

**VENTURE CAPITAL BANK B.S.C. (c) (“the Bank”)**

**Additional Public Disclosures  
31 December 2016**

# **VENTURE CAPITAL BANK B.S.C. (c) (“the Bank”)**

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## **Pillar 3 Disclosures – 31 December 2016**

### **1 Introduction**

These disclosures have been prepared in accordance with the Central Bank of Bahrain’s (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 III and the Islamic Financial Services Board’s (IFSB) recommended disclosures for Islamic banks, and should be read in conjunction with the disclosures made in the Bank’s reviewed financial statements for the half year ended 31 December 2016.

These disclosures, also referred to as "Pillar 3" disclosures are designed to promote market discipline and transparency by providing information on a firm’s risk exposures and risk management processes. The Bank makes these disclosures on a comprehensive basis comprising qualitative and quantitative information annually and on a restricted basis at the half year reporting stage.

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 31 December 2016, the Bank’s total risk weighted assets amounted to US\$ 1,224 million; Common Equity, Tier 1 Capital and total regulatory capital amounted to US\$ 202.0 million, US\$ 202.0 million and US\$ 203.4 million respectively. Accordingly, Common Equity Ratio, Tier 1 Capital Adequacy Ratio and total Capital Adequacy Ratio was 16.51%, 16.51% and 16.62% respectively, which exceeds the minimum capital requirement of the CBB of 12.5%.

### **2 Capital Structure**

#### **2.1 Capital Base**

The authorized share capital of the Bank is US\$ 500 million, comprising 500 million common shares of US\$ 1 each. The Bank’s current paid up capital is US\$ 190 million held by 172 shareholders from the GCC.

# VENTURE CAPITAL BANK B.S.C. (c) (“the Bank”)

## Pillar 3 Disclosures – 31 December 2016

### 2 Capital Structure

#### 2.2 Group structure:

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

<u>Subsidiary</u>	<u>Country</u>	<u>Capital</u>	<u>Percentage interest</u>
Gulf Projects Company W.L.L	Kingdom of Bahrain	BHD 1,000,000	100%
The Lounge Serviced Offices Co. W.L.L	Kingdom of Bahrain	BHD 20,000	100%

#### 2.3 Review of financial performance:

The Bank commenced operations in October 2005 and achieved excellent returns in its initial years. The results for 2010 and 2011 were unfortunately affected by the regional market turmoil, as a consequence of which significant impairment provisions and fair value losses were recorded resulting in significant net losses for 2010 and 2011. In the following years, the Bank witnessed a turnaround registering net profits of US\$ 21.1 million for the 18 month period ended 30 June 2013, and US\$ 14.59 million, US\$ 14.06 million, and US\$ 9.28 million for the years ended 30 June 2014, 2015 and 2016 respectively. However the current half year ended 31 December 2016 has been affected by major asset impairment losses resulting in a net loss of US\$ 22.3 million for the half year.

<u>Particulars</u>	<u>December 2016</u>	<u>June 2016</u>	<u>June 2015</u>	<u>June 2014</u>	<u>June 2013 (18 mths)</u>	<u>December 2012</u>	<u>December 2011</u>
Net profit (US\$ m)	(22.57)	9.28	14.06	14.59	21.15	18.51	(58.67)
ROC (return on paid up capital)	-11.9%	4.9%	7.8%	8.1%	5.5%	7.2%	-22.9%
Head count	52	50	49	45	45	42	66
Total investments / total assets	63%	65%	76%	70%	75%	76%	76%
Leverage (total liabilities / total equity)	56.0%	49.0%	14.4%	15%	11%	6%	10%
Retained earnings / paid up capital	3%	15%	19%	17%	-22%	-23%	-30%

As shown by the consolidated financial statements, income from investment banking services is the main contributor to net income. The Bank’s investment team are working on a pipeline of deals which are expected to grow fiduciary assets under management and thereby increase the proportion of recurring income from management fees.

**2 Capital Structure (continued)**Capital Adequacy

- 2.4 The Bank’s capital adequacy management program ensures that the Bank not only complies with regulatory capital requirements, but also continues to maintain a strong capital base to support its business.
- 2.5 The Bank utilises a risk adjusted measure of capital adequacy (i.e. Capital Adequacy Ratio or “CAR”) based on the regulatory regime implemented by the CBB that is consistent with the Basel III guidelines issued by the Basel Committee on Banking Supervision’s International Convergence of Capital Measurement and Capital Standards.
- 2.6 Effective January 2015, the CBB has required all Bahrain banking institutions to implement the Basel III guidelines for the maintenance of minimum level of capital calculated for three major components of risk exposures i.e. credit risk (including investment risks), operational risk and market risk, plus minimum leverage and liquidity coverage ratios.
- 2.7 The Bank uses the Standardised Approach to quantify its credit and market risk weighted exposures and the Basic Indicator Approach for operational risk.
- a. Credit risk weighted exposures may be calculated in three different methods of varying degrees of sophistication, namely the Standardized Approach, Foundation Internal Rating Based Approach and Advanced Internal Rating Based Approach. The Bank has adopted the Standardized Approach for credit risk measurement, which uses fixed risk weights for different categories of credit risk.
  - b. Market risk weighted exposures may be quantified using the Standardized Approach, which uses fixed capital charges for specific categories of market risk, or the Internal Models Approach subject to prior approval by CBB. The Bank uses the Standardized Approach for market risk measurement.
  - c. For operational risk, there are three different approaches - Basic Indicator Approach, Standardized Approach, and Advanced Measurement Approach. The Bank uses the Basic Indicator Approach, which uses the average of the gross income for the past three years as a basis for the calculation of capital charge for operational risk.
- 2.8 In determining CAR, the Bank calculates its risk adjusted assets, which are then expressed as a factor of regulatory eligible capital rather than the equity capital appearing in the Bank’s statement of financial position. Regulatory capital is composed of three elements:
- a. Common Equity Tier 1 Capital which is the nominal value of paid in capital, audited retained earnings and accumulated reserves arising from the appropriation of current and past years’ income and/or retained earnings less treasury stock, minority interests and negative fair value reserves. Local regulations also require that certain investments or exposures should be deducted from Tier 1 capital.
  - b. Additional Tier 1 Capital, which consists of the qualifying portion of minority interests in consolidated entities given recognition.
  - c. Tier 2 Capital, which consists of the qualifying portion of subordinated loans (nil in VCB’s case) and general loss provisions. Under the CBB regulations, the aggregate amount of Tier 2 capital eligible for inclusion in the CAR is limited to no more than 100% of Tier 1 Capital.
- 2.9 As the Bank has no operating branches outside the Kingdom of Bahrain, it is subject only to the capital requirements of the CBB, which currently requires all financial institutions in Bahrain to maintain a 12.5% minimum CAR.
- 2.10 The Bank’s capital adequacy position is reviewed and stress tested regularly for various scenarios given the nature of the Bank’s investments in alternative assets. Prudential Returns on the Bank’s capital adequacy are filed quarterly with the CBB and reviewed by the external auditors.
- 2.11 During the period ended 31 December 2016, the Bank continued the development and enhancement of its risk management and internal capital adequacy assessment framework.
- 2.12 As a further step in mitigating risks, the Bank follows a policy of diversification in its activities and seeks to minimize the risk exposure to particular geographical regions, counterparties, instruments and types of business.

**VENTURE CAPITAL BANK B.S.C. (c) (“the Bank”)****Pillar 3 Disclosures – 31 December 2016****2 Capital Structure (continued)**2.13 Capital Adequacy (continued)

The quantitative details of the Bank’s regulatory capital are depicted in the following tables:

Table 1: Regulatory Eligible Capital as at 31 December 2016

<b>CAPITAL COMPONENTS - CONSOLIDATED</b>	USD '000		
	<b>CET 1</b>	<b>AT1</b>	<b>T2</b>
<b>Tier 1 Capital</b>			
<b>Common Equity Tier 1 (CET1)</b>			
Issued and fully paid ordinary shares	190,000		
Legal / statutory reserves	5,859		
Retained profit brought forward	28,562		
Current interim cumulative net income / losses	(22,566)		
Accumulated other comprehensive income and losses (and other reserves)	(69)		
<b>Total CET1 capital before minority interest</b>	<b>201,786</b>		
<b>Total Common Equity Tier 1 capital</b>	<b>201,786</b>		
<b>Other Capital (AT1 &amp; T 2)</b>			
General financing loss provisions		-	1,362
<b>Total Available AT1 &amp; T2 Capital</b>		<b>-</b>	<b>1,362</b>
<b>Net Available Capital</b>	<b>201,786</b>	<b>-</b>	<b>1,362</b>
<b>Total Tier 1</b>		<b>201,786</b>	
<b>Total Available Capital</b>			<b>203,149</b>
<b>Reconciliation with audited financial statements:</b>			
<b>Shareholder's equity per audited financial statements</b>			<b>201,786</b>
Add: Collective impairment provisions			1,362
<b>Total available capital for regulatory purposes</b>			<b>203,149</b>

# VENTURE CAPITAL BANK B.S.C. (c) (“the Bank”)

## Pillar 3 Disclosures – 31 December 2016

### 2 Capital Structure (continued)

#### 2.13 Capital Adequacy (continued)

Table 2: Details of exposures and capital requirement

Details of exposures and capital requirement			USD '000
	Gross exposures	Risk weighted exposures	Capital charge
<b>Credit risk:</b>			
Total Claims on Banks	7,355	1,565	188
Other Corporates Including Category 3 Investment Firms - (net of CRM)	67,845	67,845	8,141
Equity Investments			
Investments in listed equities in banking book	6,219	6,219	746
Investments in unlisted equities in banking book	60,747	91,120	10,934
Significant investment in the common shares of financial entities >10%	14,898	37,245	4,469
Significant investment in the common shares of Commercial Entities	57,176	457,411	54,889
other investment with excess amount over 15%	35,988	287,908	34,549
Premises occupied by the bank	9,210	9,210	1,105
Holding of Real Estate - Others	78,877	157,755	18,931
Other exposures	21,857	21,857	2,623
Total credit risk exposure under standardized approach	<b>360,174</b>	<b>1,138,134</b>	<b>136,576</b>
<b>Market risk:</b>			
Trading equities position	4,935	9,869	1,184
Foreign exchange position	22,074	22,074	2,649
Total market risk under standardized approach	<b>27,009</b>	<b>31,943</b>	<b>3,833</b>
Operational risk under Basic Indicator Approach (ref. below)		<b>52,143</b>	<b>6,257</b>
<b>Total</b>		<b>1,222,221</b>	<b>146,666</b>
<b>Total eligible capital - (Tier 1 + Tier 2)</b>		<b>203,149</b>	
<b>Total eligible capital - Tier 1</b>		<b>201,786</b>	
<b>Common Equity Tier 1</b>		<b>201,786</b>	
<b>Total Capital Adequacy Ratio (Tier 1 + Tier 2)</b>		<b>16.62%</b>	
<b>Tier 1 Capital Adequacy Ratio</b>		<b>16.51%</b>	
<b>Common Equity Tier 1 Ratio</b>		<b>16.51%</b>	
<b>Capital requirement for Operational Risk</b>			
<b>(Basic Indicator Approach)</b>			
	USD '000		
	<b>2016</b>	<b>2015</b>	<b>2014</b>
Gross income for prior three years	26,846	28,072	28,511
Average of past 3 years gross income (excl. loss years)	27,810		
Capital requirement for Operational Risk (15%)	4,171		
<b>Risk weighted exposure for Operational Risk</b>	<b>52,143</b>		
<b>Total gains / (losses) on investments:</b>			
	USD '000		
Unrealised fair value gains (losses) recognized in the statement of income	(15,340)		
Unrealised fair value gains / (losses) recognized in equity during the year	75		

## VENTURE CAPITAL BANK B.S.C. (c) (“the Bank”)

### Pillar 3 Disclosures – 31 December 2016

#### 2 Capital Structure (continued)

##### 2.13 Capital Adequacy (continued)

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

Table 3 – Details of market risk weighted exposures

Particulars	USD '000										
	31-Dec-16	30-Jun-16	30-Jun-15	31-Mar-15	31-Dec-14	30-Sep-14	30-Jun-14	31-Mar-14	31-Dec-13	Maximum	Minimum
<b>Market risk exposures</b>											
Listed equities held for trading	4,935	5,038	2,816	3,008	1,104	907	897	880	115	5,038	115
Foreign currency exposure*	22,074	24,077	73,851	77,233	72,894	79,897	76,013	65,256	78,887	79,897	22,074
<b>Market risk charge</b>											
Listed equities held for trading	790	806	451	481	177	145	143	141	18	806	18
Foreign currency exposure	1,766	1,926	5,908	6,179	5,832	6,392	6,081	5,220	6,311	6,392	1,766
Total market risk charge	2,555	2,732	6,359	6,660	6,008	6,537	6,225	5,361	6,329	7,198	1,784
<b>Market risk weighted exposure</b>											
Listed equities held for trading	9,869	10,076	5,633	6,017	2,207	1,813	1,793	1,761	230	10,076	230
Foreign currency exposure	22,074	24,077	73,851	77,233	72,894	79,897	76,013	65,256	78,887	79,897	22,074
<b>Total market risk weighted exposure</b>	<b>31,943</b>	<b>34,153</b>	<b>79,484</b>	<b>83,250</b>	<b>75,101</b>	<b>81,710</b>	<b>77,806</b>	<b>67,017</b>	<b>79,117</b>	<b>83,250</b>	<b>31,943</b>

Table 4 – Details of credit risk weight on Islamic financing contracts at 31 December 2016, which is representative of the average exposure during the year:

Asset Categories for Credit Risk	USD '000	
	Credit Exposure	Credit Risk Weighted Assets
Commodity murabaha to projects	37,356	37,356
Profit free funding to projects	1,732	3,464
<b>Total Islamic Financing Contracts</b>	<b>39,088</b>	<b>40,820</b>

# VENTURE CAPITAL BANK B.S.C. (c) (“the Bank”)

## Pillar 3 Disclosures – 31 December 2016

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### 3 Risk Management

#### Risk Governance Structure

- 3.1 As an Islamic investment bank dealing predominantly in alternative assets, the Bank is exposed to various risks in the normal course of its business. These risks include:
- a. Credit and counterparty credit risk
  - b. Market risk
  - c. Operational risk
  - d. Equity risk in the Banking Book (Investment Risk)
  - e. Liquidity risk
  - f. Profit margin rate risk in the Banking Book
  - g. Displaced Commercial Risk (DCR)
- 3.2 An understanding of and transparency in risk-taking are key elements in the Bank's business strategy. The Bank maintains a prudent and disciplined approach towards risk taking, and embeds a structured risk management process as an integral part of its decision making practice. This risk management process, which is applicable to the various risks the Bank is exposed to, is divided into three key components comprising the following:
- a. Risk Identification and Measurement
    - i. Procedures for the identification and quantification of risks
    - ii. The use of quantitative models and qualitative approaches to assess and manage risks
  - b. Risk Control
    - i. Clearly defined risk exposure limits
    - ii. Criteria for risk acceptance based on risk and return as well as other factors
    - iii. Portfolio diversification and, where possible, other risk mitigation techniques
    - iv. Robust operating policies and procedures
    - v. Appropriate Board Committee's authorization and approval for investment transactions
  - c. Risk Monitoring and Reporting
    - i. Ongoing review of exposures and risks by Risk Management Department, including stress testing and frequent reporting to the Board
    - ii. Periodic internal audits of the Bank's control environment
- 3.3 The Bank's Board of Directors through its Risk Committee (a subcommittee of the Board of Directors) has the responsibility for ensuring the establishment and effective implementation of an integrated risk management framework for the Bank. Further, the Risk Management Department which reports to the Board Risk Committee is empowered to independently identify and assess risks that may arise from the Bank's investing and operating activities; and recommend to the Executive Management Committee any prevention and mitigation measures as it deems fit. In addition, the Internal Audit Department, which is independent of both operations and the Bank's investments units, also assists in the risk management process. In particular, the Internal Audit Department is charged with a periodic review of the effectiveness of the Bank's policies and internal controls, including those relating to the risk management process.

## VENTURE CAPITAL BANK B.S.C. (c) (“the Bank”)

### Pillar 3 Disclosures – 31 December 2016

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#### 3 Risk Management (continued)

- 3.4 The Internal Audit Department adopts a risk-based audit approach whereby the nature, timing and extent of the audits are determined with regard to the risk relevant to each business or support unit of the Bank. A risk assessment is carried out annually to determine the major risks faced by each business or support unit and accordingly, an annual audit plan is prepared by the Internal Audit Department and approved by the Board’s Audit Committee. The annual plan envisages the coverage, amongst others, of the Risk Management and Compliance Departments.

Detailed operational risk assessments and tests of effectiveness of internal controls designed to mitigate risks (covering each of the risk components as mentioned above) are carried out in accordance with the annual audit plan. A follow up audit to ascertain the status of implementation of observations previously made by internal or external audit is also part of the annual audit plan.

The key findings arising from the work performed by Internal Audit is reported to the Board Audit Committee and senior management of the Bank.

#### Credit and Counterparty Credit Risk Management (PD 1.3.22 + 1.3.26)

- 3.5 Credit risk is defined as the potential that a borrower or counterparty will fail to meet its obligations in accordance with agreed terms.
- 3.6 The Bank is not involved in the granting of credit facilities in the normal course of its business activities. Further, the Bank is not engaged in retail business and therefore does not use credit “scoring” models.
- 3.7 The credit risk exposures faced by the Bank are principally in respect of its own short term 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 specific provisions made where necessary having regard to the nature of the exposure and the assessment of collection. Additionally, a collective impairment provision is also recorded to reflect general market risks and negative market conditions. As at 31 December 2016, the total collective impairment provision stood at US\$ 1.36 million.
- 3.8 The Bank uses the Standardized Approach for measuring its credit risk. As it does not use an internal credit “scoring” system, the Bank depends, where available, on ratings from External Credit Assessment Institutions recognized by the CBB for its bank counterparty exposures. As at 31 December 2016 bank balances totalling US\$ 312.8 thousand were rated as “ECAI 3 (BBB+ to BBB-)” based on ratings issued by Moody’s - resulting in a risk weight of 50%. In the absence of an external rating – e.g. in the case of an investee company, a detailed credit risk assessment of the obligor is performed by the investment team and independently reviewed by the Risk Management Department. The Bank does not have any credit exposure to “highly leveraged institutions”.
- 3.9 All lines of counterparty credit limits are subject to annual reaffirmation by the Board of Directors. The limits are also reviewed frequently to ensure consistency with the Bank’s investment strategies and to take into account the latest market developments. Given the nature of the Bank’s business, the Bank uses nominal balance sheet amounts including accrued interest and other receivables as its measure of exposure. Overall, the Bank’s management considers that its policies and procedures constitute a reasonable approach to managing the credit risk in the activities it is engaged in.

## VENTURE CAPITAL BANK B.S.C. (c) (“the Bank”)

### Pillar 3 Disclosures – 31 December 2016

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#### 3 Risk Management (continued)

##### Securitisation

- 3.10 The Bank does not generally undertake or participate in securitization activities in relation to credit synthesis, acting as a sponsor, liquidity facility provider, credit enhancement facility provider, swap provider nor have any of its assets securitized and therefore has no recourse obligations under such transactions as defined by the Financial Stability Task Force.

However, the Bank has structured and arranged certain “Liquidity Programs” which has raised funds through the issuance of Shari’ah compliant one year liquidity instruments with early redemption options of 30 days, 90 days and 180 days with attractive yields. These are backed by the rental yields of the VC Bank Building, a prime commercial property in the Diplomatic Area of the Kingdom of Bahrain, and of the Jebel Ali Labour Housing Complex in Jebel Ali, United Arab Emirates.

##### Off-Balance Sheet Items

- 3.11 The Bank’s off-balance sheet items comprise:
- a. Contingent exposure of US\$ **23.06** million (30 June 2016: US\$ 22.47 million) associated with the issuance of guarantees for investment related funding made by financial institutions to the Bank’s investment projects. Since these may expire without being drawn upon, the total contract amounts do not necessarily represent future cash requirements;
  - b. Commitments to finance and invest of US\$ **13.44** million (30 June 2016: US\$ 16.01 million; and
  - c. Restricted investment accounts of US\$ **3.52** million (30 June 2016: US\$ 3.76 million) (refer to statement of changes in off-balance equity of investment account holders to the financial statements).

##### Concentration Risk

- 3.12 Concentration of risks arises when a number of obligors, counterparties or investees are engaged in similar business activities or activities in the same geographic region or have similar economic features that would cause their ability to meet contractual obligations to be similarly affected by changes in economic, political or other conditions. Accordingly, such concentrations indicate the relative sensitivity of the Bank’s performance to developments affecting a particular industry or region.
- 3.13 The Bank has established limits based on geographic regions and industry sectors. The Bank’s Large Exposure Policy details the Bank’s exposure limits and is in compliance with the concentration limits laid down by the CBB.

## VENTURE CAPITAL BANK B.S.C. (c) (“the Bank”)

### Pillar 3 Disclosures – 31 December 2016

#### 3 Risk Management (continued)

3.14 The quantitative details of the Bank’s credit risk exposures are depicted in the following tables, which are representative of the position during the period and, accordingly, of the average exposures:

a. *Table 5: Distribution of the Bank’s exposures by geographic sector as at 31 December 2016*

#### Distribution of Bank’s exposures by geographic sector

	USD '000					
Geographic sector	GCC countries	Other MENA countries	Europe	Cayman / Americas	Global	Total
<b>Assets</b>						
Balances and placements with banks	9,147	-	-	-	-	9,147
Investments	98,183	60,890	6,112	1,289	5,829	172,303
Investment in associates and joint venture accounted under the equity method	25,949	1,105	-	-	-	27,054
Murabaha financing to investee companies	-	-	2,606	-	34,750	37,356
Receivables	14,833	18,394	1,000	1,585	-	35,812
Funding to project companies	1,056	-	-	-	-	1,056
Other assets	9,983	5,594	1,216	6,767	291	23,851
Property and equipment	8,240	-	-	-	-	8,240
<b>Total assets</b>	<b>167,391</b>	<b>85,983</b>	<b>10,934</b>	<b>9,641</b>	<b>40,870</b>	<b>314,819</b>
<b>Off statement of financial position items</b>						
Equity of investment account holders	3,524	-	-	-	-	3,524
Commitments and contingencies	18,138	18,362	-	-	-	36,500
	<b>189,053</b>	<b>104,345</b>	<b>10,934</b>	<b>9,641</b>	<b>40,870</b>	<b>354,843</b>

Note: Allocation of the Bank’s exposures is based on the asset’s country of risk.

## VENTURE CAPITAL BANK B.S.C. (c) (“the Bank”)

Pillar 3 Disclosures – 31 December 2016

### 3 Risk Management (continued)

3.14 The quantitative details of the Bank's credit risk exposures are depicted in the following tables, which are representative of the position during the period and, accordingly, of the average exposures: (continued)

b. Table 6: Distribution of the Bank's exposures by Industry Sector as at 31 December 2016

#### Distribution of Bank's exposures by industry sector

USD'000

Industry sector	Trading & manufacturing	Banks & financial Inst.	Real estate related	Oil and Gas	Health Care	Technology	Shipping	Others	Total
<b>Assets</b>									
Balances and placements with banks	-	9,147	-	-	-	-	-	-	9,147
Investments	24,032	16,749	48,521	8,489	18,948	1,774	5,829	47,959	172,304
Investment in associates and joint ventures accounted under the equity method	-	-	24,709	-	-	-	-	2,345	27,054
Murabaha financing to an investee companies	-	-	2,606	-	-	-	34,750	-	37,356
Receivables	11	40	3,625	80	174	19	-	31,863	35,812
Funding to project companies	-	-	369	-	-	-	-	686	1,055
Other assets	5,417	37	8,690	19	16	296	-	9,377	23,852
Property and equipment	-	-	7,731	-	-	-	-	509	8,240
<b>Total Assets</b>	<b>29,460</b>	<b>26,500</b>	<b>96,251</b>	<b>8,588</b>	<b>19,138</b>	<b>2,089</b>	<b>40,579</b>	<b>92,738</b>	<b>314,819</b>
<b>Off statement of financial position items</b>									
Equity of investment account holders	-	3,099	-	-	-	-	-	425	3,524
Commitments and contingencies	18,362	10,000	7,040	-	1,098	-	-	-	36,500
	<b>47,822</b>	<b>39,599</b>	<b>103,291</b>	<b>8,588</b>	<b>20,236</b>	<b>2,089</b>	<b>40,579</b>	<b>93,163</b>	<b>354,843</b>

## VENTURE CAPITAL BANK B.S.C. (c) (“the Bank”)

Pillar 3 Disclosures – 31 December 2016

### 3 Risk Management (continued)

3.14 The quantitative details of the Bank's credit risk exposures are depicted in the following tables, which are representative of the position during the period and, accordingly, of the average exposures: (continued)

c. *Table 7: Exposures by maturity as at 31 December 2016*

#### Distribution of Bank's exposures by maturity

USD '000

Maturity-wise exposures	No fixed maturity	Up to 3 months	3 to 6 months	6 months to 1 year	Total up to 1 year	1 to 3 years	Over 3 years	Total
<b>Assets</b>								
Balances and placements with banks	8,620	527	-	-	527	-	-	9,147
Investments	163,322	1,900	-	7,080	8,980	-	-	172,302
Investment in associates and joint ventures	27,054	-	-	-	-	-	-	27,054
Murabaha financing to an investee companies	-	2,606	-	-	2,606	-	34,750	37,356
Receivables	-	11,380	20,030	-	31,410	4,402	-	35,812
Funding to project companies	686	-	-	-	-	369	-	1,055
Other assets	1,074	18,619	4,093	(50)	22,662	107	10	23,853
Property and equipment	8,240	-	-	-	-	-	-	8,240
<b>Total assets</b>	<b>208,996</b>	<b>35,559</b>	<b>24,123</b>	<b>7,030</b>	<b>66,712</b>	<b>4,878</b>	<b>34,760</b>	<b>314,819</b>
<b>Off statement of financial position items</b>								
Equity of investment account holders	2	-	-	-	-	3,522	-	3,524
Commitments and contingencies	36,501	-	-	-	-	-	-	36,501
	<b>245,499</b>	<b>35,559</b>	<b>24,123</b>	<b>7,030</b>	<b>66,712</b>	<b>8,400</b>	<b>34,760</b>	<b>354,843</b>

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

## VENTURE CAPITAL BANK B.S.C. (c) ("the Bank")

Pillar 3 Disclosures – 31 December 2016

### 3 Risk Management (continued)

3.14 The quantitative details of the Bank's credit risk exposures are depicted in the following tables, which are representative of the position during the period and, accordingly, of the average exposures:

d. Related party transactions:

In the ordinary course of its business the Bank enters into transactions with related parties which are at an arm's length and approved by management. The following table gives an analysis of related party transactions and balances:

Table 8: RELATED PARTY TRANSACTIONS as at 31 December 2016

RELATED PARTY TRANSACTIONS	USD '000			
	Associates and joint venture	Board members/ key management personnel/ Shari'a board members/ external auditors	Significant shareholders / entities in which directors are interested	Total
<b>Assets</b>				
Balances with banks	-	-	430	430
Placements with financial institutions	-	-	527	527
Investments	28,815	-	12,234	41,049
Investments in associates and joint venture	27,054	-	-	27,054
Other assets	5,414	-	718	6,132
<b>Liabilities</b>				
Employee accruals	-	803	-	803
Other liabilities	-	-	336	336
<b>Income</b>				
Share of loss of associates and joint venture accounted for using the equity method	(402)	-	-	(402)
Other income	-	-	751	751
<b>Expenses (excluding compensation for key management personnel)</b>				
Impairment allowances against receivables	1,182	-	-	1,182
Commitments and contingencies	20,829	-	-	20,829

## **VENTURE CAPITAL BANK B.S.C. (c) (“the Bank”)**

Pillar 3 Disclosures – 31 December 2016

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### **3 Risk Management (continued)**

#### Market Risk Management

3.15 Market risk is defined as the risk of losses in the Bank's on and off Balance sheet positions arising from movements in market prices. These risks include:

- a. Those pertaining to profit-rate related instruments and equities in the trading book.
- b. Foreign exchange and commodities risk throughout the Bank.

3.16 The Bank's market risk exposures arise predominantly from its trading portfolio of listed equities and a small portfolio of foreign currency denominated assets that are not pegged to the United States Dollar. The Bank's market risk is currently not a major source of risk since the Bank's business strategy does not envisage taking on significant exposure to listed equities or foreign denominated assets. The Bank measures its market risk exposure using the Standardised Approach.

#### Operational Risk Management

3.17 Operational risk is defined as the risk of direct and indirect losses resulting from inadequate or failed processes, people and systems or from external events. This definition includes legal risk but excludes strategic and reputational risks. Operational risk differs from other banking risks in that it is not directly taken in return for an expected reward but exists in the natural course of Banking activity, which in turn affects the risk management process.

3.18 The Bank is exposed to operational risk due to the complex nature of its alternative investment products and the intricacy of the documentary, legal and other regulatory requirements that surround such investment transactions. Operational risk emanates from all areas of the Bank.

3.19 The Bank uses the Basic Indicator Approach for measuring its operational risk. Currently, the Bank conducts its business from a single location. Accordingly, the number of client relationships and volume of transactions at the Bank are lower than at institutions having multi-location or retail operations.

3.20 Notwithstanding this, the Bank's operations are conducted according to well-defined processes and procedures. These processes and procedures include a broad system of internal controls, including segregation of duties and other internal checks, which are designed to prevent either inadvertent staff errors or malfeasance prior to the release of a transaction. The Bank also engages in subsequent monitoring of accounting records, daily reconciliation of cash, bank and securities accounts and other checks to enable it to detect, on a timely basis, any erroneous or improper transactions which may have occurred.

3.21 The Bank is currently enhancing its operational risk management framework that will

- a. help track operational loss events and potential exposures as well as report these on a regular basis.
- b. improve the Bank's loss mitigation process and hence, the overall operational risk management framework.

In addition, the Bank is reviewing and updating its Business Continuity Plan to mitigate the risk of loss from business disruption due to unexpected events.

## **VENTURE CAPITAL BANK B.S.C. (c) (“the Bank”)**

Pillar 3 Disclosures – 31 December 2016

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### **3 Risk Management (continued)**

#### Legal Risks

- 3.22 Legal risk includes the risk of non-compliance with applicable laws or regulations, the illegality or unenforceability of counterparty obligations under contracts and additional unintended exposure or liability resulting from the failure to structure transactions or contracts properly
- 3.23 The Bank's legal risks are mitigated through legal counsel review of transactions and documentation, as appropriate. Where possible, the Bank uses standard formats for transaction documentation. To prevent potential association with any money laundering activities, the Bank has designed and implemented a comprehensive set of policies and procedures. Adherence to the Bank's policies and procedures is reinforced through staff training as well as internal and external reviews. As on the reporting date, the Bank has no significant material legal contingencies including pending legal actions.

#### Shari'ah compliance

- 3.24 The Shari'ah Supervisory Board (SSB) is entrusted with the duty of directing, reviewing and supervising the activities of the Bank in order to ensure that they are in compliance with the rules and principles of Islamic Shari'ah. The Bank also has a dedicated internal Shari'ah reviewer who performs an ongoing review of the compliance with the fatwas and rulings of the SSB on products and processes and also reviews compliance with the requirements of the Shari'ah standards prescribed by AAOIFI. The SSB reviews and approves all products and services before launching and offering to the customers and also conducts periodic reviews of the transactions of the Bank. An annual audit report is issued by the SSB confirming the Bank's compliance with Shari'ah rules and principles.

#### Equity Risk in the Banking Book (Investment Risk)

- 3.25 The Bank invests predominantly in three major segments of alternative assets, namely venture capital, private equity and real estate with the main objective to generate consistent superior returns with reasonable risks from high quality, rigorously investigated, efficiently structured and well managed investments. The intent of such investments is a later sale at a profit to strategic investors either through a private placement offering or trade sale.
- 3.26 The Bank uses the Standardised Approach for measuring its investment risks, which is considered a part of its Banking Book. The Bank manages its investment risks at the specific investment level through an in-depth pre-entry due diligence process based on an established set of guidelines, criteria and parameters, as well as active ongoing consulting-based monitoring by investment teams. The Bank also seeks to diversify its investments, not only geographically and sectorally, but across various revenue stages of investments as well.
- 3.27 Notwithstanding this, the Risk Management Department independently reviews and provides inputs on areas of risk in potential investments at an early stage of the due diligence process. Working in close co-operation with the respective investment teams, these independent risk reviews support the investment decision making process through both a qualitative assessment and quantitative analysis.

## VENTURE CAPITAL BANK B.S.C. (c) (“the Bank”)

Pillar 3 Disclosures – 31 December 2016

### 3 Risk Management (continued)

#### Unrealized Fair Value Gains (losses)

3.28 The Bank’s investments which are designated at fair value through profit or loss are re-valued at every half calendar year, and the gains / (losses) recognized in the statement of income are in accordance with the relevant International Financial Reporting Standards. The valuations are performed by the Bank’s investment divisions using appropriate internal valuation models with relevant market inputs and assumptions. These valuations are then independently reviewed by the Risk Management Department and the external auditors, and presented to the Board’s Finance and Investment Committee for approval.

Table 9: Unrealized Fair Value (Loss) / Gain

USD '000

Particulars	6 months	12 months	12 months	12 months	18 months	12 months	12 months
	ended December 2016	ended June 2016	ended June 2015	ended June 2014	ended Jun 2013	ended Dec 2012	ended Dec 2011
Private Equity investments - fair value (losses) / gains	(15,000)	(17,049)	2,000	(2,250)	(7,300)	(2,000)	(1,711)
Real Estate investments - fair value (losses) / gain	-	-	-	-	-	-	(13,572)
Listed equity investments - fair value (losses) / gains	(340)	(459)	(327)	17	(15)	(20)	(131)
<b>Total unrealized fair value (loss) / gain</b>	<b>(15,340)</b>	<b>(17,508)</b>	<b>1,673</b>	<b>(2,233)</b>	<b>(7,315)</b>	<b>(2,020)</b>	<b>(15,414)</b>

#### Liquidity Risk Management

3.29 Liquidity risk is defined as the risk that the Bank may have insufficient funds to meet its obligations as and when they fall due i.e. risk of being unable to satisfy claims without impairment of its financial capital due to mismatches in the timing of cash flows.

3.30 The Bank has obtained an Islamic financing payables comprising short term bank borrowings of US\$ 30.8 million and a medium term loan of US\$ 70.7 million as at 31 December 2016. The Bank has also extended certain guarantees and commitments in support of its investment projects as disclosed in the notes to the consolidated financial statements.

3.31 Although this gives rise to a level of liquidity funding risk, management carefully monitors liquidity through regular forecasts prepared by the Bank’s Treasury & Cash Management in consultation with the business and finance functions of the Bank, including considerations of stress scenarios. Additionally, during 2016, a Funding Plan has been developed and put in place as part of process improvements for the management of liquidity funding risk. The Bank has a portfolio of quoted equity securities in addition to holdings in its yielding Liquidity Programs which are available to meet any unexpected shortfalls in funding requirements.

## VENTURE CAPITAL BANK B.S.C. (c) (“the Bank”)

Pillar 3 Disclosures – 31 December 2016

### 3 Risk Management (continued)

3.32 The Bank’s liquidity ratio (cash and cash equivalents plus marketable securities to total liabilities) stood at 15% as at 31 December 2016:

Table 10: Liquidity Ratio as at 31 December 2016

	USD '000
Cash at bank	8,620
Placements at bank	527
Marketable trading securities	4,698
Marketable available-for-sale securities	1,455
Short term liquidity certificates	1,100
<b>Total liquid assets</b>	<b>16,400</b>
<b>Total liabilities</b>	<b>113,032</b>
Of which, due in up to 1 year	* 38,929
Non current, due after 1 year or more	74,102
<b>Liquid assets / total liabilities</b>	<b>15%</b>
<b>Liquid assets / current liabilities (due within 1 year)</b>	<b>42%</b>

NB: \* Amounts totalling \$ 29,976 thousand of this comprise interbank lines which are expected to be rolled over

## VENTURE CAPITAL BANK B.S.C. (c) (“the Bank”)

Pillar 3 Disclosures – 31 December 2016

### 3 Risk Management (continued)

#### Profit Margin Rate Risk Management in the Banking Book:

- 3.33 As a financial intermediary, the Bank may encounter profit margin risks that arise from timing differences in the maturity and repricing of the Bank’s assets and liabilities. While such repricing mismatches are fundamental to the business of banking, these can expose a bank’s income and underlying economic value to unanticipated fluctuations as profit margins vary. The factors that affect profit margin rates are principally market and economic factors including inflation and growth rates. Profit margin rate risk however, is not a major source of risk for the Bank due to the absence of significant rate sensitive assets and liabilities, as indicated below. Nevertheless, the Bank monitors its exposure to rate sensitive assets and liabilities proactively and in this regard has implemented a Liquidity Management Policy which covers the following:
- The practical steps and procedures for day to day management of liquidity.
  - Preparing periodic liquidity projections and forecasts and the review thereof.
  - Liquidity stress testing.
  - The reporting of liquidity status and projections, including stressed projections.
  - The liquidity contingency plan for identifying and dealing with unforeseen disruptive liquidity events professionally and effectively.

- 3.34 Table 11: Profit Margin Sensitivity Analysis in the Bank’s Banking Book

Position at 31 December 2016 Repricing period	USD'000				Impact of 200 bp change
	Rate sensitive assets	Rate sensitive liabilities	Gap	Cumulative Gap	
> 1 day to 3 months	3,133	30,766	(27,633)	(27,633)	(553)
> 3 months to 6 months	-	-	-	(27,633)	-
> 6 months to 12 months	1,100	-	1,100	(26,533)	22
> 1 year to 5 years	34,750	70,687	(35,937)	(62,470)	(719)
Total	38,983	101,453			
As % of total balance sheet	12%	32%			

- 3.35 The impact on net income for a benchmark change of 200 basis points in profit rates is as follows:
- Net profit margin income for the repricing period of 1 day to 3 months would potentially decrease by US\$ 553 thousand if the profit margin rate increases by 200 basis points.
  - Net profit margin income for the repricing periods of 3 months to 6 months would potentially increase by US\$ 22 thousand if the profit margin rate increases by 200 basis points.
  - Net profit margin income for the repricing periods of 1 year to 5 years would potentially decrease by US\$ 719 thousand if the profit margin rate increases by 200 basis points.

## VENTURE CAPITAL BANK B.S.C. (c) (“the Bank”)

Pillar 3 Disclosures – 31 December 2016

### 3 Risk Management (continued)

#### Equity of Investment Account Holders and Displaced Commercial Risk (DCR)

3.36 The Bank’s exposure to Displaced Commercial Risk is limited to its Equity of Investment Account Holders which comprises the following:

- > 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 approximately US\$ 3.8 million. The Bank manages the fund as a Mudarib, in exchange for a fee of 20% of returns over a 10% simple return. The investments in the GCC Pre IPO Fund are exposed to the general equity market risks prevalent in the GCC countries and in the real estate sectors.
- > Historical returns on Equity of Investment Account Holders is shown below:

Table 12: Five Years Historical Return Data on Equity of Investment Account Holders USD'000

	6 months ended Dec 2016	12 months ended Jun 2016	12 months ended Jun 2015	12 months ended Jun 2014	18 months ended Jun 2013	12 months ended Dec 2012
<b>GCC Pre IPO Fund</b>						
Net profit/(loss)	(6)	4	(152)	-	34	-
Total assets	3,524	3,756	3,833	3,879	3,740	3,678
Total equity	3,524	3,756	3,833	3,879	3,740	3,678
Return on assets (ROA)	0%	0%	-4%	0%	1%	0%
Return on equity (ROE)	0%	0%	-4%	0%	1%	0%

3.37 The Bank is aware of the importance of its fiduciary responsibilities in the management of the Equity of Investment account holders. Transactions with Investment Account Holders are entered into only on the basis of signed subscription and underlying investment agreements, and internal procedures are in place for the proper management and handling of these responsibilities. (Refer to statement of changes in off-balance equity of investment account holders to the financial statements).

## VENTURE CAPITAL BANK B.S.C. (c) (“the Bank”)

Pillar 3 Disclosures – 31 December 2016

### 4 Impairment Provisions:

4.1 The Bank follows a prudent policy of regularly reviewing all assets for impairment. Impairment is recognized and charged to the statement of income when circumstances indicate that the recoverability of the asset is in doubt or the investment is not expected to perform as expected.

General allowance represents collective impairment against exposures which, although not specifically identified, are considered to have a greater risk of loss than when originally accepted.

Impaired Islamic financing facilities includes those where full repayment (collectability) of the principal or/and the profit is in doubt, highly questionable or considered uncollectible due to inadequate protection by the impaired paying capacity of the customer (or counterparty) or by impairment of the collateral pledged if any.

4.2 The impairment provisions recorded is summarized in the tables below :

**Table 13: Impairment provisions - by asset class** USD '000

Particulars	Gross exposure	Impairment booked during the period ended 31 Dec 2016		Cumulative impairment provision as of 31 Dec 2016		Net carrying value
		Specific	Collective	Specific	Collective	
Investments	34,416	750	-	18,716	-	15,700
Investments in associates and joint venture	5,173	-	-	5,173	-	-
Receivable from investment banking services	8,672	841	-	4,962	-	3,710
Funding to project companies	14,618	-	-	12,887	1,362	369
Other assets	2,645	-	-	2,624	-	21
<b>Total</b>	<b>65,524</b>	<b>1,591</b>	<b>-</b>	<b>44,362</b>	<b>1,362</b>	<b>19,800</b>

**Table 14: Impairment provisions - by industrial sector** USD '000

Particulars (USD '000)	Gross exposure	Impairment booked during the period ended 31 Dec 2016		Cumulative impairment provision as of 31 Dec 2016		Net carrying value
		Specific	Collective	Specific	Collective	
Real estate	38,791	750	-	24,111	1,362	13,318
Health care	174	-	-	-	-	174
Technology	15,462	-	-	15,462	-	-
Oil and gas	18	-	-	18	-	-
Transportation	7,126	841	-	3,325	-	3,801
Others	3,953	-	-	1,446	-	2,507
<b>Total</b>	<b>65,524</b>	<b>1,591</b>	<b>-</b>	<b>44,362</b>	<b>1,362</b>	<b>19,800</b>

# VENTURE CAPITAL BANK B.S.C. (c) (“the Bank”)

Pillar 3 Disclosures – 31 December 2016

## 5 Corporate Governance and Transparency

Disclosures on corporate governance and transparency, including qualifications and experience of directors have been disclosed in the Annual Report for year ended 30 June 2016. The following tables give details of distribution of shares by nationality, ownership of shares by directors etc.

### 5.1 Table 15: Distribution of shareholders by nationality:

Country	Ownership %
United Arab Emirates	3.29%
Kuwait	23.66%
Kingdom of Saudi Arabia	57.71%
Qatar	4.78%
Oman	2.57%
Kingdom of Bahrain	7.99%
<b>Total</b>	<b>100.0%</b>

### 5.2 Table 16: Distribution of shareholders by size of shareholding:

Ownership %	Number of shareholders
Less than 1%	146
1% - 2%	16
2% - 3%	6
3% - 4%	2
4% - 5%	0
More than 5%	2
<b>Total</b>	<b>172</b>

Two of the Bank’s shareholders hold more than 5% ownership in the Bank. These are corporate shareholders noted below:

- The Commercial Real Estate Co. (K.S.C.C.) – 7.23% ownership; and
- Securities Group (K.S.C.C.) – 6.02% ownership.

### 5.3 Ownership of shares by government:

The Bahrain Development Bank B.S.C. (c), a public sector organization owned by the Government of Bahrain has a 1.19% interest in the share capital of the Bank.

### 5.4 Ownership of shares by Board members:

Seven members of the Board have shareholdings ranging from 0.15% to 2.51% of total capital. In addition a number of Board members represent corporate shareholders with shares ranging from 0.48% to 6.02%.

The Board is responsible for the stewardship of the Bank’s business and affairs on behalf of the shareholders, with a view to enhancing long-term shareholder value whilst taking into account the interests of other stakeholders, and maintaining high standards of transparency and accountability. The Board comprises 12 members, all of whom are independent non-executive Directors except for the CEO.