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2011

GLOBAL BANKING CORPORATION BSC (c)

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**RISK AND CAPITAL MANAGEMENT  
DISCLOSURES (BASEL II - PILLAR III)**



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## RISK AND CAPITAL MANAGEMENT DISCLOSURES (Basel II PILLAR III)

For the six months period ended 30 June 2011



### 1 INTRODUCTION

These semi-annual disclosures have been prepared in accordance with the Central Bank of Bahrain's (CBB) requirements outlined in the Public Disclosure Module ("PD"), Section PD-3.1.6: Additional Requirements for Semi Annual Disclosures, CBB Rule Book, Volume II for Islamic Banks. These semi-annual quantitative disclosure requirements follow the requirements of Basel II - Pillar 3 and the Islamic Financial Services Board's (IFSB) recommended disclosures for Islamic banks. These disclosures should be read in conjunction with the detailed risk and capital management disclosures made by the Bank in the Annual Report for the year ended 31 December 2010 and interim financial information for the six months period ended 30 June 2011.

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.

### 2 GROUP STRUCTURE

The Group's interim financial information comprises as of 30 June 2011 the financial information of the Bank and its subsidiaries (together the "Group") prepared in accordance with the Financial Accounting Standards ('FAS') issued by the Accounting and Auditing Organization for Islamic Financial Institutions ('AAOIFI').

The Bank started consolidating Diyafa Holdings from December 2010 for regulatory capital purposes as per CBB instructions. Earlier, the Bank was treating the investment in Diyafa Holdings as risk weighted asset.

Following is the structure of the Group's investment in subsidiaries and joint ventures:

Entities	Ownership	Prudential treatment
Global Energy Financial Services Company SPC	100%	Consolidated
Diyafa Holdings W.L.L	90%	Consolidated
Global Real Estate Development Company W.L.L	50%	Risk weighted

All the above entities are incorporated in the Kingdom of Bahrain and there are no restrictions on the transfer of funds or regulatory capital within the Group.

### 3 REGULATORY CAPITAL REQUIREMENTS AND CAPITAL BASE

#### 3.1 CAPITAL ADEQUACY COMPUTATIONS

The prime objective of the Bank's capital management is to ensure compliance with all the prudential requirements and to maintain healthy capital ratios in order to effectively support its business and to maximize shareholders' value.

The Bank's regulator CBB sets and monitors capital requirements for the Bank as a whole (i.e. at a consolidated level). In implementing current capital requirements CBB requires the Bank to maintain a prescribed ratio of 12% of total capital to total risk-weighted assets. Banking operations are categorised as either trading book or banking book, and risk-weighted assets are determined according to specified requirements that seek to reflect the varying levels of risk attached to assets and off-balance sheet exposures. The CBB also requires banks incorporated in Bahrain to maintain a buffer of 0.5 per cent above the minimum capital adequacy ratio.

The Bank was in compliance with the capital limits set by the regulator for the Bank during the six months ended 30 June 2011. The Bank's capital adequacy ratio as at 30 June 2011 was:

*USD '000'*

	<b>Amount</b>
Credit risk weighted assets	211,434
Market risk weighted assets	11,213
Operational risk weighted assets	42,789
<b>Total risk weighted assets</b>	<b>265,436</b>
Eligible capital	121,581
<b>Capital adequacy ratio</b>	<b>45.80%</b>
<b>Tier 1 capital adequacy ratio</b>	<b>45.80%</b>

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### 3.2 CAPITAL BASE

The following table presents the breakdown of the total available capital as at 30 June 2011:

	Tier 1 capital	Tier 2 capital	Total eligible capital
Share capital	200,000	-	200,000
Statutory reserves	5,801	-	5,801
Retained earnings	(50,860)	-	(50,860)
Current interim cumulative net losses	(13,199)	-	(13,199)
	<b>141,742</b>	<b>-</b>	<b>141,742</b>
Excess amount over maximum permitted large exposure limit	(20,161)	-	(20,161)
<b>Total eligible capital</b>	<b>121,581</b>	<b>-</b>	<b>121,581</b>

Regulatory capital consists of Tier 1 capital (core capital) and Tier 2 capital (supplementary capital). Tier 1 comprises share capital, share premium, retained earnings, statutory reserves, current interim cumulative net losses and minority interests less goodwill. Tier 2 capital includes current interim profits and assets revaluation reserves. In accordance with the Central Bank of Bahrain's Basel II capital adequacy framework, any exposure to an individual counterparty which exceeds 15% of the Capital Base of the Bank need to be deducted from the eligible capital of the Bank. The Bank has accordingly deducted USD 20.161 million from its eligible capital, being excess over 15% of the Capital Base invested in a project promoted and managed by the Bank. The Bank had obtained approval of the CBB for this large exposure.

## RISK AND CAPITAL MANAGEMENT DISCLOSURES (Basel II PILLAR III)

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### 3.3 REGULATORY CAPITAL REQUIREMENTS FOR CREDIT RISK

To assess its capital adequacy requirements in accordance with the capital adequacy module for Islamic Banks, the Bank adopts the Standardized Approach for its Credit Risk. According to standardized approach, on and off balance sheet credit exposures are assigned to various defined categories based on the type of counterparty or underlying exposure. The main relevant categories are claims on banks, claims on investment firms, investment in equities, holdings in real estate, claims on corporate portfolio and other assets. Risk Weighted Assets are calculated based on prescribed risk weights by CBB relevant to the standard categories and counterparty's external credit ratings, where available. The Bank uses the ratings of Standard & Poor's, Fitch and Moody's ratings for such counterparties. However, preferential risk weight of 20% is used which is applicable to short term claims on locally incorporated banks where the original maturity of these claims are three months or less and these claims are in Bahraini Dinar or US Dollar.

Following is the analysis of the capital requirements for credit risks:

USD'000'

	Funded exposure	Unfunded exposure	Gross exposure	Risk weighted Assets	Capital requirement
Cash	4	-	4	-	-
Claims on banks	22,617	-	22,617	4,523	543
Claims on Corporates including Takaful Companies & Category 3 Investment Firms	1,797	-	1,797	1,797	216
Investments in Securities and Sukuk	6,331	-	6,331	9,497	1,140
Holding of Real Estate (indirect holding) - Unquoted equities	37,375	-	37,375	74,750	8,970
Holding of Real Estate (direct holding)	62,314	-	62,314	110,740	13,289
Other Assets	10,127	-	10,127	10,127	1,215
	<b>140,565</b>	<b>-</b>	<b>140,565</b>	<b>211,434</b>	<b>25,372</b>

The Bank does not finance its assets using unrestricted investment accounts and hence all credit exposures are self-financed exposures.

The Bank's concentration of funded and unfunded exposures is limited to GCC countries. The unfunded exposure has been considered after use of applicable credit conversion factors.

### 3.4 REGULATORY CAPITAL REQUIREMENTS FOR MARKET RISKS

To assess its capital adequacy requirements in accordance with the CBB capital adequacy module for Islamic Banks, the Bank adopts the Standardized Approach for its Market Risk.

Market risk charge consists of foreign exchange risk and equity position risk charges. Specific market equity risk charge is computed at the rate of 8% on gross equity positions for each country or market. General market equity risk charge is computed based on 8% of the overall net position in each equity market.

Foreign exchange risk charge is computed based on 8% of overall net open foreign currency position of the Bank.

The market risk charge and foreign exchange risk charge is multiplied by 12.5 to evaluate market risk weighted assets.

Following is the computation of market risk charge:

*USD'000'*

	Risk weighted assets			Capital requirement		
	Maximum	Minimum	Closing	Maximum	Minimum	Closing
Foreign Exchange Risk Charge	10,627	10,545	10,627	1,275	1,265	1,275
Equity Position Risk Charge						
Specific	293	291	293	35	35	35
General	293	291	293	35	35	35
	<b>11,213</b>	<b>11,127</b>	<b>11,213</b>	<b>1,346</b>	<b>1,335</b>	<b>1,346</b>

## RISK AND CAPITAL MANAGEMENT DISCLOSURES (Basel II PILLAR III)

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### 3.5 REGULATORY CAPITAL REQUIREMENTS FOR OPERATIONAL RISK

The Bank adopts the Basic Indicator Approach to evaluate Operational Risk Charge in accordance with the CBB capital adequacy module for Islamic Banks. According to this approach, Bank's average gross income for three past financial years is multiplied by a fixed coefficient alpha which is 15% set by CBB. The Bank has calculated the operational risk charge based on the audited results for the years 2008, 2009 and 2010.

The operational risk charge is multiplied by 12.5 to evaluate operational risk weighted assets.

The Bank's Operational risk weighted assets and operation capital requirement as at 30 June 2011 under standardised approach was:

	<i>USD '000'</i>
	Amount
Gross income (average of three years)	22,821
Operational Risk Weighted Assets	42,789
<b>Capital Requirement (12%)</b>	<b>5,135</b>

## RISK AND CAPITAL MANAGEMENT DISCLOSURES (Basel II PILLAR III)

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### 4 QUANTITATIVE DISCLOSURES FOR CREDIT RISK

#### 4.1 GROSS CREDIT EXPOSURES

The gross and average gross credit exposure are as follows:

	<i>USD'000'</i>	
	Gross credit exposure	Average credit exposure
<b>On balance sheet items:</b>		
Bank balances	77	58
Placements with financial institutions	22,540	29,525
Available for sale investments	57,535	57,483
Investments designated for fair value through profit and loss	5,027	5,106
Investment in a joint venture	1,304	1,380
Other assets	1,815	1,932
	<b>88,298</b>	<b>95,484</b>

The average balances are based on month end average balances during the period from January 2011 to June 2011.

#### 4.2 INDUSTRY CONCENTRATION

The industry concentration of credit exposures are as follows:

	Financial institutions	Real estate and construction	Others	Total
<b>On balance sheet items:</b>				
Bank balances	77	-	-	77
Placements with financial and other institutions	22,540	-	-	22,540
Available for sale investments	-	57,535	-	57,535
profit and loss	-	-	5,027	5,027
Investment in a joint venture	-	466	838	1,304
Other assets	16	240	1,559	1,815
	<b>22,633</b>	<b>58,241</b>	<b>7,424</b>	<b>88,298</b>

#### 4.3 GEOGRAPHIC CONCENTRATION

The Bank's concentration exposure as at 30 June 2011 is limited to GCC countries.

## RISK AND CAPITAL MANAGEMENT DISCLOSURES (Basel II PILLAR III)

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### 4.4 CREDIT EXPOSURE BY INTERNAL RATING

The analysis of credit exposures by internal rating is as follows:

	Rating A to B	Rating C to E	Rating F (Unrated)	USD'000' Total
<b>On balance sheet items:</b>				
Financial institutions	22,598	19	16	22,633
Corporates	-	-	65,665	65,665
	<b>22,598</b>	<b>19</b>	<b>65,681</b>	<b>88,298</b>

### 4.5 CREDIT EXPOSURE BY RESIDUAL MATURITY

The analysis of credit exposures by residual maturity is as follows:

	Upto 3 Months	3 months to 6 Months	6 months to 1 year	1 year to 3 years	Over 3 years	Total
<b>On balance sheet items:</b>						
Bank balances	77	-	-	-	-	77
Placements with financial institutions	22,540	-	-	-	-	22,540
Available for sale investment	-	-	-	57,535	-	57,535
Investment designated for fair value through profit and loss	5,027	-	-	-	-	5,027
Investment in a joint venture	-	-	-	1,304	-	1,304
Other assets	894	659	-	262	-	1,815
	<b>28,538</b>	<b>659</b>	<b>-</b>	<b>59,101</b>	<b>-</b>	<b>88,298</b>

### 4.6 RESTRUCTURED/ RENEGOTIATED EXPOSURES

The Bank did not restructure or renegotiate any exposures as at 30 June 2011.

### 4.7 EXPOSURE ON HIGHLY LEVERAGED COUNTERPARTIES

The Bank has no exposure to highly leveraged and other high risk counterparties as per definition provided in the CBB rule book PD 1.3.24.

### 4.8 RELATED PARTY TRANSACTIONS

Related counterparties are those entities which are connected to the Bank through significant shareholding or control or both. The Bank has entered into business transactions with such counterparties, and all such transactions have been done on commercial terms that bring no disadvantage to the Bank.

**RISK AND CAPITAL MANAGEMENT DISCLOSURES  
(Basel II PILLAR III)**

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Transactions with related parties during the six months period ended 30 June 2011 and balances outstanding pertaining to related parties as at 30 June 2011 is as follows:

*USD '000'*

	<b>As at 30 June 2011</b>
<b>Assets / Transactions</b>	
Available-for-sale investments	52,023
Investment in a joint venture	1,304
Other assets	435

*USD '000'*

	<b>Six months ended 30 June 2011</b>
<b>Income</b>	
Rental income from investment property	250
Share of profit/(loss) from joint ventures	(134)
Other income	38

Please refer to 30 June 2011 Interim Financial Information for further details.

**4.9 EXPOSURE IN EXCESS OF 15% OF CAPITAL BASE**

The Bank has an investment exposure to one of its real estate development projects (non-financial institution) of USD 41.422 million which is in excess of the single exposure limit. The large exposure has been approved by the CBB. The Bank has deducted USD 20.161 million being excess exposure over the permissible 15% of capital base. Additionally, the Bank has restricted investment account exposure amounting to USD190 million in relation to a project promoted by the Bank and the exposure was part of the overall investment structure.

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### 4.10 ASSETS QUALITY AND PAST DUE EXPOSURES

The analysis of asset quality and past due exposures are as follows:

USD'000'

	Banks and Financial institutions	Others financial assets
Neither past due nor impaired	22,617	48,558
Past due but not impaired	-	-
Individually impaired	-	45,184
	<b>22,617</b>	<b>93,742</b>

### 4.11 COUNTERPARTY CREDIT RISK

Counterparty credit risk is the risk that a counterparty to a contract in the profit rate, foreign exchange, equity and credit markets defaults prior to maturity of the contract. The Bank does not enter into any trading positions in foreign exchange contracts and also does not engage in proprietary trading of foreign exchange or profit rate derivatives. For other credit markets transactions (primarily inter-bank placements), the Bank has established a limit structure based on the credit quality (assessed based on external rating) of each counter party bank to avoid concentration of risks by counterparties. The Bank is constantly reviewing and monitoring the position to ensure proper adherence to the limits and defined policies of the Bank.

## RISK AND CAPITAL MANAGEMENT DISCLOSURES (Basel II PILLAR III)

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### 5 QUANTITATIVE DISCLOSURES FOR MARKET RISKS

#### 5.1 PROFIT RATE RISK

The group's profit rate sensitive assets are mainly placements with financial institutions. The effective profit rate on the profit bearing financial instruments is given below:

	% p.a
<b>Assets</b>	
Placement with financial institutions	1.01
<b>Liabilities</b>	
Bank financing	1.87
Investors' funds	0.71

An analysis of the Group's sensitivity to an increase or decrease in market financing rates (assuming no asymmetrical movement in yield curves and a constant balance sheet position) by 100 / 200 basis points is as follows:

	USD '000'	
	Amount	Amount
	100 bps	200 bps
As at 30 June 2011	127	254
Average for the period	169	338
Maximum for the period	225	450
Minimum for the period	127	254

#### 5.2 EQUITY POSITION RISK IN THE BANKING BOOKS

	USD '000'
Unquoted equities	57,535
Managed Funds	5,027

The Bank has recognized loss of USD 0.106 million for the six months ended 30 June 2011 on securities designated as fair value through profit and loss securities which is included in Tier 1 Capital.

## RISK AND CAPITAL MANAGEMENT DISCLOSURES (Basel II PILLAR III)

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### 6 RESTRICTED INVESTMENT ACCOUNTS

The Bank has only one restricted investment account exposure amounting to USD 190 million; in relation to a project promoted by the Bank. Historically, no distributions has been made with respect to the restricted investment account.

### 7 OTHER DISCLOSURES - LIQUIDITY RISK

The following are the key liquidity ratios which reflect the liquidity position of the Bank as at 30 June 2011.

#### 7.1 LIQUIDITY RATIOS

Liquid assets as a percentage of total assets (%)	17.17%
Liquid assets to liquid liabilities (ratio)	2.26

#### 7.2 MATURITY ANALYSIS

Maturity analysis of financing and funding categories is as follows.

USD'000'

	Upto 3 Months	Over 3 months to 6 Months	Over 6 months to 1 year	Over 1 year to 3 years	Over 3 years	Total
<b>On balance sheet items:</b>						
Investors' funds	-	3,131	-	-	-	3,131
Bank financing	3,412	3,383	3,350	-	-	10,145
Other liabilities	1,991	-	-	3,950	-	5,941
	<b>5,403</b>	<b>6,514</b>	<b>3,350</b>	<b>3,950</b>	<b>-</b>	<b>19,217</b>
<b>Off balance sheet items:</b>						
Restricted investment accounts	-	190,000	-	-	-	190,000
	<b>5,403</b>	<b>196,514</b>	<b>3,350</b>	<b>3,950</b>	<b>-</b>	<b>209,217</b>

The maturity of the bank financing is on gross undiscounted contractual basis and the maturities of other liabilities are based on expected cash flow basis.