

**Liquidity Management Centre B.S.C. (c)**

**Basel II, Pillar III Disclosures**

**30 JUNE 2009 (Unaudited)**

# Liquidity Management Centre B.S.C. (c)

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## Basel II, Pillar III Disclosures

For the period ended 30 June 2009 (Unaudited)

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## Basel II, Pillar III Disclosures

For the period ended 30 June 2009 (Unaudited)

### 1 Background

The Public Disclosures under this section have been prepared in accordance with the Central Bank of Bahrain ("CBB") requirements outlined in its Public Disclosure Module ("PD"), Section PD-1: Annual Disclosure requirements, CBB Rule Book, Volume II for Islamic Banks. Rules concerning the disclosures under this section are applicable to Liquidity Management Centre B.S.C. (c) (the "Bank") being a locally incorporated Bank with a Wholesale Islamic Investment Banking license, and its subsidiary together known as (the "Group").

The Board of Directors seeks to optimize the Bank's performance by enabling the various group business units to realize the Group's business strategy and meet agreed business performance targets by operating within the agreed capital and risk parameters and the Group risk policy framework.

### 2 Capital Adequacy

The primary objectives of the Group's capital management are to ensure that the Group complies with externally imposed capital requirements and that it maintains healthy capital ratios in order to support its business and to maximize shareholders' value.

The Group manages its capital structure and makes adjustments to it in light of changes in economic conditions and the risk characteristics of its activities. In order to maintain or adjust the capital structure, the Group may adjust the amount of dividend payment to shareholders, return capital to shareholders or issue capital securities.

The Bank's capital adequacy policy is to maintain a strong capital base to support the development and growth of the business. Current and future capital requirements are determined on the basis of growth expectations of the business and future sources and uses of funds. To assess its capital adequacy requirements in accordance with CBB regulations, the Group adopts the Standardized Approach for its Credit Risk, Basic Indicator Approach for its Operational Risk and Standardized Measurement Approach for its Market Risk.

**Table – 1. Capital Structure (PD-1.3.12, 1.3.13,1.3.15) \***

The following table summarizes the eligible capital after deductions for Capital Adequacy Ratio (CAR) calculation.

	<i>Tier 1</i> <i>USD'000</i>	<i>Tier 2</i> <i>USD'000</i>
<b>Components of capital</b>		
Issued and fully paid ordinary shares	51,000	
General reserves	1,930	
Legal / statutory reserves	1,930	
Other reserves	(317)	
Retained profit brought forward	(245)	
<b>Less:</b>		
Unrealized gross losses arising from fair valuing equity securities	2,835	
<b>Tier 1 Capital before PCD deductions</b>	<b>51,463</b>	
Current interim profits		2,000
Unrealized gains arising from fair valuing equities (45% only)		3,009
<b>Tier 2 Capital before PCD deductions</b>		<b>5,009</b>
<b>Total available capital</b>		<b>56,472</b>
<b>Tier 1 and Tier 2 eligible capital</b>	<b>51,463</b>	<b>5,009</b>
<b>TOTAL ELIGIBLE CAPITAL</b>		<b>56,472</b>

\* For the purposes of guidance we have cross referenced every table with the relevant para number of the Central Bank of Bahrain's Public Disclosures Module.

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### 2 Capital Adequacy (continued)

**Table – 2. Capital requirement by type of Islamic financing contracts (PD-1.3.17)**

The following table summarises the amount of exposures subject to standardized approach of credit risk and related capital requirements by type of Islamic financing contracts;

<b>Type of Islamic Financing Contracts</b>	<b>Amount of exposures USD'000</b>	<b>Risk weighted assets</b>	<b>Capital requirements USD'000</b>
Investment in Sukuk	238,145	174,945	20,993
Due from bank	4,000	800	96
	<b>242,145</b>	<b>175,745</b>	<b>21,089</b>

**Table – 3. Capital requirement for Market and Operational Risk (PD-1.3.18)**

The following table summarises the amount of exposures subject to standardized approach of market risk and related capital requirements;

	<b>Self Financed USD'000</b>
Market Risk - Standardised Approach	
Foreign exchange risk	1
<b>Total of Market Risk - Standardised Approach</b>	<b>1</b>
<b>Multiplier</b>	<b>12.5</b>
	<b>13</b>
Eligible Portion for the purpose of the calculation	<b>100%</b>
<b>RWE to be used in CAR Calculation</b>	<b>13</b>
<b>TOTAL MARKET RISK EXPOSURES</b>	<b>13</b>

The minimum capital requirement for the above Market risk exposure is USD 1.5 thousand.

**Table – 4. Capital Requirements for Operational Risk (PD-1.3.19) & (PD-1.3.30 (a & b))**

The following table summarises the amount of exposures subject to basic indicator approach of operational risk and related capital requirements;

	<b>Capital charge USD'000</b>
<b>Indicators of operational risk</b>	
Average Gross income	12,469
<b>Multiplier</b>	<b>12.5</b>
	<b>155,863</b>
Eligible Portion for the purpose of the calculation	<b>15%</b>
<b>TOTAL OPERATIONAL RISK EXPOSURE</b>	<b>23,379</b>

The minimum capital requirement for the above Operational risk exposure is USD 2,806 thousand.

**2 Capital Adequacy (continued)**

**Table – 5. Capital Adequacy Ratios (PD-1.3.20)**

The following table summarises the Capital Adequacy Ratios for total capital and Tier 1 capital;

	<i><b>Total capital ratio</b></i>	<i><b>Tier 1 capital ratio</b></i>
Top consolidated level	<b>23.23%</b>	<b>21.17%</b>

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### 3 Risk Management

#### 3.1 Credit Risk

**Table – 6. Credit Risk Exposure (PD-1.3.23 (a))**

The following table summarises the amount of gross funded credit exposure and average gross funded exposures over the period allocated in own capital. The average gross funded exposure is calculated based on month end balances.

	<i>Own capital</i>	
	<i>Total gross credit exposure USD'000</i>	<i>Average gross exposure over the period USD'000</i>
<b>Funded</b>		
Cash and balances with banks	2,061	2,862
Available-for-sale investments - Sukuk	28,087	24,752
Held to Maturity investments - Sukuk	212,580	201,123
Murabaha receivables	-	1,151
Due from Bank	4,000	13,167
Other assets	5,819	3,714
<b>Total</b>	<b>252,547</b>	<b>246,769</b>
<b>Unfunded / commitments</b>		
Ijara commitment	26,525	26,525
Investment commitment	580	580
<b>Total</b>	<b>27,105</b>	<b>27,105</b>

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## Basel II, Pillar III Disclosures

For the period ended 30 June 2009 (Unaudited)

### 3 Risk Management (continued)

#### 3.1 Credit Risk (continued)

**Table – 7. Credit Risk – Geographic Breakdown (PD-1.3.23(b))**

The following table summarises the geographic distribution of exposures, broken down into significant areas by major types of credit exposure;

	<i>Own capital</i>			<i>Total</i> <i>USD'000</i>
	<i>Geographic area</i>			
	<i>Bahrain</i> <i>USD'000</i>	<i>GCC</i> <i>USD'000</i>	<i>Others</i> <i>USD'000</i>	
Cash and balances with banks	987	-	1,074	<b>2,061</b>
Available-for-sale investments - Sukuk	-	28,087	-	<b>28,087</b>
Held to Maturity investments - Sukuk	81,969	114,611	16,000	<b>212,580</b>
Due from bank	4,000	-	-	<b>4,000</b>
Other assets	1,269	3,969	581	<b>5,819</b>
<b>Total</b>	<b>88,225</b>	<b>146,667</b>	<b>17,655</b>	<b>252,547</b>

**Table – 8. Credit Risk – Industry Sector Breakdown (PD-1.3.23(c))**

The following table summarises the distribution of exposures by industry, broken down into major types of credit exposure;

	<i>Own capital</i>					<i>Total</i> <i>USD'000</i>
	<i>Industry sector</i>					
	<i>Banks and</i> <i>financial</i> <i>institutions</i> <i>USD'000</i>	<i>Government</i> <i>USD'000</i>	<i>Real estate</i> <i>USD'000</i>	<i>Construction</i> <i>and building</i> <i>materials</i> <i>USD'000</i>	<i>Others</i> <i>USD'000</i>	
<b>Funded</b>						
Cash and balances with banks	2,061	-	-	-	-	<b>2,061</b>
Available-for-sale investments - Sukuk	8,965	-	16,061	-	3,061	<b>28,087</b>
Held to Maturity investments - Sukuk	18,899	4,901	145,968	26,000	16,812	<b>212,580</b>
Due from bank	4,000	-	-	-	-	<b>4,000</b>
Other assets	479	148	4,226	506	460	<b>5,819</b>
<b>Total</b>	<b>34,404</b>	<b>5,049</b>	<b>166,255</b>	<b>26,506</b>	<b>20,333</b>	<b>252,547</b>
<b>Unfunded / commitments</b>						
Ijara commitment	26,525	-	-	-	-	<b>26,525</b>
Investment commitment	-	-	580	-	-	<b>580</b>
<b>Total</b>	<b>26,525</b>	<b>-</b>	<b>580</b>	<b>-</b>	<b>-</b>	<b>27,105</b>

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### 3 Risk Management (continued)

#### 3.1 Credit Risk (continued)

##### Table – 9. Credit Risk – Intra-group transactions (PD-1.3.23(d))

The balances of major transactions with the subsidiary are as follows:

	<i><b>Own capital Balance as of 30 June 2009 USD'000</b></i>
<b>Balance sheet</b>	
Investment in the Short Term Sukuk Centre	102,929
Payable to the Short Term Sukuk Centre	(9)
Fee receivable from the Short Term Sukuk Centre	1,667
<b>Total</b>	<b>104,587</b>

The income and expenses arising from dealing with the subsidiary included in the consolidated statement of income are as follows:

	<i><b>Six month period ended 30 June 2009 USD'000</b></i>
<b>Statement of income</b>	
Income from investment in the Short Term Sukuk Centre	397
Agency Fee Income	3,352
<b>Total</b>	<b>3,749</b>

**3 Risk Management (continued)**

**3.1 Credit Risk (continued)**

**Table – 10. Credit Risk – Concentration of Risk (PD-1.3.23(f))**

The following table summarises the disclosure for concentration of risk to individual counterparties;

<b>Counterparties</b>	<b><i>Own capital USD'000</i></b>
Counterparty # 1 *	25,094
Counterparty # 2 *	21,217
Counterparty # 3 *	17,181
Counterparty # 4 *	16,454
Counterparty # 5 *	15,216
Counterparty # 6 *	15,188
Counterparty # 7 *	14,988
Counterparty # 8 *	14,362
Counterparty # 9 *	13,720
Counterparty # 10 *	11,152
Counterparty # 11 *	10,312
Counterparty # 12 *	10,149
Counterparty # 13 *	10,052
Counterparty # 14 *	9,904
Counterparty # 15 *	8,617
<b>Total</b>	<b>213,606</b>

\* The exposure is in excess of the 15% individual obligor limit

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### 3 Risk Management (continued)

#### 3.1 Credit Risk (continued)

**Table – 11. Credit Risk – Residual Contractual Maturity Breakdown (Own Capital) (PD-1.3.23(g))**

The following table summarises the residual contractual maturity of own capital breakdown of the whole credit portfolio, broken down by major types of credit exposure:

	<i>Own capital</i>								<i>Total</i>
	<i>Maturity breakdown</i>								
	<i>Up to One Month</i>	<i>1-3 months</i>	<i>3-6 months</i>	<i>6-12 months</i>	<i>1-3 years</i>	<i>3 - 5 years</i>	<i>5 - 10 years</i>	<i>No fixed maturity</i>	
<i>USD'000</i>	<i>USD'000</i>	<i>USD'000</i>	<i>USD'000</i>	<i>USD'000</i>	<i>USD'000</i>	<i>USD'000</i>	<i>USD'000</i>	<i>USD'000</i>	
Cash and balances with banks	2,061	-	-	-	-	-	-	-	<b>2,061</b>
Available-for-sale investments - Sukuk	-	-	-	5,059	8,965	14,063	-	-	<b>28,087</b>
Held to Maturity investments - Sukuk	-	-	12,969	34,169	84,412	43,226	37,804	-	<b>212,580</b>
Due from Bank	4,000	-	-	-	-	-	-	-	<b>4,000</b>
Other assets	311	842	453	-	-	-	-	4,213	<b>5,819</b>
<b>Total</b>	<b>6,372</b>	<b>842</b>	<b>13,422</b>	<b>39,228</b>	<b>93,377</b>	<b>57,289</b>	<b>37,804</b>	<b>4,213</b>	<b>252,547</b>

**Table – 12. Credit Risk – Impaired Facilities and Allowances (Own capital by industry and geographic sector) (PD-1.3.23(h & i))**

The following table summarises the own capital impaired financing contracts and allowances disclosed by major industry and geographic sector;

	<i>Own capital</i>								
	<i>Impaired Islamic financing contracts</i>	<i>Aging of Past Due</i>			<i>Specific allowances</i>				<i>* General allowances</i>
		<i>Less than 90 days</i>	<i>3 months to 1 year</i>	<i>Balance at the beginning of the period</i>	<i>Charges during the period</i>	<i>Charge-offs during the period</i>	<i>Balance at the end of the period</i>		
<i>USD'000</i>	<i>USD'000</i>	<i>US\$ 000</i>	<i>USD'000</i>	<i>USD'000</i>	<i>USD'000</i>	<i>USD'000</i>	<i>USD'000</i>	<i>USD'000</i>	
Banks and financial institutions (GCC countries)	6,868	1,768	-	2,040	1,360	-	3,400	-	
Others (not specific to a geographic area)	-	-	-	-	-	-	-	700	
<b>Total</b>	<b>6,868</b>	<b>1,768</b>	<b>-</b>	<b>2,040</b>	<b>1,360</b>	<b>-</b>	<b>3,400</b>	<b>700</b>	

\* General allowance represents collective impairment provision against exposures which, although not specifically identified, have a greater risk of default than when originally granted.

**3 Risk Management (continued)**

**3.1 Credit Risk (continued)**

**Table – 13. Credit Risk – Restructured Islamic financing contracts (PD-1.3.23(j))**

The following table summarises the restructured islamic financing contracts, provisions and the effect on present and future earnings:

	<i>Own capital</i>	
	<i>Impact of restructured Islamic financing contracts</i>	
	<i>Balance as of 30 June 2009 USD'000</i>	<i>Present and future earnings Provisions USD'000</i>
Held to Maturity investments - Sukuk	11,551	-      *1,819
<b>Total</b>	<b>11,551</b>	<b>-      1,819</b>

\* The balance is the additional profit of USD 1,819 thousand due to increase in profit rate from, 6 month LIBOR + 3%, to 9% fixed rate and an extended one year to the maturity of the facility.

**3 Risk Management (continued)**

**3.2 Market Risk**

**3.2.1 Market Risk Strategy**

The Bank's Board is responsible for approving and reviewing (at least annually), the risk strategy and significant amendments to the risk policies. The Bank's senior management is responsible for implementing the risk strategy approved by the Board, and continually enhancing the policies and procedures for identifying, measuring, monitoring and controlling risks.

In line with the Bank's risk management objectives and risk tolerance levels, the specific strategies for market risk management include:

- 1 The Bank shall manage its market risk exposure by evaluating each new product/ activity with respect to the market risk introduced by it;
- 2 The Bank shall proactively measure and continually monitor the market risk in its portfolio;
- 3 The Bank shall at all time hold sufficient capital in line with the CBB Pillar 1 regulatory capital requirements;
- 5 The Bank shall establish a limit structure to monitor and control the market risk in its portfolio. These limits shall include position limits and maturity limits;
- 6 The Bank shall carry out stress testing periodically using the worst case scenarios to assess the effects of changes in the market value due to changing market conditions;
- 8 The Bank shall match the amount of floating rate assets with floating rate liabilities; and
- 9 The Bank shall clearly identify the foreign currencies in which it wishes to deal in and actively manage its market risk in all foreign currencies in which it has significant exposure.

**Table – 14. Market Risk Capital Requirements (PD-1.3.27 (b))**

The following table summarises the capital requirement by each category of market risk;

	<i>Foreign exchange risk USD'000</i>
Foreign exchange risk capital requirements	<b>2</b>
Maximum value	<b>12</b>
Minimum value	<b>2</b>

**3.3 Operational Risk**

**3.3.1 Introduction**

Operational risk is the risk of loss arising from inadequate information systems, technology failures, breaches in internal controls, fraud, unforeseen catastrophes, or other operational problems that may result in unexpected losses or damage Bank's reputation.

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For the period ended 30 June 2009 (Unaudited)

### 3 Risk Management (continued)

#### 3.3 Operational Risk (continued)

##### 3.3.1 Introduction (continued)

**Table – 15. Equity Position Risk in Banking Book (PD-1.3.31 (b) (c) & (f))**

The following table summarises the amount of total and average gross exposure of equity based financing structures by types of financing contracts and investments.

	<i>Total gross exposure USD'000</i>	<i>* Average gross exposure USD'000</i>	<i>Publicly traded USD'000</i>	<i>Risk weighted assets USD'000</i>	<i>Capital Requirement USD'000</i>
Equity investments	1,721	1,459	1,721	1,689	203
<b>Total</b>	<b>1,721</b>	<b>1,459</b>	<b>1,721</b>	<b>1,689</b>	<b>203</b>

\*Average Balances are computed based on month end balances.

**Table – 16. Equity Gains or losses in Banking Book (PD-1.3.31 (d) and (e))**

The following table summarises the cumulative realised and unrealised gains or (losses) during the year:

	<i>USD'000</i>
Cumulative realized gains (losses) arising from sales or liquidations in the reporting period	-
Unrealized gain included in Tier Two Capital	473

### 3.4 Liquidity Risk

#### 3.4.1 Introduction

The liquidity risk is defined as “the risk that the Bank will be unable to meet its obligations as they come due because of an inability to obtain adequate funding or to liquidate assets”.

#### 3.4.2 Sources of Liquidity Risk

The sources of liquidity risk can broadly be categorized in the following:

- Funding Risk** is the risk of not being able to fund net outflows due to unanticipated withdrawal of capital or deposits;
- Call Risk** is the risk of crystallization of a contingent liability; and
- Event Risk** is the risk of rating downgrades or other negative public news leading to a loss of market confidence in the Bank.

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For the period ended 30 June 2009 (Unaudited)

### 3 Risk Management (continued)

#### 3.4 Liquidity Risk (continued)

##### 3.4.2 Sources of Liquidity Risk (continued)

**Table – 17. Equity Position in Banking Book Liquidity Ratios (PD-1.3.37)**

The following table summarises the liquidity ratios;

	<b>30 June 2009 (Unaudited)</b>	<i>31 December 2008 (Audited)</i>	<i>31 December 2007 (Audited)</i>	<i>31 December 2006 (Audited)</i>	<i>31 December 2005 (Audited)</i>
Short term assets (maturity of less than 1 year) / Short term liabilities (maturity of less than 1 year)	<b>0.3</b>	0.2	0.2	0.2	1
Commodities Murabaha / Total Assets	-	5%	4%	14%	13%
Liquid Assets / Total Assets	<b>2%</b>	11%	5%	14%	14%
Liquid Assets / Total Assets *	<b>33%</b>	40%	29%	22%	14%
Due to Short Term Sukuk - investors/ Total Assets	<b>46%</b>	58%	71%	72%	78%

\* The management evidenced that certain sukuk are tradable or liquid and the ratio is calculated after including the tradable sukuk as liquid assets.

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**3 Risk Management (continued)**

**3.4 Liquidity Risk (continued)**

**Table – 18. Maturity analysis of assets, liabilities and equity (PD-1.3.38)**

The table below shows an analysis of assets, liabilities and equity analysed according to when they are expected to be recovered or settled.

<b>31 December 2008</b>	<i>Up to 1 month US\$ 000</i>	<i>1 to 3 months US\$ 000</i>	<i>3 to 6 months US\$ 000</i>	<i>6 months to 1 year US\$ 000</i>	<i>1 to 3 years US\$ 000</i>	<i>Over 3 years US\$ 000</i>	<i>No fixed maturity US\$ 000</i>	<i>Total US\$ 000</i>
<b>ASSETS</b>								
Cash and balances with banks	2,061	-	-	-	-	-	-	2,061
Due from bank	4,000	-	-	-	-	-	-	4,000
Investments	-	1,392	12,969	44,993	103,154	97,558	-	260,066
Other assets	311	842	453	-	-	-	4,363	5,969
Equipments	-	-	-	-	-	-	949	949
<b>Total assets</b>	<b>6,372</b>	<b>2,234</b>	<b>13,422</b>	<b>44,993</b>	<b>103,154</b>	<b>97,558</b>	<b>5,312</b>	<b>273,045</b>
<b>LIABILITIES AND EQUITY</b>								
Due to Short Term Sukuk - investors	123,510	3,021	-	-	-	-	-	126,531
Due to banks	61,171	20,320	53	-	1,654	-	-	83,198
Due to non banks	-	-	-	-	-	-	-	-
Other liabilities	1,483	97	363	316	-	907	-	3,166
Equity	-	-	-	-	-	-	60,150	60,150
<b>Total liabilities and equity</b>	<b>186,164</b>	<b>23,438</b>	<b>416</b>	<b>316</b>	<b>1,654</b>	<b>907</b>	<b>60,150</b>	<b>273,045</b>
<b>Liquidity gap</b>	<b>(179,792)</b>	<b>(21,204)</b>	<b>13,006</b>	<b>44,677</b>	<b>101,500</b>	<b>96,651</b>	<b>(54,838)</b>	
<b>Cumulative liquidity gap</b>	<b>(179,792)</b>	<b>(200,996)</b>	<b>(187,990)</b>	<b>(143,313)</b>	<b>(41,813)</b>	<b>54,838</b>	<b>-</b>	

**3 Risk Management (continued)**

**3.5 Profit Rate Risk**

**3.5.1 Introduction**

Profit rate risk is the potential impact of the mismatch between the rate of return on assets and the expected rate of funding due to the sources of finance.

**3.5.2 Profit Rate Risk Measurement Tools**

The Bank uses the following tools for profit rate risk measurement in the banking book:

- a. Re-pricing gap analysis which measures the arithmetic difference between the profit-sensitive assets and liabilities of the banking book in absolute terms; and
- b. Basis Point Value (“BPV”) analysis which is the sensitivity measure for all profit rate priced products and positions. The BPV is the change in net present value of a position arising from a 1 basis point shift in the yield curve. This quantifies the sens

**Table – 19. Profit Rate Risk in Banking Book (PD-1.3.40 (b))**

The following table summarises the effect on the value of assets, liabilities and economic capital for a benchmark change of 200bp in profit rates:

	<i>Effect on value of Asset &amp; Income USD’000</i>	<i>Effect on value of Liability &amp; Expense USD’000</i>	<i>Effect on value of Economic Capital &amp; Net Income USD’000</i>
Upward rate shocks:	1,289	(1,931)	(642)
Downward rate shocks:	(1,289)	1,931	642

**Table – 20. Quantitative Indicators of Financial Performance and Position (PD-1.3.9 (b))**

The following table summarises the basic quantitative indicators of financial performance for the past 5 years:

	<i>30 June 2009 (Unaudited)</i>	<i>31 December 2008 (Audited)</i>	<i>31 December 2007 (Audited)</i>	<i>31 December 2006 (Audited)</i>	<i>31 December 2005 (Audited)</i>
Return on average equity	3%	2%	18%	15%	10%
Return on average assets	1%	0%	4%	4%	3%
Cost to Income Ratio	65%	92%	28%	32%	53%