

VENTURE CAPITAL BANK BSC (c)
BASEL 2
PILLAR 3 DISCLOSURE AS AT 30 JUNE 09

1 Introduction

The Central Bank of Bahrain's (CBB) Basel II guidelines outlining the capital adequacy framework for banks in the Kingdom of Bahrain became effective from 1 January 2008. These semi-annual disclosures have been prepared in accordance with the CBB's Public Disclosure Module ("PD"), Section PD-3.1.6: "Additional Requirements for Semi Annual Disclosures, CBB Rule Book, Volume II for Islamic Banks." These quantitative 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 2008.

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 2009, the Bank's total risk weighted assets amounted to US\$ 460,889 thousands; Tier 1 capital and total regulatory capital amounted to US\$ 222,687 thousands. Accordingly, Tier 1 and Total Capital Adequacy Ratio was 48.32%. 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 and for capital computation purposes.

Subsidiary	Country	Capital	Percentage interest
The Lounge Serviced Offices Co. WLL	Bahrain	BHD 20,000	90%
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	173,250	
Less: Unvested shares of ESOP	(15,000)	
Share premium	13,533	
Statutory reserve	9,315	
Prior year retained earnings b/fwd	13,444	
Earnings of current year (audited)		
Unrealized gains reported in income (45%)	4,424	
Minority interest	8	
Less: deductions		
Goodwill	(3,232)	
Unrealized losses in AFS reserve	(85)	
Other		
Total Tier 1 capital	<u>195,656</u>	
Interim profits (reviewed)		5,449
Advance for capital increase		17,082
ESOP equity reserve		3,708
Unrealized fair value gains (45%)		1,233
Total Tier 2 capital		<u>27,473</u>
Excess amount over maximum permitted large exposure limit	(442)	
Net Available Capital	<u>195,214</u>	<u>27,473</u>
Total eligible capital (Tier 1 + Tier 2)		<u>222,687</u>

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2.1 Capital increase:

The Bank is currently in the process of increasing its paid up capital by USD 87.75 million through a rights issue to existing shareholders of USD 60.75 million at a price of USD 1.20 per share and an issue to new investors of USD 27 million at a price of USD 1.60 per share. The capital increase process, which is expected to be completed during 2009, will further strengthen the Bank's capital base.

2.2 Credit risk:

The credit risk exposures faced by VCBank are in respect of its own short term liquidity related 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 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:	Risk weighted		
	Gross exposures	exposures	Capital charge
Exposures to banks	26,108	5,315	638
Exposures to corporates	55,020	55,020	6,602
Investments in listed equities in banking book	4,791	4,791	575
Investments in unlisted equities in banking book	74,974	112,460	13,495
Investments in real estate	80,391	160,782	19,294
Other exposures	15,616	15,616	1,874
Total credit risk exposure under standardized approach	256,899	353,984	42,478
Market risk:			
Trading equities position	1,670	3,341	401
Foreign exchange position	2,872	2,872	345
Total market risk under standardized approach	4,543	6,213	746
Operational risk under Basic Indicator Approach (ref. below)		100,692	8,055
Total		460,889	51,279
Total eligible capital - (Tier 1 + Tier 2)		222,687	
Total eligible capital - Tier 1		195,656	
Total Capital Adequacy Ratio (Tier 1 + Tier 2)		48.32%	
Tier 1 Capital Adequacy Ratio		42.45%	

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Capital requirement for Operational Risk (Basic Indicator Approach)	USD '000		
	2006	2007	2008
Gross income for year	24,660	54,398	82,048
Average of past 3 years gross income			53,702
Capital requirement for Operational Risk (15%)			8,055
Risk weighted exposure for Operational Risk			100,692
Total unrealized fair value gains / (losses):	2,009	2,008	2,007
On investments designated at FVTP&L	1,730	9,830	3,626
On available for sale investments recognized in equity	925	(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
	30-Jun-08	30-Sep-08	31-Dec-08	31-Mar-09	30-Jun-09			
Market risk exposures								
Listed equities held for trading	3,499	3,872	4,646	2,813	1,670	4,646	1,670	
Foreign currency exposure	6,421	4,870	3,045	2,398	2,872	6,421	2,398	
Market risk charge								
Listed equities held for trading	560	620	743	450	267	743	267	
Foreign currency exposure	514	390	244	192	230	514	192	
Total market risk charge	1,074	1,009	987	642	497	1,257	459	
Market risk weighted exposure								
Listed equities held for trading	6,999	7,744	9,292	5,626	3,341	9,292	3,341	
Foreign currency exposure	6,421	4,870	3,045	2,398	2,872	6,421	2,398	
Total market risk weighted exposure	13,420	12,614	12,337	8,024	6,213	15,712	5,738	

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 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 2009, 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's 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	0	1,418	0	0	0	0	0	0	1,418
Placements with financial institutions	0	24,690	0	0	0	0	0	0	24,690
Investment securities	15,338	833	49,625	12,598	0	1,209	13,855	23,753	117,212
Inv in associates and joint ventures	0	0	1,891	0	3,722	5,397	0	5,897	16,907
Assets held for sale	0	0	22,843	0	0	0	0	0	22,843
Investment property	0	0	9,130	0	0	0	0	0	9,130
Receivable from investment banking services	274	0	3,812	0	0	163	900	1,442	6,590
Short-term financing to project companies	6,270	0	7,867	0	2,167	1,598	0	0	17,903
Other assets	19	20,988	4,998	23	769	6	635	2,045	29,483
Equipment	0	0	0	0	0	0	0	4,502	4,502
Total on balance sheet	21,900	47,929	100,166	12,621	6,659	8,373	15,391	37,640	250,678
Off balance sheet exposures									
Restricted investment accounts	0	3,290	0	0	0	0	0	1,211	4,501
Contingent items	2,764	0	9,394	0	0	0	0	0	12,158
Total gross credit exposure	24,665	51,219	109,559	12,621	6,659	8,373	15,391	38,850	267,336
Percentage of gross exposure by sector	9%	19%	41%	5%	2%	3%	6%	15%	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	1,418	0	0	0	1,418
Placements with financial institutions	24,690	0	0	0	24,690
Investment securities	79,501	24,711	13,000	0	117,212
Inv in associates and joint ventures	14,053	1,904	0	950	16,907
Assets held for sale	22,843	0	0	0	22,843
Investment property	9,130	0	0	0	9,130
Receivable from investment banking services	5,416	274	900	0	6,590
Short-term financing to project companies	11,633	6,270	0	0	17,903
Other assets	28,584	653	0	246	29,483
Equipment	4,502	0	0	0	4,502
Total Assets	201,770	33,812	13,900	1,196	250,678
Off balance sheet assets					
Restricted investment accounts	4,501				4,501
Contingent items	12,158		0		12,158
	218,429	33,812	13,900	1,196	267,336
Percentage exposure by geographic sector	82%	13%	5%	0.4%	100%

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 years	Total USD'000
Assets						
Cash and balances with banks	1,418	0	0	0	0	1,418
Placements with financial institutions	24,690	0	0	0	0	24,690
Investment securities	0	0	1,670	39,660	75,882	117,212
Inv in associates and joint ventures	0	0	0	0	16,907	16,907
Assets held for sale	0	0	22,843	0	0	22,843
Investment property	0	0	9,130	0	0	9,130
Receivable from investment banking services	60	1,252	107	5,172	0	6,590
Short-term financing to project companies	5,763	4,159	40	7,941	0	17,903
Other assets	155	558	851	1,033	26,885	29,483
Equipment	0	0	0	0	4,502	4,502
Total assets	32,085	5,969	34,641	53,806	124,176	250,678
Off-balance sheet items						
Restricted investment accounts	193	0	0	4,308	0	4,501
Contingent items		4,492		7,666		12,158
	32,278	10,461	34,641	65,780	124,176	267,336

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		
	Subsidiary (changed to associate at year end)	Associates and joint ventures	Directors and others
Income statement			
Placement and investment management fees	0	278	-
Income from Islamic financing	0	0	-
Investment banking income	0	10,000	-
Income from investments designated at fair value	0	0	-
Share of net results of associates and joint ventures	0	-623	-
Total related party	0	9,655	-

Balance sheet	USD '000
Investments designated at fair value through profit or loss	33,172
Assets held for sale	22,843
Investments in associates under equity method	15,957
Investments in joint ventures under equity method	950
Advances to invest and project financing	33,662
Total related party	72,921

7 Impairment provisions

	USD '000				
Particulars	Impairment booked in 2009	Impairment booked in 2008	Impairment booked in prior years	Total impairment recognized	Carrying value
Listed securities in the GCC classified as available for sale (AFS)	941	6,390	2,583	8,973	5,347
Investment projects of VC Bank	-	173	576	749	-
Total	941	6,563	3,158	9,722	5,347

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 provisions, and does not have any significant receivables which are past due.

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8 Unrealized fair value gains on unquoted investments designated at FVTPL

USD '000

Particulars	30-Jun-09	31-Dec-08	31-Dec-07	Total
Private Equity investments	1,730	3,330	3,108	6,438
Real Estate investments	-	6,500	-	6,500
Venture Capital investments	-	-	518	518
Total unrealized fair value gains	1,730	9,830	3,626	13,456

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.

Total unrealized fair value gains / (losses) included in Tier 1 and Tier 2 capital:

	Tier 1	Tier 2
On unquoted investments designated at FVTP&L	9,830	1,730
On available for sale investments recognized directly in equity	(85)	1,011

9 Concentration risk to individual counterparties

The Bank had a large exposure of USD 33,172 thousands on 30 June 2009 to one individual counterparty which represented 15.2% of eligible capital. The amount in excess of the 15% ceiling has been deducted from eligible capital for capital adequacy computation purposes in accordance with the regulations.

10 Exposures to highly leveraged counterparties

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

11 Liquidity ratio:	30-Jun-09	31-Dec-08	31-Dec-07
	USD'000	USD'000	USD'000
Cash at bank	1,418	1,093	170
Placements at bank	24,690	31,718	69,823
Marketable securities	1,670	4,646	1,396
Total liquid assets	27,778	37,457	71,389
Liabilities	17,403	18,396	19,392
Liquidity ratio	160%	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 2009 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	24,690.0	-	24,690.0	24,690.0	493.8
> 3 months to 6 months	-	-	-	24,690.0	-
> 6 months to 12 months	-	-	-	24,690.0	-
> 1 year to 5 years	-	-	-	24,690.0	-
> 5 years	-	227.1	(227.1)	24,462.9	(4.5)

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

VC Bank's exposure to Displaced Commercial Risk is limited to its GCC Pre IPO Fund, which is a Restricted Investment Account (RIA) set up to invest in the shares of unlisted GCC companies in the pre-IPO stage. The total size of the fund is relatively small, as the total investors' funds under investment is only 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. The Bank is aware of its fiduciary responsibilities in management of the RIA investments and has clear policies on discharge of these responsibilities. The performance of the fund is detailed in the consolidated statement of changes in restricted investment accounts included in the reviewed interim financial statements.