Bahrain Middle East Bank B.S.C.

Basel II Pillar 3 Disclosures

For the six months period ended 30 June 2014

These disclosures have been prepared in accordance with the Public Disclosure Module ("PD"), Section PD-3.1.6, CBB Rule Book, Volume I for Conventional Banks. These disclosures should be read in conjunction with the Group's interim condensed consolidated financial statements for the six months period ended 30 June 2014.

These disclosures have been reviewed by the Bank's external auditors Ernst & Young, based upon agreed upon procedures as required under Para PD-A.2.4 of the PD Module.

TABLE OF CONTENTS

1 EXECUTIVE SUMMARY

The Central Bank of Bahrain's ("the 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"). The disclosures also contain certain other additional information which the Bank believes will be useful to readers in interpreting these Disclosures and in understanding BMB's approach to risk management. The Basel II Pillar 3 Disclosures must be read in conjunction with the Bank's interim condensed consolidated financial statements as at 30 June 2014.

Bahrain Middle East Bank B.S.C. ("the Bank", "BMB" or "BMB Investment Bank") has adopted the Standardised Approach for Credit Risk and Market Risk, and the Basic Indicator Approach for Operational Risk to determine the capital requirements.

The Bank's previous Basel II Pillar 3 Disclosures report was for the year ended 31 December 2013 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. is a Bahraini Shareholding Company incorporated in the Kingdom of Bahrain. On 9 April 2007, the Central Bank of Bahrain issued a Conventional Wholesale Banking license to the Bank. The commercial registration (CR) number of the Bank is 12266. The Bank is listed on the Bahrain Bourse under the ticker 'BMB'.

The principal activities of the Bank and its subsidiaries (together "the Group") are trade finance and corporate advisory in the digital media and e-commerce sectors. The Bank has a legacy portfolio of private equity investments.

The subsidiaries of the Bank at 30 June 2014 were as follows:

Subsidiary	Ownership %	Country of incorporation	Nature of business
BMB Investment Company (Jersey) Limited	100%	Jersey	Investment holding
BMB Property Services W.L.L.	100%	Kingdom of Bahrain	Building Management
BMB Trade Finance	100%	Cayman Islands	Investment holding
Universal Merchant Holdings NV*	100%	Netherlands Antilles	Investment holding
Universal Finance Holding NV*	100%	Netherlands	Investment holding
European Universal Finance NV*	100%	Netherlands	Investment holding
BMB Netherlands Antilles NV	100%	Netherlands Antilles	Investment holding
BMB Curacao Netherlands NV	100%	Netherlands Antilles	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 New Era Ventures – IV LDC	100%	Cayman Islands	Investment holding
BMB New Era Ventures – V LDC	100%	Cayman Islands	Investment holding

**Under liquidation*

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.

3.2 Consolidation

All the subsidiaries of the Bank are fully consolidated in the Bank's consolidated financial statements. There is no material difference between the basis of consolidation used for financial statements and regulatory purposes.

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 entities

The Bank does not have any subsidiaries or investments in companies engaged in the insurance business.

3.5 Aggregate regulatory and other 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. 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 period under review, nor does it have any such capital instruments outstanding.

The Bank's Tier 1 Capital comprise of share capital, retained earnings and eligible reserves.

The Bank's Tier 2 Capital comprise of interim profits, collective impairment provisions up to 1.25% of risk weighted assets and 45 per cent of unrealized gains arising on revaluation of available-for-sale investments.

The Bank had no Tier 3 Capital as at 30 June 2014.

4 CAPITAL STRUCTURE (continued)

4.2 Capital Adequacy

The Bank's Capital Adequacy Ratio as at 30 June 2014 was as follows:

Regulatory capital	***30 June 2014 US$ '000***
Tier 1 capital	
Share capital	**60,501**
Accumulated losses	**(36,157)**
Total qualifying Tier 1 capital (a)	**24,344**
Tier 2 capital	
Current interim profits	**2,372**
Revaluation reserves – available-for-sale investments	**1,678**
Collective impairment provision	**1,227**
Total qualifying Tier 2 capital (b)	**5,277**
Regulatory capital base under Basel II (c) = (a) + (b)	**29,621**

	30 June 2014	
Risk weighted exposure	***Principal amounts US$ '000***	***Risk weighted equivalents US$ '000***
Claims on sovereigns	**3,115**	**-**
Claims on banks	**38,322**	**8,591**
Claims on corporates	**116,260**	**111,268**
Past due exposures - net of provisions	**858**	**858**
Investments in securities	**12,755**	**18,931**
Other assets	**2,090**	**2,090**
Credit risk weighted exposure		**141,738**
Market risk weighted exposure		**2,213**
Operational risk weighted exposure		**15,450**
Total risk weighted exposure (d)		**159,401**
Tier 1 capital ratio (a) / (d)		**15.27%**
Capital adequacy ratio (c) / (d)		**18.58%**
Minimum required as per CBB regulatory guidelines under Basel II		**12.00%**

5 CREDIT RISK

The Bank uses standardised approach for credit risk and has a diversified credit portfolio, which is divided into exposure classes in line with the CBB's Basel II capital adequacy framework.

5.1 Gross and average credit exposures

	30 June 2014	
	Gross exposures US$ '000	*Average exposures US$ '000*
Balances with banks and financial institutions	**18,322**	**11,369**
Placements with financial institutions	**23,049**	**22,255**
Trading securities	**341**	**339**
Loans and advances	**109,051**	**108,632**
Available-for-sale investments	**14,465**	**15,743**
Held-to-maturity investments	**248**	**3,956**
Other assets	**1,959**	**2,195**
Total on-balance sheet exposures	**167,435**	**164,489**
Off-balance sheet items	**9,185**	**9,050**
Total credit risk exposures	**176,620**	**173,539**

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. The 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.

5.2 Geographical Sector Exposures

	30 June 2014				
	North America US$ '000	*Europe US$ '000*	*GCC US$ '000*	*Rest of the world US$ '000*	*Total US$ '000*
Balances with banks and financial institutions	**6,538**	**4,758**	**7,017**	**9**	**18,322**
Placements with financial institutions	**-**	**-**	**17,049**	**6,000**	**23,049**
Trading securities	**-**	**-**	**341**	**-**	**341**
Loans and advances	**-**	**100,385**	**7,797**	**869**	**109,051**
Available-for-sale investments	**8,491**	**5,307**	**237**	**430**	**14,465**
Held-to-maturity investments	**-**	**248**	**-**	**-**	**248**
Other assets	**-**	**1,638**	**316**	**5**	**1,959**
Total on-balance sheet exposures	**15,029**	**112,336**	**32,757**	**7,313**	**167,435**
Off-balance sheet items	**4,160**	**2,292**	**2,733**	**-**	**9,185**
Total credit risk exposures	**19,189**	**114,628**	**35,490**	**7,313**	**176,620**

5 CREDIT RISK (continued)

5.3 Industry Sector Exposures

	30 June 2014				
	Banking/ Finance US$ '000	*Govern-ment US$000*	*Consumer Goods US$ '000*	*Others US$ '000*	*Total US$ '000*
Balances with banks and financial institutions	**18,322**	**-**	**-**	**-**	**18,322**
Placements with financial institutions	**20,000**	**3,049**	**-**	**-**	**23,049**
Trading securities	**341**	**-**	**-**	**-**	**341**
Loans and advances	**-**	**869**	**100,385**	**7,797**	**109,051**
Available for sale investments	**12,637**	**-**	**-**	**1,828**	**14,465**
Held-to-maturity investments	**-**	**-**	**-**	**248**	**248**
Other assets	**1,692**	**66**	**-**	**201**	**1,959**
Total on-balance sheet exposures	**52,992**	**3,984**	**100,385**	**10,074**	**167,435**
Off-balance sheet items	**6,452**	**-**	**-**	**2,733**	**9,185**
Total credit exposures	**59,444**	**3,984**	**100,385**	**12,807**	**176,620**

5.4 Past due and impaired loans – Industry and geographical sector wise

The details of past due and impaired loans are as follows:

	30 June 2014 US$ '000
Gross amount of past due loans	**1,159**
Specific impairment provision	**(290)**
Net past due loans	**869**

The past due and impaired loans relate to industry sector “Government” and geographical sector “Rest of the world”. The ageing of past due and impaired receivables is “3 months or less”.

5.5 Movement in impairment provisions

	Specific provision US$ '000	*Collective provision US$ '000*	*Total US$ '000*
At 1 January 2014	**-**	**1,077**	**1,077**
Charge / movement for the period	**290**	**150**	**440**
At 30 June 2014	**290**	**1,227**	**1,517**

The collective provision is allocated to the loans and advances based on the geographical areas.

5.6 Large exposures

Loans and advances include an exposure to a corporate entity, amounting to US$ 7.8 million, which is in excess of 15 % of the Bank’s capital base. However, an exemption has been obtained from the CBB for this exposure and hence, this has not been deducted from the capital base of the Bank.

5 CREDIT RISK (continued)

5.7 Credit Risk Mitigation

The reduction of the capital requirement attributable to credit risk mitigation is calculated in different ways, depending on the type of credit risk mitigation, as under:

Adjusted exposure amount: The Bank uses the comprehensive method for eligible financial collateral such as cash. In the comprehensive approach, when taking collateral, adjusted exposure to a counterparty for capital adequacy purposes is calculated by taking account of the effects of that collateral.

Substitution of counterparty: The substitution method is used for eligible guarantees and credit derivatives (if the rating of the credit provider is A- or better) whereby the rating of the counterparty is substituted with the rating of the guarantor / credit protection provider.

Gross credit exposures and eligible financial collateral, presented by standard portfolio are as under:

Exposures	**30 June 2014**		
	Gross credit exposures US$ '000	***Eligible financial collateral US$ '000***	***Net credit exposures US$ '000***
Claims on sovereigns	**3,115**	-	**3,115**
Claims on banks	**38,322**	-	**38,322**
Claims on corporates*	**116,260**	**1,473**	**114,787**
Past due exposures	**858**	-	**858**
Investments in securities	**12,755**	-	**12,755**
Other assets	**2,090**	-	**2,090**
Total credit exposures	**173,400**	**1,473**	**171,927**

*Claims on corporates include exposures of US$ 4,335 thousand which are protected by credit derivatives.

5.8 Residual contractual maturity

The residual contractual maturity of credit exposures is as follows:

	Upto 3 months US$'000	*3 to 6 months US$'000*	*6 to 12 months US$'000*	*1 to 5 years US$'000*	*Over 5 years US$'000*	*Total US$'000*
Balances with banks and financial institutions	18,322	-	-	-	-	18,322
Placements with financial institutions	20,049	3,000	-	-	-	23,049
Trading securities	341	-	-	-	-	341
Loans & advances	64,836	35,548	869	7,798	-	109,051
Available-for-sale investments	2,893	4,339	7,233	-	-	14,465
Held-to-maturity investments*	-	-	-	-	248	248
Other assets	1,692	267	-	-	-	1,959
Total on-balance sheet exposures	**108,133**	**43,154**	**8,102**	**7,798**	**248**	**167,435**
Off- balance sheet items	1,290	1,935	3,226	2,734	-	9,185
Total exposures	**109,423**	**45,089**	**11,328**	**10,532**	**248**	**176,620**

*Held-to-maturity investments mature in 2028.

6 MARKET RISK

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

- Equity position risk
- Foreign currency risk

The Bank is not exposed to interest rate risk as it does not have any interest bearing exposures in its trading book.

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 mainly in Sterling and Euro. The capital requirement for market risk using the Standardised Approach as at 30 June 2014 was as follows:

	Capital requirement			
Risk type	***30 June 2014 US$ '000***	***Maximum value US$ '000***	***Minimum value US$ '000***	***Average value US$ '000***
Equity position risk	**55**	**55**	**54**	**55**
Foreign exchange risk	**122**	**263**	**122**	**193**
Total	**177**	**318**	**176**	**248**

7 OPERATIONAL RISK

The Bank follows the Basic Indicator Approach for assessing the capital requirement for Operational Risk. As at 30 June 2014, the total capital requirement in respect of operational risk was US$ 1,854 thousand on operational risk weighted exposure of US$ 15,450 thousand. The operational risk weighted exposure is based on the gross operating income (excluding profit/loss on available-for-sale and held to maturity categories and any exceptional items of income) for the last 3 years multiplied by 15% (Alpha) and 12.5 (the reciprocal of the 8 percent minimum capital ratio) to arrive at the operational risk-weighted exposure.

8 EQUITY POSITIONS IN BANKING BOOK

The Bank holds certain investments in equity securities as part of its strategic holdings and others are held with the objective of capital appreciation and realizing gains on sale thereof. All equity positions in the Banking book are classified as "available-for-sale" investments.

The capital requirement for investments using the Standardised Approach as at 30 June 2014 was as follows:

	Carrying value US$ '000	***Capital requirement US$ '000***
Available-for-sale investments - Quoted	**98**	**12**
Available-for-sale investments - Unquoted	**14,367**	**1,724**
Total	**14,465**	**1,736**

9 INTEREST RATE RISK IN THE BANKING BOOK (IRRBB)

Interest rate risk is the risk that changes in market interest rates will affect the future cash flows or the fair values of financial instruments.

All of the Group's interest earning assets and interest bearing liabilities carry fixed rates of interest; hence, there is no sensitivity to interest rate risk.

10 REMUNERATION

During the six months period ended 30 June 2014, there was no variable remuneration, guaranteed bonuses and deferred remuneration paid to any of the approved persons or material risk-takers. The total fixed remuneration paid, to the approved persons and material risk-takers, during the period was US$ 1,178 thousand.

11 RELATED-PARTY TRANSACTIONS AND BALANCES

Parties are considered to be related if one party has the ability to control the other party or exercise significant influence over the other party in making financial and operating decisions. Related parties include entities over which the Bank exercises significant influence, major shareholders, directors, key management personnel of the Bank and entities owned, controlled, jointly controlled or significantly influenced by such parties.

Please refer note 8 of interim condensed consolidated financial statements for details on related party balances and transactions.