BMB Investment Bank

Basel II Pillar 3 Disclosures

Half-Year ended 30 June 2009

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1. INTRODUCTION

Beginning June 2008, the Central Bank of Bahrain (CBB) requires licensed banking institutions to publish risk disclosures in addition to the normal financial statement disclosures on a half yearly basis and an annual basis as part of the Basel II Pillar 3 disclosures. This report contains the BMB Group's Basel II Pillar 3 Disclosures for the half-year ended 30 June 2009 in conformity with the requirements of the CBB's Rulebook Number 1 – Module PD as well as certain other additional information which the Bank believes will be useful to readers in interpreting this material and in understanding BMB's approach to risk management. The Basel II Pillar 3 Disclosures must be read in conjunction with the Bank's 2009 semi-annual financial statement disclosures.

The Disclosures are part of Basel II Pillar 3 and are based on paragraph numbers 820 through to number 826 of the Basel Committee on Banking Supervision's (BCBS) "International Convergence of Capital Measurement and Capital Standards" (June 2006 edition) (the "Basel II Framework"). The Central Bank of Bahrain's Rulebook is available at www.cbb.gov.bh and the BCBS Basel II Framework is available at www.bis.org.

This document discusses BMB's risk management strategies, processes, structures, risk mitigation strategies and their effectiveness. Risks covered include those related to Basel II Pillar 3 (credit risk, market risk, and operational risks) and to Pillar 2 risks (Interest Rate Risk in the Banking Book (IRRBB), liquidity risk, legal and other related risks). The Bank considers this report and the information it contains a critical part of its efforts in fostering transparency and disclosure of the performance and condition of the Bank.

The Bank's previous Basel II Pillar 3 Disclosures report was for the year-ended 31 December 2008 and is available at its website, www.bmb.com.bh .

2. GENERAL INFORMATION

2.1. Incorporation And Principal Activity

Bahrain Middle East Bank (B.S.C.) (the "Bank", "BMB" or "BMB Investment Bank") is a Bahraini Shareholding Company with limited liabilities and is incorporated in the Kingdom of Bahrain as well as being listed on the Bahrain Stock Exchange ("BSE").

The registered office of the Bank is:
BMB Centre, Building 135,
Road 1702, Block 317,
Diplomatic Area,
Manama,
Kingdom of Bahrain.

The Bank operates under a Wholesale Banking License issued by the Central Bank of Bahrain ("CBB") and is regulated by the CBB. The Bank is part of a group that comprises the Bank and its subsidiaries. The principal subsidiaries of the Bank at 30 June 2009 were as follows:

	Ownership interest	**Country of incorporation**	**Nature of business**
Subsidiaries	**2009**		
BMB Investment Company (Jersey) Limited	100%	Jersey	Investment holding
Adhari Limited	100%	Cayman Islands	Investment holding
BMB Property Services	100%	Bahrain	Property Management
BMB Finance Limited	100%	Cayman Islands	Investment holding
BMB-H Investment Company Limited	100%	Channel Islands	Investment holding
BMB-H Investment Trading Limited	100%	Cayman Islands	Investment holding
Universal Merchant Holdings NV	100%	Netherlands Antilles	Investment holding
BMB Netherlands Antilles NV	100%	Netherlands Antilles	Investment holding
BMB Curacao Netherlands NV	100%	Netherlands Antilles	Investment holding
Universal Finance Holding NV	100%	Netherlands	Investment holding
European Universal Finance NV	100%	Netherlands	Investment holding
Beverages Limited	100%	Channel Islands	Investment holding
Qassari Limited – LDC	100%	Cayman Islands	Investment holding
Umm Shoum Limited – LDC	100%	Cayman Islands	Investment holding
Bu Zaidan Limited – LDC	100%	Cayman Islands	Investment holding
BMB SP Holdings Limited	100%	Channel Islands	Investment holding
BMB New Era Ventures – I LDC	100%	Cayman Islands	Investment holding
BMB New Era Ventures – II LDC	100%	Cayman Islands	Investment holding
BMB New Era Ventures – III LDC	100%	Cayman Islands	Investment holding
BMB New Era Ventures – IV LDC	100%	Cayman Islands	Investment holding
BMB New Era Ventures – V LDC	100%	Cayman Islands	Investment holding
BMB Ventures Limited	100%	Cayman Islands	Investment holding
T&T Beverages Limited (T&T)	93.9%	United Kingdom	Softdrinks

With the exception of BMB Property Services ("BMBPS"), which is an operating company involved in property management, and T&T Beverages, which is in liquidation, all of the Bank's other subsidiaries are passive investment holding companies. BMB Group subsidiaries do not engage in banking or other regulated financial services. As such, they are therefore not subject to bank or other financial supervision or regulation independent of that to which the Bank is subject by virtue of its license.

3. SCOPE OF APPLICATION

3.1. Legal Entity

The name of the principal entity in the Group to which these Disclosures apply is Bahrain Middle East Bank (B.S.C.). The section "General Information" in Note 1 to the accompanying half-year 2009 financial statements provides detailed information on the history, formation, corporate and legal status, banking license and stock listing of the Bank.

3.2. Consolidation

All of BMB's subsidiaries are fully consolidated in the preparation of the Bank's financial statements. There is no material difference between the basis of consolidation used for financial statement and regulatory purposes, except for the calculation of the regulatory Capital Adequacy Ratio ("CAR") where certain elements of equity are assigned to different capital tiers and assets are risk-weighted using certain risk factors as specified in the Basel II Framework.

3.3. Restrictions on transfer of Capital

Since none of the Bank's subsidiaries are regulated financial institutions, there is no regulatory impediment to the transfer of retained earnings to the Bank. However, as separate legally incorporated entities, the transfer of paid in capital and mandatory reserves would require shareholder action. As the sole shareholder (either direct or indirect) in these entities, the Bank has the power to undertake the legal processes for the transfer of such capital. None of the Bank's subsidiaries are registered and domiciled in jurisdictions which impose exchange controls or other restrictions on the cross border transfer of funds.

3.4. Insurance Subsidiaries

BMB does not have any subsidiary engaged in the insurance business.

3.5. Capital Deficiencies and Deductions

Since none of the Bank's subsidiaries are regulated financial institutions, they are not subject to standalone capital requirements in excess of their paid in capital. On a legal and accounting basis, none of the Bank's subsidiaries has a deficit in its legal or accounting capital, except for T&T Beverages, which is in liquidation. For the purposes of the Bank's implementation of Basel II under CBB regulations, none of the capital of any of the Group's subsidiaries is required to be deducted from regulatory capital.

4. CAPITAL STRUCTURE

4.1. Capital Instruments

All of the Bank's equity capital consists of one class of common equity. The Bank has not issued any innovative, complex or hybrid capital instruments in the year under review, nor does it have any such capital instruments outstanding.

4.2. Tier 1 Capital

Tier 1 Capital 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 any treasury stock, minority interests, or negative fair value reserves. Local regulations require that certain investments or exposures be deducted from Tier 1 capital. The aggregate amount of Tier 1 Capital as at 30 June 2009 was US$ 27.6 million.

4.3. Tier 2 Capital

Tier 2 Capital consists of the qualifying portion of subordinated loans and unrealised gains arising on changes in the fair value of assets and liabilities. Under Central Bank of Bahrain 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. The aggregate amount of Tier 2 Capital as at 30 June 2009 was US$ 5.6 million.

4.4. Tier 3 Capital

The Bank had no Tier 3 Capital as at 30 June 2009.

4.5. Deductions from Regulatory Capital

As at 30 June 2009, there were no deductions from eligible Tier 1 Capital. Since BMB uses the Standardised Approach for both Credit and Market Risk, there are no IRB model based deductions.

4.6. Total Eligible Capital

As at 30 June 2009, the aggregate amount of regulatory Capital (Tier 1 and Tier 2) was US$ 33.2 million.

5. DESCRIPTION OF BUSINESS ACTIVITIES

BMB’s main activities are:

- investment banking which forms the core of our activities
- asset management and funds distribution, and
- trading and investment

These activities are conducted through dedicated specialist business units.

5.1. Investment banking

This activity consists of originating and structuring investments. It is conducted by our Investment Department. Our Investment Department engages in limited, selective investments in equities, funds and equity derivatives. Additionally, the Investment Department manages the Bank’s portfolio of listed equities, which primarily consist of IPOs or listed shares resulting from the realization of private equity investments.

5.2. Private equity

Since 1988, the Bank has developed strong relationships with premier unquoted equity fund managers, both directly and through private equity fund distributors. Drawing on our own fundamental macro trend analysis, we seek out unquoted equity funds and direct investments which meet our stringent investment criteria. These investments are both for the Bank's own account and for clients. Our primary focus is on fund managers who pursue a strategy of taking a controlling interest in high quality investments with a solid financial history. The fund managers selected by BMB must be able to demonstrate both a proven track record over a number of years and economic cycles, as well as strong institutional backing. They must have a strict pricing discipline, make investments with a pre-determined exit strategy and for the most part must not merely be sourcing transactions through the auction process.

5.3. Private placements

BMB raises equity on a private placement basis for mid-size companies. Our Investment Department and executive management originate transactions drawing on BMB’s network of contacts. After a satisfactory internal review and structuring, the Bank places the transactions with its customers.

5.4. Funds distribution

This activity consists of marketing investment products to BMB’s individual and institutional clients and the management of BMB proprietary funds. Our Investor Marketing Department has responsibility for the former, while our Investment Department handles funds’ management.

5.5. Investor marketing

Our Investor Marketing Department distributes structured products and private equity transactions to our investor base. This group also markets other specially developed products, including private equity funds, listed funds and hedge funds which are designed to meet our clients’ needs. For our proprietary funds, we provide a full range of accounting, reporting and support services. Investor Marketing is based upon our knowledge of each client’s investment objectives and risk parameters. This detailed understanding enables us to focus product development and marketing efforts to more effectively meet our clients' needs. It also facilitates the cross-selling of other products and establishment of long-term client relationships.

5.6. Funds management

The Bank manages BMB's first fund of private equity funds, BMB Technology & Telecommunications Company, a US$ 70 million fund. We were also actively involved in BMB Shield through our role as Investment Advisors to this fund.

5.7. Treasury Activities

Our Treasury Department trades in bonds, foreign exchange, capital markets and related derivative instruments.

6. CORPORATE GOVERNANCE

BMB conducts its business activities under a written corporate governance framework which sets forth the roles and responsibilities of members of the Board of Directors and Bank management.

The Bank’s framework comprises the following which are available on the Bank’s website at http://www.bmb.com.bh/corporate/more.asp

- Code of Ethics and Code of Conduct
- Corporate Governance Policies and Procedures
- Charter of the Board of Directors
- Directors’ Roles and Responsibilities
- Charter of the Executive Committee of the Board of Directors
- Charter of the Audit Committee of the Board of Directors
- Charter of the Chairman of the Board of Directors
- Charter of the Chief Executive
- Disclosure Policy and Procedures

7. CAPITAL MANAGEMENT

The primary purpose of the Bank's capital management program is to ensure that the Bank complies with externally imposed capital requirements and that the Bank maintains strong credit ratings and healthy capital ratios in order to support its business and to maximize shareholders' value. As a further step in mitigating risks, the Bank follows a policy of diversification in its activities and seeks to minimise the risk exposure to particular geographical regions, counterparties and instruments and types of business. To manage its capital, BMB employs a risk adjusted measure of capital adequacy (a Capital Adequacy Ratio or "CAR") based on the local regulatory regime as implemented by the CBB in line with the Basel Committee on Banking Supervision's International Convergence of Capital Measurement and Capital Standards: A Revised Framework" guideline. Beginning January 2008, CBB required all Bahrain banking institutions to implement Pillar 1 of Basel II, which involves calculation of capital charges for market, credit and operational risks. BMB uses the Basic Indicator Approach of Operational Risks and the Standardised Approach for market and credit risk.

BMB manages its capital with the following objectives:

1. To comply at all times with the capital adequacy ratio set by the Group's regulator, the Central Bank of Bahrain,
2. To ensure that the Bank has sufficient capital to enable it to absorb diminutions in the value of its assets or unexpected losses while continuing to function as a "going concern",
3. To maintain a sound capital base that allows the Bank to take advantage of opportunities to develop and grow its business,
4. To assess the utilization of capital by the Bank's business units

Reports on the Bank's capital adequacy are filed quarterly with the CBB. 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 12.0% CAR. In determining its CAR, the Bank calculates risk adjusted assets which are then divided by regulatory capital rather than the equity capital appearing in the Bank's balance sheet. Regulatory equity capital is composed of two elements:

(a) Tier 1 Capital 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 any treasury stock, minority interests, or negative fair value reserves. Local regulations require that certain investments or exposures be deducted from Tier 1 capital.

(b) Tier 2 Capital consists of the qualifying portion of subordinated loans and unrealised gains arising on fair valuation. Under Central Bank of Bahrain 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.

Currently, the Bank is revising its business strategy and refining its approach to capital management program, including the formal development of an Internal Capital Adequacy Assessment Program (ICAAP). This process, including Board ratification of both the strategy and ICAAP, is targeted for completion this year. The Bank's Capital Adequacy Ratio as at 30 June 2009 was as follows:

Table 1: Capital Composition

Tier 1 capital	US$000
Share capital	54,955
Legal reserves	16,310
General reserves	7,521
Retained earnings	(31,484)
Net (loss) for the period	(19,670)
Total qualifying Tier 1 capital	27,632
Tier 2 capital	
Revaluation reserves – available-for-sale investments	592
Subordinated loan	5,008
Total qualifying Tier 2 capital	5,600
Total regulatory capital	33,232
Risk weighted assets	
On-balance sheet	132,579
Off-balance sheet	58,686
Total risk weighted assets	191,265
Capital Adequacy Ratio	17.37%
Core Capital Ratio	14.45%

The table below summarises the capital requirement for credit risk using the Standardised Approach as at 30 June 2009:

Table 2: Credit Risk Capital Requirement

	Net exposure US$000	Risk weighted amount US$000	Capital requirement US$000
Sovereigns	9,070	4,928	592
Banks	8,740	1,748	210
Corporates	76,305	76,305	9,156
Securities	43,102	62,234	7,468
Others	5,283	5,283	634
Total			18,060

8. OPERATIONAL RISK CAPITAL CHARGE

The capital requirement for operational risk using the Basic Indicator Approach as at 30 June 2009 amounted to US$ 11.9 million.

9. MARKET RISK CAPITAL CHARGE

The Bank uses the Standardised Approach for calculating market risk capital charges for the following market risk components:

- Equity exposure risk
- Interest rate exposure risk
- Foreign currency exposure risk

For calculating market risk capital the Bank uses CBB guidelines in line with the Basel Committee's "Amendment to the Capital Accord to Incorporate Market Risks" document.

The Bank's market risk capital charge is largely composed of foreign currency risk arising from the Bank's foreign exchange exposure on private equity investments denominated in USD, GBP and Euros. The Bank plans to migrate to the more advanced Internal Models Approach (IMA) in 2010. To prepare for this transition, earlier this year, the Bank upgraded to the latest RiskMetricsTM Risk Manager. The remainder of the period until 2010 will be used to accumulate a sufficiently large data base to perform robust testing of the VaR model as the required precondition for CBB acceptance of the IMA.

Table 3: Market Risk Capital

	Capital requirement US$000	Maximum value during the period US$000	Minimum value during the period US$000	Average value during the period US$000
Equity risk capital	40	200	31	68
FX risk capital	2,004	3,614	1,917	2,465
Interest rate risk capital	264	482	185	286
Total	2,308			2,819

10. FINANCIAL RISK MANAGEMENT

10.1. Risk Governance Structure

In the normal course of its business, the Bank is exposed to various risks, related to the nature of the activities in which it engages and these risks include:

- Private equity investment risk
- Market risk
- Credit risk
- Interest rate risk
- Currency risk
- Liquidity risk
- Operational risk
- Strategic risk and
- Legal risks

At BMB, the management of financial and other risks is based on the establishment of an appropriate risk governance structure, comprising:

1. Procedures for the identification and quantification of risks
2. Criteria for risk acceptance based on risk and return as well as other factors
3. Clearly defined exposure and risk limits
4. Robust operating policies and procedures, including those for specific allocation of risk limits to individual obligors and/or transactions
5. The use of quantitative models and qualitative approaches to assess and manage risks
6. Portfolio diversification and, where possible, other risk mitigation techniques
7. Ongoing review of exposures and risks by an independent department, including stress testing and frequent reporting
8. Periodic internal audits of the control environment,
9. Risk Management Committee authorization and approval for certain activities and transactions

10.2. Risk Limits

Risk limits are at the heart of risk management processes at BMB. The Bank begins by setting maximum exposure limits as a percentage of capital for major lines of business. Within these macro limits, sub-limits are set by geography, obligor type/credit grade, instrument, tenor, etc. For trading activities the Bank uses 10 day VaR limits. Individual transactions and positions then take place within these VaR sub-limits.

Despite the existence of various risk limits, overall risk discipline is maintained by the requirement that the Bank:

(a) Maintains Basel II capital adequacy ratio in excess of the regulatory required minimum, and
(b) Considers the impact on the Bank's liquidity position of any major transaction(s) or new business initiative.

10.3. Role of the Board

Risk management at BMB begins at the Board of Directors level. The Board of Directors exercises oversight and final approval of the risk management process at BMB. It operates through two Board Committees, the Executive Committee and the Audit Committee. With input provided by the Bank's Risk Management Committee, the Executive Committee proposes the overall risk management strategy of the Bank. Based on the recommendations of the Executive Committee, the Board of Directors approves the aggregate levels of risk the Bank can assume as well as reviewing and approving the Bank's risk management policies, risk limits and risk control framework.

Among its duties, the Audit Committee is charged with reviewing and approving the Bank's policies and procedures as well as overseeing both the internal and external audits of the Bank, including matters related to the Bank's compliance with CBB anti-money laundering regulations. The Board delegates certain authority to the Executive Committee and the executive management of the Bank to implement the risk control decisions of the Board. To carry out these responsibilities, executive management operates through a Risk Management Committee (the "RMC"). The RMC is chaired by the Chief Executive and comprises members of senior management. It serves as the Bank's credit committee, asset/liability management committee, and investment approval committee. In addition, it prepares and submits to the Board detailed risk control policies and procedures as well as country, asset class and individual counterparty limits for Board approval. On an ongoing basis, the RMC monitors the environment in which the Bank operates and the risks to which it is exposed and recommends adjustments, as appropriate.

10.4. Risk Management Department

The Risk Management Department ("RMD") plays a key role in the Bank's risk management process. The RMD is independent of the Bank's trading and business areas and reports directly to the Chief Executive. It is responsible for identifying and quantifying risk exposures, recommending appropriate limits and monitoring usage of them. As part of its duties, the RMD prepares daily risk reports, including stress tests, for senior management and the RMC. In addition, the RMD manages problem or past-due assets. In identifying and monitoring risk exposures, BMB uses a variety of quantitative tools (including Value at Risk) as well as qualitative approaches to measure risks at the "macro" level. The Bank seeks to judiciously balance the use of these two approaches rather than rely on a single approach.

10.5. Independent Review

Internal Audit, which is independent of both operations and the Bank's business units, also assists in the risk management process. In particular, Internal Audit is charged with a periodic review of the effectiveness of BMB's policies and internal controls - a review which is independent of the Bank's executive management.

11. CREDIT RISK MANAGEMENT

BMB's principal line of business is placement of private equity investments, and, as such, the Bank is not involved in the granting of credit facilities. Further, BMB is not engaged in retail business and therefore does not use credit "scoring" models. However, the Bank is exposed to counterparty credit risk through its money market trading activities. In this respect credit risk is the risk of loss arising from the inability or unwillingness of a counterparty to meet its obligations to the Bank.

The Risk Management Department, under the oversight of RMC, has the responsibility for establishing credit risk standards and implementing the Bank's credit risk management process. BMB uses the Standardised Approach under the Basel II framework for measuring and managing its credit risk.

11.1. Internal Risk Grading

For internal credit risk management the Bank estimates the probability of default through its risk grading system which employs a ten-grade scale, with "1" representing a risk which has the least probability of default (equivalent to AAA rating) and "10" representing a defaulted obligation (equivalent to rating below CCC-). Risk grading is based on (a) quantitative factors (historical and prospective such as cash flow, profitability, asset quality and tenor of risk), (b) qualitative factors (such as management quality, market share and competitive position) and other factors, including country risk, the type of transaction, tenor, and credit mitigation. Where ratings from an External Credit Assessment Institution, recognised by the CBB, are available, BMB considers these as part of its internal rating process. The Bank uses credit ratings by S&P, Fitch, Moody's and Capital Intelligence.

All obligors and countries are risk graded. All lines of credit, counterparty, country and trading limits are subject to annual reaffirmation by the Board of Directors. The limits are also reviewed more frequently as necessary to ensure consistency with the Bank's trading and investment strategies or to take into account latest market developments. The Bank seeks to mitigate its exposure to losses through a variety of techniques such as investing in senior instruments (those with legal priority), transaction structuring and collateral or other security. 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. Credit risks for a given economic entity (including its subsidiaries and affiliates) are aggregated as the measure of exposure and are managed at that level. Credit standards are defined in the Bank's Credit Policies and Procedures Manual and include a sound process for evaluating obligor, transaction and product risks as well as concentration risk, etc.

Overall, Bank management considers that its policies and procedures constitute a reasonable approach to managing the credit risk in the activities it is engaged in. With respect to specific assets, the following summarises key credit risk issues:

1. Cash and deposits are placed with major OECD and regional banks,
2. Government and Government Agency bonds mainly comprise bonds received in settlement for an outstanding past due loan,
3. A significant portion of the bond portfolio is secured by US Government securities and
4. The Instalment Sale Receivable (ISR), which is in the Bank's books, resulted from the workout more than a decade ago of a credit facility granted by the Bank and is a performing asset with appropriate security package in place.

11.2. Collateral and Netting

The Group attempts to manage its credit risk exposure through diversification of its equity investments, capital markets and trading activities. Where possible, collateral agreements and master netting agreements are obtained to further control risks. In order to ensure a common approach to risk control, the Bank uses the same credit procedures when entering into trading activities, including foreign exchange and derivatives, as it does for traditional lending products.

11.3. Off-Balance Sheet Items

The Bank's off-balance sheet items consist primarily of commitments to various private equity funds representing the undrawn portion of the Bank's commitment for future investments which may be made by these funds. Undrawn investment commitments comprise contractual commitments to make investments in quoted equities and in other equities and funds as amounts are called by fund managers. The Bank's commitments for its private equity investments and other funds are generally for a period of between four and six years.

The Bank has no contingent exposure related to the issuance of letters of credit, standby letters of credit/guarantees or loans. Credit-related financial instruments include commitments to extend credit, standby letters of credit, guarantees and acceptances which are designed to meet the requirements of the Bank's customers. Commitments to extend credit represent contractual commitments to make loans and revolving credits. Commitments generally have fixed dates or other termination clauses and require the payment of a fee. Since commitments may expire without being drawn upon, the total contract amounts do not necessarily represent future cash requirements. Standby letters of credit, guarantees and acceptances commit the Bank to make payments on behalf of customers contingent upon the failure of the customer to perform under the terms of the contract.

11.4. Securitisation

The Bank does not participate in Securitisation activities in relation to credit synthesis; acting as sponsor, liquidity facility provider, credit enhancement facility provider, swap provider and during the period to 30 June 2009 has not securitised any of its assets and therefore has no recourse obligations under such transactions. In addition the Bank does not have any exposure to "Highly Leveraged Institutions" ("HLI") as defined by the Financial Stability Task Force.

11.5. Concentration Credit Risk

Concentration of credit risk arises when a number of obligors or counterparties 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 Group's performance to developments affecting a particular industry or region. The Bank sets limits based on geographic regions, types of investment, risks involved. The Bank's Large Exposure Policy details the Bank's exposure limits and the policy is in compliance with CBB restrictions on concentration limits.

The table below summarizes the Group's gross and average gross credit exposures as at and for the six month period ended 30 June 2009:

Table 4: Gross and average credit exposures

	Gross exposure 30 June 2008 US$000	Six months average 30 June 2009 US$000
Cash and deposits with banks	8,806	5,087
Government and Government Agencies bonds	4,388	4,388
Other equities and funds	43,102	44,937
Other bonds	5,141	7,963
Derivative financial instruments	-	10
Loans and advances	1,445	1,394
Instalment sale receivable	15,682	16,490
Other assets	4,724	5,482
Total	83,288	85,751
Trading equities and funds	250	238
Fixed assets	526	532
Total	84,064	86,521
Off-balance sheet credit and investment instruments	58,686	57,922

The gross average credit exposures are based on quarter end prudential return reporting.

The following tables summarize the Group's geographical and industry sector exposures, and any potential risk concentrations arising therefrom. Maximum credit risk exposures are detailed without considering the effects, if any, of collateral or other credit mitigation techniques on the Group's assets, liabilities and off-balance sheet items.

Table 5: Geographical Sector Exposures

	North America US$000	Europe US$000	Rest of the world US$000	Total US$000
Assets				
Cash and deposits with banks	6,725	1,272	809	8,806
Government and Government Agency bonds	-	-	4,388	4,388
Other equities and funds	21,441	19,991	1,670	43,102
Other bonds	4,901	240	-	5,141
Derivative financial instruments	-	-	-	-
Loans and advances	1,368	-	77	1,445
Instalment sale receivable	-	-	15,682	15,682
Other assets	2,122	1,213	1,389	4,724
Total assets subject to credit risk	36,557	22,716	24,015	83,288
Trading equities and funds	-	-	250	250
Fixed assets	-	-	526	526
Reconciliation to total assets	36,557	22,716	24,791	84,064
Off-balance sheet credit and investment instruments	24,693	49,052	2,500	76,245

Table 6: Industry sector exposure

	Banking/ Finance US$000	Govern-ment US$000	Technology/ Telecoms US$000	Diversified US$000	Others US$000	Total US$000
Assets						
Cash and deposits with banks	8,740	66	-	-	-	8,806
Government and Government Agency bonds	-	4,388	-	-	-	4,388
Other equities and funds	-	-	27,138	15,532	432	43,102
Other bonds	-	4,076	-	-	1,065	5,141
Derivative financial instruments	-	-	-	-	-	-
Loans and advances	-	540	872	-	33	1,445
Instalment sale receivable	-	-	-	-	15,682	15,682
Other assets	203	117	1,721	1,572	1,111	4,724
Total assets subject to credit risk	8,943	9,187	29,731	17,104	18,323	83,288
Trading equities and funds	-	-	250	-	-	250
Fixed assets	-	-	-	-	526	526
Reconciliation to total assets	8,943	9,187	29,981	17,104	18,849	84,064
Off-balance sheet credit and investment instruments	-	-	11,314	64,931	-	76,245

11.6. Provisions for impairment

A provision is made in respect of a financial asset that is impaired if its carrying amount is greater than its estimated recoverable amount. Provisions for assets carried at amortised cost are calculated as the difference between the asset's carrying amount and the present value of expected future cash flows discounted at the financial instrument's original effective interest rate. By comparison, the recoverable amount of an instrument measured at fair value is the present value of expected future cash flows discounted at the current market rates of interest for similar financial assets.

Unquoted equity investments, included in other equities and funds, and CDO's, included in other bonds, are stated after deducting impairment provisions as follows:

Table 7: Provisions

	Unquoted equity investments US$000	CBO's US$000
At 1 January 2009	5,374	11,458
Charge for the year	13,516	177
Amounts written off	(525)	-
Writebacks	-	-
Foreign exchange movements	4	-
At 30 June 2009	18,369	11,635

12. MARKET RISK

Market risk is defined as potential adverse changes in the fair value or future cash flows of a trading position or portfolio of financial instruments resulting from the movement of market variables, such as interest rates, currency rates, equity prices and commodity prices, market indices as well as volatilities and correlations between markets. As its primary tool, the Bank measures its market risk exposure using the Standardised Approach under Basel II.

12.1. Value at Risk

The Bank uses Value at Risk (VaR) to calculate and aggregate its market risk. In calculating VaR BMB uses RiskMetrics™ Value at Risk model as a secondary market risk measurement and monitoring tool, as well as for stress testing of positions. VaR is a statistical risk measure which quantifies, within a given confidence level, the maximum expected fluctuation in the fair value of a portfolio within a specified time period. BMB calculates VaR for a 99% one-tailed confidence level for a one-day holding period, based on market price changes during a previous one-year historical observation period. As such, the VaR parameters correspond to a maximum potential loss in one of one hundred trading days.

The market data, on which these calculations are made, including correlations and volatility, are provided by an independent third party vendor, Riskmetrics. Calculations are made both by risk factor and then for the Bank's entire market risk portfolio after consideration of correlations between asset classes, which may result in diversification benefits or may reflect additional risk due to unfavourable co-movements between asset classes; hence because of this imperfect correlation the total VaR is always less than the sum of the VaR of the individual risk components, which results in diversification benefits. The majority of the Bank's market risk exposure arises from the foreign exchange risk inherent in the bank's private equity investments which are predominantly denominated in euro and sterling. The total 1-day VaR for these risks, segregated by the sources of risk, at 30 June 2009 are as shown in the table below.

Table 8: Value at Risk

USD000s	30 June 2009	Average	Minimum	Maximum
Equity Risk	17	28	13	51
Interest Rate	155	150	136	168
Commodity Risk	-	-	-	0.8
Foreign Exchange	587	372	93	631
Diversification Benefit	113			
Total VaR	646	438	175	703

Specifications: 1 day, Historical simulation methodology, 0.94 decay factor, 99% confidence

While VaR captures the Bank's market risk exposure under normal market conditions, stress testing is used to add insight to the possible outcomes under abnormal market conditions for a variety of historical and simulated extreme market events. The results of these stress tests are reported to senior management as part of the daily VaR reports.

12.2. Stress Testing

The Bank's daily VaR calculations are complemented by daily stress testing of the market risk portfolio for a variety of historical and simulated extreme market events. The Bank also performs stress tests on interest rate risk in its "banking book." The results of these stress tests are reported to senior management as part of the daily VaR reports. Existing interest rate and foreign exchange exposures (the latter chiefly from foreign currency denominated private equity investments), as well as equity exposures from existing publicly traded equity investments, are considered by the VaR model as market exposures.

12.3. Interest rate risk

Interest rate risk is the risk that changes in market interest rates will affect (a) the fair value of financial instruments ("fair value interest rate risk") and/or (b) the future cash flows associated with financial instruments subject to periodic repricing ("cash flow interest rate risk"). The Bank is exposed to interest rate risk as a result of mismatches or gaps in the amounts of assets and liabilities and off-balance sheet instruments that mature or reprice in a given period. The Bank manages this risk by matching the repricing of assets and liabilities through a variety of means, such as the daily risk analysis reports from the market risk model which assist the management in measuring and monitoring the Bank's exposure to interest rate risk. The Bank's interest rate sensitivity position is based on the contractual repricing or maturity dates, whichever dates are earlier, as follows:

Table 9: Interest Rate Gap Report

	Up to 1 month US$000	1 – 3 months US$000	3 - 6 months US$000	6 - 12 months US$000	1 – 5 years US$000	Over 5 years US$000	Non-interest bearing US$000	Total US$000
Cash and deposits with banks	66	-	-	-	-	-	8,740	8,806
Trading equities and funds	-	-	-	-	-	-	250	250
Government and Government Agency bonds	-	-	-	-	-	4,388	-	4,388
Other equities and funds	-	-	-	-	-	-	43,102	43,102
Other bonds	240	-	-	4,901	-	-	-	5,141
Derivative financial instruments	-	-	-	-	-	-	-	-
Loans and advances	33	-	-	-	872	-	540	1,445
Instalment sale receivable	-	-	1,696	-	7,646	6,340	-	15,682
Fixed assets	-	-	-	-	526	-	-	526
Other assets	222	330	-	117	3,780	-	275	4,724
Total assets	561	330	1,696	5,018	12,824	10,728	52,907	84,064
Customer deposits	25,244	-	-	-	-	-	900	26,144
Securities sold under repurchase agreements	-	-	-	-	-	-	-	-
Derivative financial instruments	-	-	-	-	-	-	-	-
Subordinated loan	-	-	-	10,000	-	-	-	10,000
Revolving loan facility	11,600	-	-	-	-	-	-	11,600
Other liabilities	696	956	620	78	256	3,363	1,405	7,374
Shareholders' equity	-	-	-	-	-	-	28,946	28,946
Total liabilities and shareholders' equity	37,540	956	620	10,078	256	3,363	31,251	84,064
Total interest rate sensitivity gap	(36,979)	(626)	1,076	(5,060)	12,568	7,365		

13. INTEREST RATE RISK IN THE BANKING BOOK (IRRBB)

The Bank employs various analytical techniques to measure interest rate sensitivity within the banking book. This includes economic value of equity for a standard interest rate shock and stress-testing earnings at risk and economic value of equity for a number of stressed interest rate scenarios. These analyses include the application of parallel and non-parallel interest rate shocks. As at 30 June 2009 a 200 basis point shift in interest rates would affect the present value of the bank's positions as follows;

Table 10: 200 basis point shock

USD 000s	Up 200 basis point	Down 200 Basis Points
Euro	257	(166)
British Pound	106	(96)
United States Dollar	1,045	(1,110)
Total	1,408	(1,371)

14. LIQUIDITY RISK

Liquidity risk is primarily the risk that the Bank will be unable to meet its payment obligations as they fall due and/or to replace funds when they are withdrawn (“liability liquidity risk”). It also represents the risk that the Bank will be unable to realise its assets in a timely fashion for prices close to their carrying values (“asset liquidity risk”). BMB strives to minimise liability liquidity risk by diversifying its sources of funding across markets, instruments and counterparties, and by matching the maturity of liabilities to the maturity of assets. The Bank seeks to maintain high quality marketable securities within its portfolio as well as sizeable short-term deposits with banks as a cash reserve. In its investing activities, BMB seeks to diversify its assets across instruments and markets and to avoid obligor concentrations which could constitute asset liquidity risk. This is particularly the case for our investments in unlisted private equity funds where BMB has consciously implemented a strategy of reducing our average individual investment size. Liquidity is managed on a daily basis and senior management closely monitors significant daily changes to the liquidity position. In evaluating the liquidity position, the Bank also takes into account the possible call of undrawn commitments in its investment portfolio. The maturity profile of the Group's assets and liabilities as at 30 June 2009 is shown below:

Table 11: Maturity Gap Report

	Within 1 month US$000	1 - 3 months US$000	3 - 6 months US$000	6 - 12 months US$000	1-5 years US$000	5-10 years US$000	10-20 years US$000	Over 20 years US$000	Total US$000
Assets									
Deposits with banks	8,806	-	-	-	-	-	-	-	8,806
Trading equities and Funds	250	-	-	-	-	-	-	-	250
Government and Government Agency bonds	127	-	-	-	127	-	-	4,388	4,642
Other equities and Funds	-	-	-	1,645	39,677	1,780	-	-	43,102
Other bonds	-	-	-	-	5,000	-	-	240	5,240
Derivative financial instruments	-	-	-	-	-	-	-	-	-
Loans and advances	33	540	-	-	1,011	-	-	-	1,584
Instalment sale Receivable	-	-	-	2,457	9,829	6,946	-	-	19,232
Fixed assets	-	-	-	-	504	-	-	-	504
Other assets	105	330	-	28	4,054	-	-	-	4,517
Total assets	9,321	870	-	4,130	60,202	8,726	-	4,628	87,877
Liabilities									
Customer deposits	1,685	463	1,733	4,000	18,294	-	-	-	26,175
Securities sold under repurchase agreements	-	-	-	-	-	-	-	-	-
Derivative financial Instruments	-	-	-	-	-	-	-	-	-
Revolving loan facility	26	3,000	3,000	2,600	-	-	-	-	8,626
Subordinated loan	-	-	1,226	-	10,000	-	-	-	11,226
Other liabilities	576	956	-	66	256	3,363	-	-	5,217
Total liabilities	2,287	4,419	5,959	6,666	28,550	3,363	-	-	51,244
Net liquidity gap	7,034	(3,549)	(5,959)	(2,536)	31,652	5,363	-	4,628	

15. PRIVATE EQUITY RISK

BMB invests in private equity with the intent of later sale of these investments at a profit to third parties either through a sale to another business ("trade sale") or an initial public offering ("IPO"). Private equity risk is the risk that the Bank will not be able to sell its investments at a profit within the intended time period. This risk arises from three factors:

1) The first relates to the risk that the funded underlying business does not develop a sustainable business or its line of business is not attractive to other investors

2) The second factor relates to macro trends in markets for IPO's and mergers and acquisition activity. The state of these markets affects both the price and timing of any "exit" from an investment and

3) The third factor is that these investments typically are realised over the medium term and are not traded on organised exchanges, hence they have limited liquidity.

BMB uses the Standardised Approach under the Basel framework for measuring and managing its private equity risk, which is considered a part of its "banking book". The Bank manages risks at the specific investment level in the following ways. First, it invests primarily in independently managed third party funds whose managers have a demonstrated successful track record. Based on its own experience and analysis of the private equity industry, BMB believes that the quality of the fund manager is a key risk mitigant. Second, the Bank seeks to diversify its investments across fund managers, different stages in the investment cycle (various stages of venture capital, buy-out, etc), geographical locations and industries. The goal is to reduce exposure to any one investment. Trends in macro economic events and their effects on the IPO and trade sale market are largely out of the control of the Bank. BMB seeks to mitigate its exposure to these risks by selecting managers who have demonstrated a solid track record over different economic cycles and by diversification of investments. Diversification is also the key tool for dealing with the inherent limited liquidity of this asset class.

16. EQUITY EXPOSURE RISK

Equity risk is the risk of adverse impact on the Bank's income and economic value arising from adverse movements in equity prices. The Bank is exposed to equity exposure risk arising from its trading portfolio of equities listed in the GCC, India, UK/Europe and the US. The Bank has Board-approved geographic equity exposure limits based on cost as the first line of defense against equity risk. In addition, the Bank calculates 1-day and 10-day VaR at the 99% confidence interval using historical simulation for the equity exposures and the Bank manages equity risk within the context of VaR equity risk limits. Equity VaR usage is monitored by the Risk Management Department daily and reported to senior management for review and to the Board on a periodic basis. In addition, the Risk Management Department conducts a set of 16 stress tests against its market risk exposures on a daily basis by simulating historical market stress events and the results of the stress tests are reported to senior management. The Bank uses the Standardised Approach for calculating capital charges for equity risk exposures as part of its market risk capital charge under Basel II.

17. OPERATIONAL AND LEGAL RISK

Operational risk is the risk of loss arising from errors that can be made in instructing payments or settling transactions, breakdown in technology and internal control systems. BMB uses the Basic Indicator Approach under the Basel II framework for measuring and managing its operating risk. Currently, the Bank conducts its business from a single location. BMB is an investment bank and does not operate a retail or commercial banking franchise. Accordingly, the number of client relationships and volume of transactions at BMB are lower than at such institutions. The nature of transactions differ as well given the Bank's focus on investing in unlisted private equities for its own and its clients' accounts. These factors mitigate to some extent the operational risks to which the Bank is exposed both in terms of volumes of transactions and the liquidity of the assets underlying these transactions. As noted above, the Bank does not provide commercial or retail banking products and as such does not offer its clients cash deposit/withdrawal services, ATMs, credit cards, letter of credit or loan facilities.

BMB’s operations are conducted according to well-defined procedures. These procedures include a comprehensive 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 and securities accounts and other checks to enable it detect any erroneous or improper transactions which may have occurred.

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. 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 periodic staff training and internal and external reviews, as well as internal and external review by auditors. To further mitigate operational and legal risks, the Bank uses insurance contracts to transfer risk off its books.