

VENTURE CAPITAL BANK
BASEL 2
PILLAR 3 DISCLOSURE AS AT 30 JUNE 11

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 disclosures made in the Bank's reviewed financial statements for the half year ended 30 June 2011.

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 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 30 June 2011, the Bank's total risk weighted assets amounted to US\$ 611 million; Tier 1 Capital and total regulatory capital amounted to US\$ 263 million. Accordingly, Tier 1 and Total Capital Adequacy Ratio was 43%, which exceeds the minimum capital requirements of the CBB of 12%.

Capital Base

The authorized share capital of VC Bank is 500 million shares of US\$ 1 each, and the Bank's paid up capital is US\$ 250 million par value, comprising 250 million shares of US\$ 1 each, including 24.85 million shares allotted to the Employees's Share Ownership Plan.

Group structure:

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

Name of subsidiary	Country of incorporation	Capital	Percentage interest
Gulf Projects Company WLL	Bahrain	BHD 1,000,000	100%
The Lounge Serviced Offices Co. WLL	Bahrain	BHD 20,000	100%
The Lime Restaurants Management & Catering Services Co. WLL	Bahrain	BHD 20,000	100%
Mena SME Fund Manager Limited	Cayman Islands	USD 2	100%

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		USD '000	
2 Details of eligible capital base		Tier 1	Tier 2
Issued and fully paid ordinary shares		250,000	
Less: Employee stock incentive program funded by the bank		(22,764)	
Disclosed reserves		44,098	
Legal / statutory reserves		10,415	
Share premium		28,429	
Others		5,254	
Accumulated losses brought forward		(39,189)	
Unrealized gains arising from fair valuing equities (45% only)		7,816	
Minority interest in consolidated subsidiaries		63,602	
Less:			
Current period interim cumulative net losses		(15,420)	
Unrealized gross losses arising from fair valuing equity securities		(13,285)	
Tier 1 Capital before deductions		<u>274,857</u>	
Unrealized gains in current period from fair valuing equities (45% only)			3,697
Tier 2 Capital before deductions			<u>3,697</u>
Total Available Capital			<u>278,555</u>
Excess amount over maximum permitted large exposure limit		(7,594)	(7,594)
Additional deduction from Tier 1 to absorb deficiency in Tier 2		(3,896)	
Total Deductions		<u>(11,490)</u>	<u>(7,594)</u>
		<u>i</u>	<u>ii</u>
Net Available Capital		<u>263,367</u>	<u>-</u>
Total Eligible Capital (i + ii)			<u>263,367</u>

Credit risk:

The Bank is exposed to credit risk on its short term placements with other financial institutions, and in respect of investment related funding made to projects which arise in the normal course of its activities and are generally transacted without contractual due dates, collateral or other credit risk mitigants. All such exposures are reviewed regularly for recoverability, and provision made where necessary having regard to the nature of the exposure and the assessment of collection. Collective impairment provisions are also made where considered appropriate based on market conditions.

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3 Details of exposures and capital requirement 30 June 2011

USD '000

	Risk weighted		Capital charge
	Gross exposures	exposures	
Credit risk:			
Exposures to banks	20,506	4,191	503
Exposures to corporates	56,536	56,536	6,784
Investments in listed equities in banking book	3,038	3,038	365
Investments in unlisted equities in banking book	162,305	243,458	29,215
Investments in real estate	91,113	182,226	21,867
Other exposures	8,564	8,564	1,028
Total credit risk exposure under standardized approach	342,062	498,013	59,762
Market risk:			
Trading equities position	1,591	3,182	382
Foreign exchange position	2,014	2,014	242
Total market risk under standardized approach	3,605	5,196	623
Operational risk under Basic Indicator Approach (ref. below)		107,363	12,884
Total		610,571	73,269
Total eligible capital - (Tier 1 + Tier 2)		263,367	
Total eligible capital - Tier 1		263,367	
Total Capital Adequacy Ratio (Tier 1 + Tier 2)		43%	
Tier 1 Capital Adequacy Ratio		43%	

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Capital requirement for Operational Risk (Basic Indicator Approach)

	USD '000		
	2010	2009	2008
Gross income for prior three years	445	31,737	82,047
Average of past 3 years gross income (excluding loss years)	56,892		
Capital requirement for Operational Risk (15%)	8,534		
Risk weighted exposure for Operational Risk	106,672		

Total unrealized fair value gains / (losses):

	Jun 2011	Dec 2010	Dec 2009	Dec 2008	Dec 2007	Dec 2006
Unrealized fair value (losses)/ gains recognized in income	1,189	(15,100)	3,080	9,800	3,626	-
Unrealized fair value gains/ (losses) recognized in equity	(833)	2,229	1,496	(85)	180	-

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

Particulars	US\$ '000					Maximum	Minimum
	31-Mar-10	30-Jun-10	30-Sep-10	31-Dec-10	30-Jun-11		
Market risk exposures							
Listed equities held for trading	1,305	1,115	1,218	1,293	1,591	1,591	1,115
Foreign currency exposure	2,803	2,755	2,236	1,860	2,014	2,803	1,860
Market risk charge							
Listed equities held for trading	313	268	292	310	382	382	268
Foreign currency exposure	336	331	268	223	242	336	223
Total market risk charge	650	598	561	534	623	718	491
Market risk weighted exposure							
Listed equities held for trading	2,610	2,230	2,436	2,586	3,182	3,182	2,230
Foreign currency exposure	2,803	2,755	2,236	1,860	2,014	2,803	1,860
Total market risk weighted exposure	8,120	7,478	7,007	6,669	7,793	8,978	6,136
Credit risk weight on Islamic financing contracts	4,887	5,309	6,475	6,551	2,809	6,551	2,809
Total credit risk weight exposure	560,972	559,308	558,726	498,910	498,013	560,972	498,013

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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 investment related funding made to its projects.

These exposures arise in the ordinary course of its investment banking activities and are generally entered into without any collateral or other credit risk mitigants. As at 30 June 2011, there were no credit risk mitigants and, accordingly, the gross credit exposure detailed above represents the total credit risk exposure of the Bank.

5 Concentration Risk

The quantitative details of the bank credit risk exposures are depicted in the following tables, which are representative of the positions 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									
Balances with banks	-	6,051	-	-	-	-	-	-	6,051
Placements with financial institutions	-	13,167	-	-	-	-	-	-	13,167
Investment securities	35,713	21,975	29,991	7,620	10,160	-	16,228	14,968	136,655
Investment in associates and joint ventures	-	4,439	22,865	-	2,022	-	-	1,767	31,094
Investment property	-	-	9,130	-	-	-	-	-	9,130
Receivable from investment banking services	390	1,091	2,550	-	456	-	2,050	3,085	9,623
Short-term financing to project companies	2,936	8	10,197	-	7,353	4,533	-	(2,000)	23,028
Other assets	185	2,768	168	-	124	10	3,076	1,672	8,003
Property and equipment	-	-	9,336	-	-	-	-	2,327	11,662
Total on balance sheet	39,224	49,499	84,238	7,620	20,115	4,544	21,354	21,819	248,413
Off balance sheet exposures									
Restricted investment accounts		3,365	12,784					553	16,702
Commitments and contingencies	9,441	37,260	14,992						61,693
Total gross credit exposure	48,665	90,124	112,014	7,620	20,115	4,544	21,354	22,372	326,808
Percentage of gross exposure by sector	15%	28%	34%	2%	6%	1%	7%	7%	100%

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

USD '000

Geographic sector	GCC countries	Other MENA countries	Europe	Cayman / Americas	Total USD'000
Assets					
Balances with banks	6,051	-	-	-	6,051
Placements with financial institutions	13,167	-	-	-	13,167
Investment securities	81,618	24,838	16,228	13,971	136,655
Investment in associates and joint ventures	29,327	1,767	-	-	31,094
Investment property	9,130	-	-	-	9,130
Receivable from investment banking services	6,307	390	2,050	876	9,623
Short-term financing to project companies	15,559	2,936	-	4,533	23,028
Other assets	4,731	196	3,076	-	8,003
Property and equipment	11,662	-	-	-	11,662
Total Assets	177,552	30,127	21,354	19,380	248,413
Off balance sheet assets					
Restricted investment accounts	16,703	-	-	-	16,703
Commitments and contingencies	52,252	9,441	-	-	61,693
	246,507	39,568	21,354	19,380	326,808
Percentage exposure by geographic sector	75%	12%	7%	5.9%	100%

5.c Credit exposure by maturity

USD '000

	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 USD'000
Assets								
Balances with banks	-	6,051	-	-	6,051	-	-	6,051
Placements with financial institutions	-	13,167	-	-	13,167	-	-	13,167
Investment securities	136,655	-	-	-	-	-	-	136,655
Investment in associates and joint ventures	31,094	-	-	-	-	-	-	31,094
Investment property	-	9,130	-	-	9,130	-	-	9,130
Receivable from investment banking services	-	98	1,691	3,443	5,231	2,363	2,028	9,623
Short-term financing to project companies	-	2,100	2,008	6,162	10,270	6,375	6,383	23,028
Other assets	-	669	3,200	3,038	6,907	1,096	-	8,003
Property and equipment	11,662	-	-	-	-	-	-	11,662
Total assets	179,411	31,214	6,900	12,642	50,756	9,834	8,411	248,413
Off-balance sheet items								
Restricted investment accounts	-	268	-	12,784	13,051	3,651	-	16,702
Commitments and contingencies	-	-	-	-	-	14,557	47,136	61,693
	179,411	31,482	6,900	25,426	63,808	28,042	55,547	326,808

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

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6 Related party transactions

USD '000

	Associates and joint ventures	Key management personnel	Significant shareholders / entities in which directors are interested	Assets under management including special purpose entities	Total
Balance sheet					
Assets					
Cash and balances with banks	-	-	313	-	313
Placements with financial institutions	-	-	2,603	-	2,603
Investment securities	-	-	58,419	13,548	71,966
Investments in associates and joint ventures	9,513	-	-	107,735	117,248
Receivable from investment banking services	747	-	4,355	-	5,103
Short term funding to project companies	15,490	-	2,788	-	18,278
Other assets	150	-	135	-	284
Liabilities					
Employee accruals		2,255			
Income					
Income from investment banking services	872				
Share of profit/ (loss) of associates and joint ventures	(583)				
Expenses (excluding compensation for key management personnel)					
Impairment allowances against receivables	400				
Commitments and contingencies					
	435		14,066		
Restricted investment accounts					
	12,784				
Total related party	25,900	-	68,613	121,283	215,796

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7 Impairment provisions

Particulars - asset category (USD '000)	Gross exposure Jun 2011	Impairment booked in Q2 2011	Impairment booked 2010	Cumulative impairment booked	Net carrying value
Available for sale investments	35,900	-	(14,065)	(24,430)	11,470
Investments in associates and joint venture	4,702	-	(3,418)	(3,418)	1,284
Receivable from investment banking services	12,959	(1,832)	(5,831)	(8,414)	4,545
Short term funding to project companies	23,559	(134)	(7,578)	(8,112)	15,447
Other assets	4,388	(269)	(106)	(1,744)	2,644
Collective impairment provision		(2,000)		(2,000)	
Total	81,509	(4,235)	(30,999)	(48,117)	35,391

Particulars - industry sector (USD '000)	Gross exposure Jun 2011	Impairment booked in Q2 2011	Impairment booked 2010	Cumulative impairment booked	Net carrying value
Real estate and related	46,743	(2,012)	(22,059)	(28,931)	17,812
Health care	8,653	-	(1,300)	(1,300)	7,353
Technology	11,721	-	(6,788)	(7,187)	4,534
Others	14,392	(223)	(851)	(8,699)	5,693
Collective impairment provision		(2,000)		(2,000)	
Total	81,509	(4,235)	(30,999)	(48,117)	35,391

The Bank follows a prudent policy of regularly reviewing all assets for impairment, and does not currently have significant receivables which are past due. Impairment is recognized and charged to the income statement when circumstances indicate that the recoverability of the asset is in doubt with consequent impairment. During 2011, the Bank recorded a collective impairment provision of USD 2,000 thousand to reflect current market conditions.

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8 Unrealized fair value gains

Particulars (USD '000)	USD '000					Total
	Jun 2011	Dec 2010	Dec 2009	Dec 2008	Dec 2007	
Private Equity investments	2,789	-	3,830	3,330	3,108	13,057
Real Estate investments	(1,600)	(15,100)	(750)	6,500	-	(10,950)
Total unrealized fair value gains	1,189	(15,100)	3,080	9,830	3,108	2,107

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 also approved by the Board's Finance and Investment Committee before recognition.

9 Concentration Risk to Individual Counterparties

The bank has a large exposure to one individual counterparty which is USD 15,188 K in excess of 15% of eligible capital. The excess amount has been deducted from the capital base above.

10 Exposures to highly leveraged counterparties

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

11 Liquidity ratio:	30-Jun-11	31-Dec-10	31-Dec-09	31-Dec-08	31-Dec-07
	USD'000	USD'000	USD'000	USD'000	USD'000
Cash at bank	6,051	2,672	14,287	1,093	170
Placements at bank	13,167	11,267	50,789	31,718	69,823
Marketable securities	1,591	1,293	1,351	4,646	1,396
Total liquid assets	20,809	15,232	66,427	37,457	71,389
Liabilities	17,790	9,544	70,204	18,395	19,392
Liquidity ratio	117%	160%	95%	204%	368%

12 Profit margin rate risk management in the Banking Book

As a financial intermediary, VCBank 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 2011 Repricing Period	USD'000			Cumulative Gap	Impact of 200 bp change
	Rate Sensitive Assets	Rate Sensitive Liabilities	Gap		
1 day	-	-	-	-	-
> 1 day to 3 months	13,167	5,000	8,167	8,167	163
> 3 months to 6 months	-	-	-	8,167	-
> 6 months to 12 months	-	-	-	8,167	-
> 1 year to 5 years	-	-	-	8,167	-
> 5 years	-	-	-	8,167	-

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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, and the performance of which are detailed in the financial statements:

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.