



Bank Mandiri (Europe) Limited

Pillar 3 Disclosures for the year ended 31st December 2009

Bank Mandiri (Europe) Limited
Pillar 3 Disclosures – 31st December 2009

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1. OVERVIEW

1.1. Introduction

Bank Mandiri (Europe) Limited (BMEL) is a wholly-owned subsidiary of PT Bank Mandiri (Persero), Jakarta, Indonesia (“Bank Mandiri”) which, in turn, is 70% owned by the Republic of Indonesia, with the remaining 30% being widely held. Bank Mandiri was established in October 1998 and on 2 August 1999 it took over the business activities of four Indonesian State-owned banks, namely, PT Bank Ekspor Impor Indonesia (Persero), PT Bank Bumi Daya (Persero), PT Bank Dagang Negara (Persero) and PT Bank Pembangunan Indonesia (Persero).

BMEL was established on 1 August 1999 at which time it assumed, on a going concern basis, the banking business activities of PT Bank Ekspor Impor Indonesia (Persero), London Branch.

BMEL is a UK incorporated bank (company registration number 3793679), which is licensed and regulated by the UK Financial Services Authority. The Bank does not have any subsidiaries or branches and its operations are conducted from one office located at:

6 Thomas More Square
Thomas More Street
London
E1W 1YW

The Bank’s business is comprised principally of the following activities:

- Trade finance whereby we provide letters of credit, guarantees, loans and bill discounting facilities in support of our corporate customers import and export activities on a global basis. We also provide letter of credit confirmation and services and discount accepted bank bills on behalf of our customers.
- Ship Finance.
- Wholesale Money Market business.
- Marketable and Investment Securities; principally instruments issued by bank and state-owned institutions.
- Syndicated Lending Business both as an originator and participant with a mixture of corporate, sovereign entities and banks.
- Current and Deposit Accounts on behalf of our corporate and Indonesian Embassy customers.

1.2. Background

The Capital Requirements Directive (“CRD”), often referred to as Basel 2, introduced the need for banks operating under this new legislative framework to publish certain qualitative and quantitative information relating to their risk management and capital adequacy. The disclosure of this information is known as Pillar 3 and is designed to complement the two other pillars of CRD namely the minimum capital requirements (Pillar 1) and the supervisory review process (Pillar 2). BMEL's Pillar 3 disclosures, as outlined below, have been prepared in accordance with rules laid out in the FSA Handbook BIPRU Chapter 11.

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Bank Mandiri (Europe) Limited ("BMEL") has been operating in accordance with the Basel 2 guidelines since 1st January 2008 and has adopted the Pillar 1 Standardised Approach to Credit Risk and Market Risk and the Basic Indicator Approach for Operational Risk.

1.3. Basis of Disclosures

The Pillar 3 disclosures contained in this document are not subject to audit except where they are equivalent to those required by accounting requirements for inclusion in the Bank's Annual Report and Financial Statements ("Annual Report"). These disclosures have been reviewed by the Bank's Audit Committee and are published as an unaudited supplement to the BMEL's Annual Report for the corresponding financial year.

1.4. Scope

BMEL has no subsidiaries or affiliate companies included in its financial statements and, accordingly, these Pillar 3 disclosures apply solely to BMEL.

1.5. Frequency of Disclosures

The Bank's Pillar 3 disclosures will be published on an annual basis and will be referenced to our financial year-end, i.e. as at 31st December each year.

The Bank will aim to release the disclosures shortly after the publication of our Annual Report.

1.6. Media & Location

BMEL's Pillar 3 disclosures will be published on the Bank's website (www.bankmandiri.co.uk).

2. RISK MANAGEMENT & POLICIES

2.1. Introduction

In a Banking environment risks can never be fully removed but they can be mitigated by the installation of a systematic and controlled management approach. BMEL's approach to risk management starts with high-level controls established at Board level and through delegation and division of responsibilities to the General Management under the supervision of the Chief Executive.

The identification, measurement and containment of risk is integral to the management of our business. Our risk policies and procedures are regularly updated to meet changing business requirements, and to comply with best practice. Our Audit Committee is apprised of these and other developments throughout the year to ensure adequate controls are in place to meet our changing business requirements.

The following basic elements of sound risk management are applied to all financial risk instruments, including derivatives.

- Review by the Board of Directors and Senior Management.
- Risk management processes with integral product risk limits.
- Measurement procedures and information systems.

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- Continuous risk monitoring and frequent management reporting.
- Segregation of duties, comprehensive internal controls and audit procedures.
- Pro-active staff training.

In the opinion of the Directors, the period end numerical disclosures provided in this report are not materially unrepresentative of the Bank's position during the period or its agreed objectives, policies and strategies. In addition, the Directors have no plans, at the current time, to make any significant changes either to the product base or to the methods employed in the management and control of the above-mentioned risks.

2.2. Risk Management

The Bank is firmly committed to the management of risk, recognising that sound internal risk management is essential to its prudent operation, particularly with the growing complexity, diversity and volatility of markets, facilitated by rapid advances in technology and communications. Risk management is given high priority throughout the Bank.

Responsibility for risk management policies, limits, and the level of risk assumed, lies with the Board of Directors. The Board charges Senior Management with developing, presenting and implementing these policies and limits. The structure is designed to provide a reasonable degree of assurance that no single event, or contribution of events, will materially affect the wellbeing of the Bank.

A Risk Committee comprised of Senior Management plays a key role in the identification, evaluation and management of all risks. All credit and other new product decisions require direct Senior Management & Risk Committee approval. Management is supported by a comprehensive structure of independent controls, analysis and reporting processes.

The Bank has strict controls and detailed procedures in place for the monitoring of the financial instruments employed in its business. Before any new financial instrument is employed by the Bank approval must be sought from the Bank's Senior Management Committee and as part of this approval process the Senior Management Committee ensures that the Bank has the relevant expertise, adequate controls and operating procedures in place before the new financial instrument is initiated. Where it is deemed necessary product or sector limits are established and monitored such that excessive concentration risk is minimised.

The Bank's Board of Directors, Asset and Liability Committee, Risk Committee and Audit Committee, assist in appraising market trends, economic and political developments, and providing strategic direction for all aspects of risk management.

The Bank has in place an extensive number of limit controls and management information systems to facilitate effective management overview. Limit breaches, if any, are reported to the Chief Executive and Senior Management on a daily basis.

2.2.1. High Level Controls

Four reporting pillars have been established within the Bank, being:

- Financial Management being Accounting Compliance and Systems including IT and Systems.

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- Front Office activities being Business Development, Treasury and Debt Trading.
- Credit Review, Treasury Support and Loan/Trade Finance Administration,
- Office Services, Premises and Personnel Management.

These activities are controlled and monitored by regular meetings of the following committees:

- Risk Committee
- Management Committee
- Asset & Liabilities Committee (“ALCO”)
- Credit Committee
- Staffing & Remuneration Management Committee
- Disaster Recovery Committee

The effectiveness of these high level controls is monitored by regular meetings of the Audit Committee and Remuneration Review Committee, comprised of appointees of BMEL’s Board, General Management and the Internal Auditors (as appropriate). The performance and activities of BMEL and the findings of the Audit Committee are reported at regular Board Meetings.

2.2.2. Policy Statements

To support these high level controls BMEL has established policies, approved by its Board, and, where appropriate, the FSA. These policies identify the risks which BMEL faces in its day to day operations and the controls which should be put in place to mitigate these risks.

2.2.3. Detailed Operating Procedures

Actual implementation of Bank Policy is effected by detailed departmental procedures that cover allocation of duties, operating and processing practices.

2.3. Risk Management of Specific Risks

The principal risks to which the Bank is exposed and our approach to these risks are articulated below.

2.3.1. Credit Risk

The Bank uses a formal credit process to quantify and evaluate the risk of proposed credits, and to ensure appropriate returns for assuming risks. Relationship Managers undertake a full financial review of each client at least annually, so that the Bank remains aware of counterparties' risk profiles. This analysis includes a review of previous historical financial data, future projections, industry reviews, broker reports and credit analysis techniques.

Securities, Letters of Credit, Guarantees and Off-Balance Sheet instruments are managed by the same process. Settlement and any other credit risks are restricted through product limits and counterparty netting agreements.

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From time to time the Bank takes collateral to mitigate credit or transactional risks. The taking of collateral as security is governed by detailed policies and procedures and where necessary the security is registered and perfected in the relevant jurisdictions using legal counsel.

2.3.2. Market Risk

Market risk refers to the uncertainty of future earnings, resulting from changes in interest rates, foreign exchange rates, market prices and volatility thereof. Senior Management constantly monitors market risk by a combination of reports and real time market information systems.

The Bank does not actively trade in the foreign exchange markets on its own account, and foreign exchange swaps and forward foreign exchange contracts are committed for management of the Bank's expenses and the Bank's assets and liabilities.

Where possible the Bank matches its currency transactions. The majority of the asset and liability positions are denominated in US Dollars and therefore, the level of currency risk is considered to be minimal.

2.3.3. Operational Risk

Operational risk is the risk that deficiencies in information systems or internal controls result in unexpected business, financial and operating losses. Operational Risk is ultimately managed by the Board of Directors and is given the highest priority. Senior Management are charged with applying stringent procedures to mitigate risk of error, fraud, money laundering, and other irregularities. In addition, strong disaster recovery procedures have been formulated and are tested on at least a yearly basis. Internal Audit reviews the risk mitigation processes to ensure that these meet the organisation's current needs and are being properly implemented and controlled.

2.3.4. Liquidity Risk

Liquidity risk arises from fluctuations in cash flows. The liquidity risk management process ensures that the Bank is able to honour all of its financial commitments as they fall due. Liquidity is monitored daily through specialised reports provided to Senior Management against appropriate limits set by the Board of Directors and with reference to statutory requirements. In addition the Asset and Liability Committee and the Risk Committee review the liquidity position periodically. The Bank has access to a variety of funding sources including bank deposits, loan facilities, customer deposits and corporate trade finance deposits. Regular weekly reviews are conducted, via meetings of the Asset and Liability Committee, of these sources and requirements for perusal by Senior Management. In practice, the Bank operates well within its prescribed liquidity levels.

2.3.5. Concentration Risk

Concentration risk is the additional risk that arises where there are large exposures or concentrations in the credit portfolio to certain countries, sectors or industries. Concentration of risk is managed by client/counterparty, by geographical region and industry sector. So as to manage and monitor its concentration risks, in addition to individual obligor and group assessments the Bank has set concentration limits in respect of:

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- Country Risk
- Exposures by Sector/Industry
- Large Exposures

As per the guidelines contained in the Bank's Large Exposures Policy Statement, no credit limit or extension of credit to an individual counterparty or a group of related counterparties is allowed to exceed 25% of BMEL's Large Exposures Capital Base ("LECB") unless the Bank has taken collateral in accordance with the eligibility requirements in BIPRU 5 and also qualifies for recognition as an exempt exposure under BIPRU 10.6.

2.3.6. Interest Rate Risk

Interest rate risk arises when there is a mismatch between positions which are subject to interest rate adjustments within a specific period. In the Bank's funding/lending activities, fluctuations in interest rates are reflected in interest margins and earnings. In order to minimise risks our interest rate risk profile is maintained short term and liquid.

An interest rate gap is a common measure of interest rate sensitivity. A liability gap occurs when more liabilities than assets are subject to rate changes during a prescribed future time period. Interest rate gaps are monitored by Senior Management & Asset & Liability Committee regularly.

Note: Non Trading Book Interest Rate Risk

The Bank does not have a trading book, however, interest rate exposure exists within its non-trading book. Instruments have been allocated to time bands by reference to the earlier of their next contractual interest rate repricing date and their maturity date.

The majority of the Bank's balance sheet is denominated in US Dollars, with only a minor element of currencies regarded as volatile.

3. CAPITAL RESOURCES

As at 31st December 2009 the Bank's capital base amounted to US\$72.4 million and was comprised wholly of Tier 1 Capital Items; being US\$49 million of paid up share capital and US\$23.4 million of 'audited' retained earnings.

The table below provides a breakdown of the Bank's capital resources as at 31st December 2009:

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	Notes	As at 31 December 2009 Basel II (\$ '000)
Core tier 1 Capital		
<i>Called up ordinary share capital</i>		49,000
<i>Retained earnings</i>	<i>1</i>	23,407
Core tier 2 Capital		
		Nil
<i>Total tier 1 & 2 after deductions</i>		72,407
Notes:		
1. Retained earnings and other reserves excludes unrealised gains or losses on cash flow hedges and available for sale assets.		

4. CAPITAL ADEQUACY

Controls are in place to constantly monitor the level of capital to ensure the Bank is able to meet its regulatory obligation on a daily basis. In doing so the Board of directors believe that the interest of all stakeholders including customers and shareholders are fully protected. Account is taken of all potential events that could have an impact on capital.

Management have stress tested the Bank's capital requirements. This stress testing takes into account reasonably likely developments in all of the above risks, the Board's balance sheet management strategy and the deteriorating market conditions. This stress testing has demonstrated that the Bank is adequately capitalised to support the existing business and future plans.

Internal capital adequacy assessment process (“ICAAP”)

In accordance with the guidelines of the Capital Requirement Directive (“CRD”), the FSA requires that Bank Mandiri (Europe) Limited (“BMEL” or the “Bank”) undertake a regular review of the Internal Capital Adequacy Assessment Process (“ICAAP”) through which the Bank determines the level of capital (Individual Capital Guidance or “ICG”) required to support its business activities. The ICAAP is reviewed at least annually. The last review was undertaken by the Bank’s Risk Department in December 2009 and the findings were reviewed and approved by the Bank’s Audit Committee and Board.

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By reference to our ICAAP model, as at 31st December 2009 the amount of capital required to satisfy our ICG was US\$36.7 million. Comparison of our ICG to our actual capital resources demonstrates that as at 31st December 2009 the Bank had a surplus capital of US\$36.5 million over and above that required by its ICG.

The following table provides a summary of BMEL's Pillar 1 and Pillar 2 Capital Allocations as at 31st December 2008:

BMEL Capital Resource Requirement (ICG) (all figures in US\$ 000)	31-Dec-09
<u>Pillar 1 Capital Allocations</u>	
<i>Credit Risk (8% of Risk Weighted Assets)</i>	13,217
<i>Counterparty Risk</i>	12
<i>Market Risk</i>	40
<i>Operational Risk – basic indicator approach</i>	1,826
Total Pillar 1 Capital Resource Requirement	15,095
<u>Pillar 2 Capital Allocations</u>	
<i>Liquidity Risk</i>	12,000
<i>Insurance Risk</i>	0
<i>Concentration Risk</i>	5,500
<i>Residual Risk</i>	0
<i>Securitisation Risk</i>	0
<i>Business Risk</i>	0
<i>Interest Rate Risk</i>	0
<i>Pension Obligation Risk</i>	0
<i>Stress Testing Adjustment (Allocation for Currency Risk in the Banking Book)</i>	3,300
Total Pillar 2 Capital Requirement	20,800
Total Capital Requirement (ICG)	35,895
Total Eligible Capital	72,407
Surplus Capital over Total Capital Requirement (ICG)	36,512

Note: In calculation of our Pillar 1 Capital Resource Requirement BMEL adopted the following approaches:

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1. The Basic Indicator Approach for Operational Risk based on an allocation of 15% of BMEL's Gross Operational Earnings; details of the calculation are provided in the table below:

	31 December 2007	31 December 2008	(\$'000) 31 December 2009
Net Interest Income	7,692	8,455	6,538
Non-Interest Income	4,867	5,133	3,839
Gross Income	12,559	13,588	10,377
Average Income			12,174
Operational Risk Capital Requirement - (ORCR)			15%
ORCR =			1,826

2. The Standardised Approach for Credit Risk based on the FSA's guidelines for the Basel 2 risk weightings that should be applied to each type of credit risk; and the relevant credit conversion factors where applicable.
3. The Standardised Approach to Market Risk based on an allocation of 8% of the market risks arising from the Bank's business activities.

The Following table shows the Bank's Pillar 1 Capital Requirement by asset class:

	(\$'000)
Central governments or central banks	924
Institutions	731
Corporates	2,864
Retail	2
Short term claims on institutions and corporates	6,774
other	54
Past due items	1,868
Capital Component for Credit Risk	13,217
ORCR	1,826
Counterparty risk capital component	12
Foreign exchange PRR	40
Total Pillar 1 Capital requirement	15,095

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CREDIT RISK & DILUTION RISK

4.1. Impaired Assets

The Bank assesses at each balance sheet date whether there is any objective evidence that a financial asset is impaired. A financial asset is deemed to be impaired if, and only if, there is objective evidence of impairment as a result of one or more events that has occurred after the initial recognition of the asset and the loss event has an impact on the estimated cash flows of the financial asset that can be reliably estimated.

It is BMEL's policy to maintain a level of provisions, which is in line with accepted prudential banking norms for a bank incorporated in the United Kingdom. The Bank takes provisions such that:

“When an advance has been identified as being impaired, the amount of the specific provision should be the Bank's estimate of the amount (if any) needed to reduce the carrying value to the expected ultimate net realisable value.”

Loans and advances

For loans and advances carried at amortised cost, the Bank first assesses individually whether objective evidence of impairment exists individually for financial assets that are individually significant.

If there is objective evidence that an impairment loss has been incurred, the amount of the loss is measured as the difference between the asset's carrying amount and the present value of estimated future cash flows (excluding future expected credit losses that have not yet been incurred). The carrying amount of the asset is reduced through the use of specific provision, and the amount of the loss is recognised in the profit and loss account. Interest income continues to be accrued on the reduced carrying amount based on the original effective interest rate of the asset. Loans together with the associated specific provision are written-off when there is no realistic prospect of future recovery and all collateral has been realised or has been transferred to the Bank. If, in a subsequent year, the amount if the estimated impairment loss increases or decreases because of an event occurring after the impairment was recognised, the previously recognised impairment loss is increased or reduced by adjusting the specific provision. If a write-off is later recovered, the recovery is recognised in the profit and loss account.

The present value of the estimated future cash flows is discounted at the financial asset's original effective interest rate. If a loan has variable interest rate, the discount rate for measuring any impairment loss is the effective interest rate at the date at which the impairment occurs.

A Financial asset is treated as past due when a counterparty has failed to make a payment when contractually due. In contrast under regulatory rules, a financial asset is treated as past due when the payment is ninety days past the due contractual due date.

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The below table provides details of movements in BMEL's provisions and impaired debts over the past financial year and the position of the impaired debts as 31st December 2008:

	(\$ '000)	
As at 1 January 2009		508
Charges for the year		2,442
Recoveries		-
Amounts written off		-
As at 31 December 2009		2,950
Individual Impairment against specific loan		2,950
Non-performing loans and advances to customers:	2,009	2,008
- <i>Loans and advances before provisions</i>	21,658	4,918
- <i>Loans and advances after provisions</i>	18,708	4,410

Impaired and past due exposures; value adjustments and provisions; charges for value by significant counterparty type:

	Impaired loans as at 31 December 2009 (\$' 000)	Past due loans as at 31 December 2009 (\$' 000)	Value adjustments and provisions as at 31 December 2009 (\$' 000)	Charges for adjustments and provisions as at 31 December 2009 (\$' 000)
Corporates	21,658	16,477	2,950	2,442

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Geographical analysis of impaired and past due exposures; value adjustments and provisions as at 31st December 2009

	UK	Europe	Asia	North America	(\$'000) Total
Impaired Loans	705		18,002	2,951	21,658
Past Due Loans	627		15,466	384	16,477
Value adjustments & provisions	508		2,442		2,950

4.2. Sectoral Analysis of Credit Risk Exposure

A sectoral analysis of the Bank's credit portfolio as at 31st December 2009 is provided below in tables (i) to (iv). The exposures are shown after application of the FSA's credit conversion factors.

(i) *Exposures by Asset Class*

	(\$'000) Exposure Value
<i>Central governments or central banks</i>	11,551
<i>Institutions</i>	15,837
<i>Corporates</i>	44,352
<i>Retail</i>	25
<i>Past due items</i>	16,477
<i>Short term claims on institutions and corporates</i>	146,881
<i>Other Items</i>	1,237
Total	236,360

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(ii) *Exposures by Geographic Distribution*

	UK	Europe	Asia	North America	(\$'000) Total
<i>Central governments or central banks</i>			11,551		11,551
<i>Institutions</i>	5,540		10,297		15,837
<i>Corporates</i>	14,762		27,469	2,121	44,352
<i>Retail</i>	25				25
<i>Past due items</i>	627		15,466	384	16,477
<i>Short term claims on institutions and corporates</i>	64,196	1,424	33,976	47,285	146,881
<i>Other Items</i>	1,237				1,237
Totals	86,387	1,424	98,759	49,790	236,360

(iii) *Exposures by Industry & Asset Class*

	Central Gov'ts or Central Banks	Institutions	Corporates	Retail	Past Due Items	Short term claims on institutions Corporates	Other Items	(\$'000) Total
Banks		15,837				93,304		109,141
Wholesale, excluding motor vehicles			14,762		12,183	47,645		74,590
Transport, Storage & Communication			29,550		4,294	1,931		35,815
Public Administration and Defence	11,551							11,551
Other Financial Intermediaries						4,001		4,001
Individuals				25				25
Other Internal accounts							1,237	1,237
Total	11,551	15,837	44,352	25	16,477	146,881	1,237	236,360

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(iv) *Residual Maturity Analysis by Asset Class*

Note: The exposures in this table are based upon the contractual maturity dates and not on an expected basis and do not take account of cashflows over the life of the exposures.

	<1 year	1-5 years	>5 years	(\$'000) Total
<i>Central governments or central banks</i>	1,172	8,071	2,308	11,551
<i>Institutions</i>	10,297	5,540		15,837
<i>Corporates</i>	29,853	14,499		44,352
<i>Retail</i>	25			25
<i>Pat Due items</i>	16,477			16,477
<i>Short term claims on institutions and corporates</i>	146,881			146,881
<i>Other Items</i>	1,237			1,237
Totals	205,942	28,110	2,308	2236,360

5. CREDIT RISK: STANDARDISED APPROACH

For all exposure classes, the Bank uses the most conservative of the three external credit assessments provided by Moody's, Standard & Poors and Fitch. Exposures that are not rated by external agencies are allocated risk weightings in accordance with the prevailing FSA guidelines. Under the Standardised Approach BMEL's total Capital Requirement for Credit Risk as at 31st December 2009 was US\$15.1 million. An analysis of the Bank's weighted assets is provided in tables (i) to (viii), below:

(i) *Analysis of Capital Requirement using the Standardised Approach*

Analysis of capital requirement using the Standardised Approach					
	Exposure value before credit mitigation	Cash Collateral	Exposure value after credit mitigation	Risk Weighted Exposures	(\$'000) Capital Requirement
<i>Central governments or central banks</i>	11,551		11,551	11,551	924
<i>Institutions</i>	15,837		15,837	9,140	731
<i>Corporates</i>	44,352		44,352	44,352	3,548
<i>Retail</i>	25		25	19	2
<i>Past Due items</i>	16,477		16,477	23,349	1,868
<i>Short Term Claims on Institutions and corporates</i>	146,881	22	146,859	84,680	6,774
<i>Other Items</i>	1,237		1,237	686	54
Total	236,360	22	236,338	173,767	13,901

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(ii) *Central Government or Central Banks*

Central Governments or Central Banks			
			(\$'000)
Credit Quality Step	Risk Weight	Exposure	Exposure after credit risk mitigation
1	0%		
2	20%		
3	50%		
4	100%		
5	100%		
6	100%		
<i>Unrated</i>	100%	11,551	924
Total		11,551	924

(iii) *Institutions with an Original Maturity Greater than Three Months*

Institutions with an original maturity greater than 3 months			
			(\$ '000)
Credit Quality Step	Risk Weight	Exposure	Exposure after credit risk mitigation
1	20%	5,540	5,540
2	50%		
3	50%	4,529	4,529
4	100%	5,768	5,768
5	100%		
6	150%		
<i>Unrated</i>	50%		
Total		15,837	15,837

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(iv) *Corporates with an Original Maturity Greater than Three Months*

Corporates with an original maturity greater than 3 months			
			(\$ '000)
Credit Quality Step	Risk Weight	Exposure	Exposure after credit risk mitigation
1	20%		
2	50%		
3	100%		
4	100%	10,717	10,171
5	150%		
6	150%		
<i>Unrated</i>	100%	34,181	34,181
<i>Default Unrated</i>	150%		
Total		44,352	44,352

(v)

Retail exposures have been assigned a risk weight of 75%		
		(\$ '000)
	Exposure	Exposure after credit risk mitigation
Total	25	25

(vi)

Past Due items			
			(\$ '000)
Credit Quality Step	Risk Weight	Exposure	Exposure after credit risk mitigation
1	20%		
2	50%		
3	100%		
4	100%		
5	150%		
6	150%		
<i>Unrated</i>	100%	2,734	2,734
<i>Default Unrated</i>	150%	13,743	13,743
Total		16,477	16,477

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(vii) *Short Term Claims on Institutions*

Short term claims on Institutions			
			(\$ '000)
Credit Quality Step	Risk Weight	Exposure	Exposure after credit risk mitigation
1	20%	81,064	81,042
2	50%	1,884	1,884
3	100%	3162,	3,162
4	100%		
5	150%	7,194	7,194
6	150%		
<i>Unrated</i>	100%		
<i>Default Unrated</i>	150%		
Total		93,304	93,282

(viii) *Short Term Claims on Corporates*

Short term claims on Corporates			
			(\$ '000)
Credit Quality Step	Risk Weight	Exposure	Exposure after credit risk mitigation
1	20%		
2	50%		
3	100%		
4	100%		
5	150%		
6	150%		
<i>Unrated</i>	100%	53,577	53,577
<i>Default Unrated</i>	150%		
Total		53,577	53,577

Short Term Claims on Institutions and corporates	146,881	146,859
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6. COUNTERPARTY CREDIT RISK

Counterparty Credit Risk (“CCR”) is the risk to the Bank that a counterparty to a derivative transaction in our non-trading book may default prior to final settlement of the transaction. Both the credit quality of the counterparty and the duration of the derivative are included into the relevant credit limits and internal capital allocations for counterparty credit exposures.

The Bank has no netting or collateral arrangement in respect of counterparty credit risk.

The Bank uses the CRR mark to market method to measure its exposures on counterparty credit exposures. The value of each exposure is calculated using the fair value of the contract (replacement cost) to the contracts potential credit exposure, which is derived by using a multiple of the contracts residual maturity to the notional value of the contract.

The CCR risk and related Pillar 1 Capital Allocation of US\$39K as at 31st December 2008 is shown in the below table:

	Gross Positive Fair Value of contracts	Potential Credit Exposure	Total Derivatives Exposure	(\$ '000) Counterparty risk capital component
Banking Book	111	36	147	12

7. MARKET RISK

The Bank has very little appetite for market risk and takes a very conservative and low risk approach to market risk. This lack of appetite for market risk is reflected in the business strategy, i.e. the Bank does not run a trading book of any sort and, therefore, does not run the risk of significant trading losses.

In view of the above, the Bank has adopted the Standardised Approach for its market Risk based on a capital allocation of 8% of such market positions that we may hold at any given time. As at 31st December 2009 this calculation identified a Pillar 1 Capital Requirement for Market Risk of US\$40K.

Notwithstanding the fact that the Bank does not have trading book activities, management are aware that positions may arise from timing differences on commercial transactions and that interest rate and foreign exchange risks may arise from its banking book activities.

Foreign exchange risks arising from our banking book activities were addressed in our ICAAP as a **Stress Testing Adjustment** (on a worst scenario basis) and using our ICAAP model a Pillar 2 capital requirement of US\$3.3 million was identified as at 31st December 2009.

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8. LIQUIDITY RISK

The Bank is aware that one of the principal risks that it faces in its day-to-day business is a threat to its liquidity. The Bank's management has significant experience of managing liquidity under unfavourable conditions and has put in place procedures for constant monitoring of its position. Management reviews investment policy through scheduled and ad hoc meetings of the Assets and Liabilities Committee, so that actions match the prevailing conditions and the Bank maintains the appropriate degree of liquidity.

The Bank has a small appetite for liquidity risk, and is bound by the following mismatch limits:

- Between sight and eight days - a 0% surplus of liabilities and contingent liabilities maturing over assets.
- Between sight and one month – a short position of minus 5%.

In order to prevent a breach in these ratios we forecast our mismatch ratios forward, based on our best estimation of the Bank's likely inflows and outflows, and, if we identify a possible future breach, our Assets and Liabilities Committee is empowered to take such preventative measures as may be necessary.

The table below summarises the maturity profile of the Bank's financial liabilities as at 31 December 2009 based on contractual undiscounted repayment obligations. Repayments which are subject to notice are treated as if notice were to be given immediately. However, the Bank expects that many customers will not request repayment on the earliest date the Bank could be required to pay and the table does not reflect the expected cash flows indicated by the Bank's deposit retention history.

DEPOSITS FROM BANKS	
(\$ '000)	
With agreed maturity dates or periods of notice, by remaining maturity of:	
<i>Repayable on demand</i>	1,303
<i>- 3 months or less</i>	80,000
<i>- Between 3 months and 1 year</i>	28,043
<i>- Between 1 year and 5 years</i>	11,000
 <i>Amounts include:</i>	 120,346

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<i>Due to group undertakings</i>	25,000
CUSTOMERS ACCOUNTS	
With agreed maturity dates or periods of notice, by remaining maturity of:	
<i>Repayable on demand</i>	39,722
<ul style="list-style-type: none"> - 3 months or less - 1 year or less but over 3 months 	39,722
A total of US\$1.24 million (2008 - US\$4.07 million) of deposits are frozen and held as collateral against trade finance loan facilities.	

In application of worst scenario testing in our ICAAP model we were satisfied that the Bank has sufficient liquid assets to meet its liabilities as and when they fall due. We also considered the possibility that losses may be incurred in distressed market conditions on disposal of assets are disposed to raise liquidity and, accordingly, as at 31st December 2009 a Pillar 2 Capital Allocation of US\$12 million was made for Liquidity Risk.

9. INSURANCE RISK

The Bank has little appetite for insurance risk and is not involved in the provision of insurance products and does not use credit insurance as means of mitigating credit or market risk for the purposes of capital allocation. In view of the foregoing, the Bank did not consider it necessary to make a Pillar 2 Capital Allocation for Insurance Risk.

10. CONCENTRATION RISK

Concentration risk arises when a number of counter-parties are engaged in similar activities or similar geographic locations so that they have economic characteristics that would cause their ability to meet their obligations to be similarly affected by changes in economic or other circumstances.

The Bank's appetite for concentration risk is conservative and is defined by reference to country limits and industry limits. We considered the possible impact of adverse movements in asset categories ("sectors") that represent more than 10% of BMEL's total assets as these could indicate a concentration risk.

In our ICAAP model, the only concentration risk for which it was considered necessary was in relation to our Ship Finance activities and as at 31st December a Pillar 2 Capital Allocation of US\$5.5 million was made for Concentration Risk.

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11. CREDIT RISK MITIGATION (RESIDUAL RISK))

Residual risk is the risk that credit risk mitigation techniques used by the Bank prove less effective than expected so that the offset arrangements reflected in the assessment of credit risk do not provide the protection expected. With the exception of cash collateral the Bank currently has no appetite for other credit risk mitigation techniques that may result in residual risk exposures.

The only mitigant that the Bank included in the calculation of its credit risk allocation was cash collateral and all other forms of security have been ignored. The cash collateral arrangements are formally documented in accordance with English law; where such exposures are in excess of our LECB, we have ensured compliance with the guidelines contained in BIPRU 5 and BIPRU 10.6. In view of the foregoing, the Bank did not consider it necessary to make a Pillar 2 Capital Allocation for Residual Risk.

12. SECURITISATION RISK

The Bank has no appetite for Securitisation Risk and does not securitise any elements of its portfolio or hold any securitised assets in its balance sheet. In view of the foregoing, the Bank did not consider it necessary to make a Pillar 2 Capital Allocation for Securitisation Risk Risk.

13. BUSINESS RISK

Business risk is any risk to the Bank arising from changes in its business including the risk that it may not be able to carry out its business plan and its desired strategy.

The most significant risks to the Bank's business levels comprise the level of economic activity in key markets and the Bank's ability to access that activity. The Bank has an unsophisticated product base and a business model it has operated successfully since 1999 and there are no current plans to diversify significantly from our business model. Accordingly, we believe that it is highly unlikely that the Bank will be unable to carry out its business plan.

Other business risks of a reputational, or legal nature, are mitigated by the range of policies and processes put in place by management.

In view of the foregoing, the Bank did not consider it necessary to make a Pillar 2 Capital Allocation for Business Risk.

14. INTEREST RATE RISK

The Bank has little appetite for interest rate risk and does not take strategic positions with a view to making a profit from movements in interest rates or trade in instruments that are designed to generate profit from movements in interest rates.

Notwithstanding the foregoing, interest rate risk is likely to be relevant to every firm but is of specific concern where it is not fully captured in the market risk capital requirement

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because a firm has exposure to interest rate risk in its non-trading book, i.e. it has interest rate risk from its banking book activities.

In view of the above and, in line with best banking practice, we monitor the interest rate risk inherent in our banking book activities on an on-going basis through an interest rate sensitivity report which reflects the potential exposure resulting from a parallel change of 2.0% in interest rates to each major currency both upwards and downwards. This report is reviewed regularly at ALCO meetings or more frequently if market circumstances dictate, and any action that may be required is decided upon and implemented by the Committee.

Following application of worst scenario testing in our ICAAP model the Bank did not consider it necessary to make a Pillar 2 Capital Allocation for Interest Rate Risk.

15. PENSION OBLIGATION RISK

The Bank has no appetite for pension risk and BMEL provides its staff with a pension benefit by way of money purchase non-contributory contributions and, therefore, does not accrue pension obligation risks due to its staff. In view of the foregoing, the Bank did not consider it necessary to make a Pillar 2 Capital Allocation for Pension Obligation Risk.