due.

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8 Unrealized fair value gains

Particulars (USD '000)	USD '000				
	2010	2009	2008	2007	Total
Private Equity investments	-	3,830	3,300	3,108	10,238
Real Estate investments	-	-750	6,500	-	5,750
Venture Capital investments	-	-	-	518	518
Total unrealized fair value gains	-	3,080	9,800	3,626	16,506

Investments which are designated at fair value through income are fair valued at each half year end and the gains / (losses) are recognized in income in accordance with IFRS.

The valuations are performed using internal valuation models applicable to the investments concerned, with market inputs, and reviewed by the Bank's Risk Management team and the external auditors, and are approved by the Board's Finance and Investment Committee before recognition.

9 Concentration Risk to Individual Counterparties

The Bank has a large exposure of USD 66.15 m to one individual counterparty which exceeds 15% of the bank's eligible capital. The excess amount has been deducted from the Bank's eligible capital.

10 Exposures to highly leveraged counterparties

The Bank does not have any exposures to highly leveraged counterparties.

11 Liquidity ratio:	30-Jun-10
	USD'000
Cash at bank	4,457
Placements at bank	18,425
Marketable securities	1,115
Total liquid assets	23,997
Liabilities	9,734
Liquidity ratio	247%

12 Profit margin rate risk management in the Banking Book

As a financial intermediary, VC Bank may encounter profit margin risks that arise from timing differences in the maturity and repricing of the Bank's assets and liabilities.

The table below depicts a profit margin sensitivity analysis in the Bank's banking book, which is not a major source of risk for the Bank.

Position @ 30 June 2010 Repricing Period	Rate Sensitive Assets	Rate Sensitive Liabilities	Gap	USD'000	
				Cumulative Gap	Impact of 200 bp change
1 day	-	-	-	-	-
> 1 day to 3 months	18,425	-	18,425	18,425	368
> 3 months to 6 months	-	-	-	18,425	-
> 6 months to 12 months	8,049	-	8,049	26,474	161
> 1 year to 5 years	-	104	(104)	26,370	(2)
> 5 years	-	-	-	26,370	-

13 Restricted Investments Accounts (RIA) and Displaced Commercial Risk (DCR)

VC Bank's exposure to Displaced Commercial Risk is limited to its Restricted Investment Accounts (RIA) which comprises the following:

i. The GCC Pre IPO Fund, which was set up in 2006 to invest in the shares of unlisted GCC companies in the pre-IPO stage. The total size of the fund is relatively small with funds under investment of approximately USD 4.5 million. The Bank manages the fund as mudarib, in exchange for a fee of 20% of returns over a 10% simple return.

ii. The VC Bank Investment Projects Mudarabah, which was set up in 2009 to provide liquidity financing to selected investment projects of VC Bank. The Mudarabah comprises an investment of USD 12 million on which it earns a return of 7% less the Bank's share of profit as Mudarib of 7% thereof, which is distributed to investors on maturity.

The Bank is aware of its fiduciary responsibilities in management of the RIA investments and has clear policies on discharge of these responsibilities.