

# **RIYAD BANK**

## **BASEL II – PILLAR 3 QUALITATIVE DISCLOSURES 31 DECEMBER 2011**

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## Introduction

This document provides information on the capital adequacy, and risk management processes and policies, at Riyad Bank. The information contained in this document is supplementary to information published in the Riyad Bank Annual Report for Year 2011 including the Annual Financial Statements and disclosure notes, which are available on the Riyad Bank website at [www.riyadbank.com](http://www.riyadbank.com) or on request to Riyad Bank Finance Division at Riyad Bank Head Office, PO Box 22622, Riyadh, 11416, Saudi Arabia.

These risk and capital adequacy disclosures are consistent with the requirements of Saudi Arabian Monetary Agency ("SAMA") and the Basel II Accord Capital Adequacy requirements commonly referred to as Pillar 3 Disclosure requirements. The table headings follow the guidelines provided by SAMA. Tables 6, 9 and 11 are not covered in this document as the topic is not relevant to Riyad Bank.

### Table 1: Scope of Application

1. In accordance with SAMA requirements, the Basel II Accord Capital Adequacy Regulations are applicable to Riyad Bank ("the Bank") on a consolidated basis, comprising of Riyad Bank and its subsidiaries: Riyad Capital and Ithra' Al-Riyad (collectively the "Group").
2. Riyad Bank has a wholly owned Capital Market subsidiary (through direct and beneficial shareholding), "Riyad Capital", which is a Saudi limited liability company registered in the Kingdom of Saudi Arabia. Riyad Capital is a registered financial corporation involved in the management of the Bank's investment services and asset management activities related to dealing, managing, arranging, advising and custody of securities. For accounting purposes all entities, where control exists, are consolidated in the Group Financial Statements, as well as for regulatory capital purposes.
3. Ithra' Al-Riyad is a Saudi limited liability company registered in the Kingdom of Saudi Arabia with the objective to hold, manage, sell and purchase real estate assets for owners or third parties as collateral.

Each company within the Group ensures compliance with regulations in terms of transfer of funds within the Group, regulatory capital, minimum capital adequacy ratios and statutory appropriation to reserves as per the applicable regulations and laws.

**Table 2: Capital Structure**

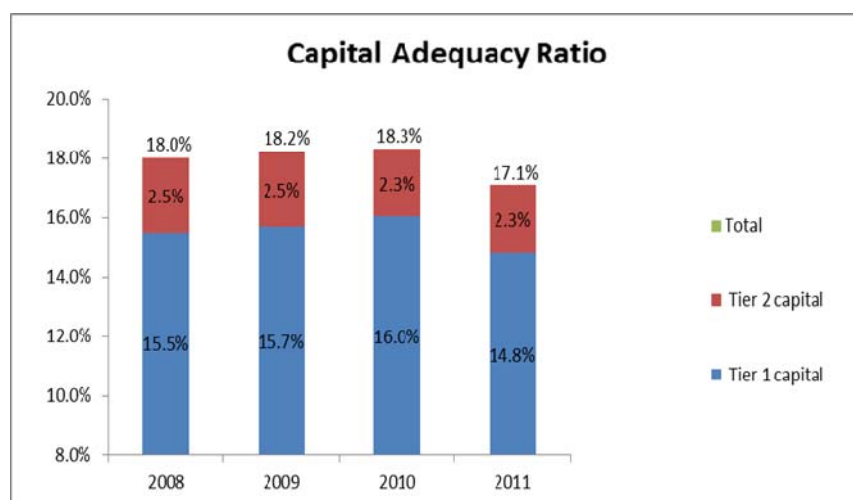
Shareholders' Equity of the Bank consists of the following:

1. Eligible paid-up share capital: consisting of Ordinary share capital of 1500 million shares of SAR 10 each. All these shares carry equal voting rights and are not redeemable. These shares rank junior to all other capital instruments and claims on the Bank.
2. Reserves consist of Statutory Reserves, Other Reserves and Retained Earnings. Statutory Reserves represent the accumulated appropriations of profit while Other Reserves mainly represent the net unrealized revaluation gains (losses) on available for sale investments and cash flow hedges. Please refer to notes 16,17, 18 and 24 of the audited consolidated financial statements for year-ended 31 December 2011 for more information on this topic.

**Table 3: Capital Adequacy**

Riyad Bank provides SAMA with quarterly capital adequacy reports which detail its current capital adequacy position and on annual basis submits an Internal Capital Adequacy Assessment Plan (ICAAP). The ICAAP details the current capital position, significant capital plans for the future and stress tests of the Bank's capital position under plausible yet severe scenarios. Riyad Bank has a strong capital position under these scenarios. The capital adequacy position at end of financial year and half year is set out in the Bank's annual report, and in the semi-annual financial statements.

In accordance with SAMA's minimum capital requirements, the Bank provides capital for the core banking risks (Credit, Market and Operational Risk) in accordance with Pillar 1 of the Basel II Accord. As depicted below Bank has been consistently maintaining a strong Capital Adequacy Ratio (CAR):



Under the Supervisory Review Process (SRP) with SAMA, the Bank also provides additional capital for risks not directly covered in Pillar 1 under the Pillar 2 provisions of the Basel II Accord including Settlement risk, IT risk, Strategic risk, etc. The Bank's capital position, under the SRP, is the total of Pillar 1 and Pillar 2 Capital requirements, plus any additional capital requirements determined by the Regulator.

The Bank is actively developing more sophisticated models and methodologies to move towards advanced approaches for measuring and monitoring Credit, Market, and Operational risks for capital adequacy purposes.

### **Table 3.1: General Qualitative Disclosure Requirements**

Riyad Bank has a dedicated centralized Risk Management function headed by the Chief Risk Officer. The Risk Management function is conducted through Credit Policy Division and Risk Management Division, both reporting to the CRO. The CRO is also responsible for overall implementation of Basel Regulatory Standards as adopted by SAMA. Bank's Capital Management Unit overseeing and coordinating the Internal Capital Adequacy Assessment Plan (ICAAP) is a part of Risk Management organization.

Credit Policy Division is responsible for managing and controlling credit risk throughout the Bank, development and implementation of credit policy, and implementation of Basel-II Internal Ratings Based (IRB) Approach for Credit Risk.

Risk Management Division is responsible for managing and monitoring Market and Operations Risk. Responsibilities for future induction of Basel II related Internal Model Approach (IMA) for Market Risk, and Advance Measurement Approach (AMA) for Operational Risk reside within this Division.

Internal Audit, Finance, IT and Legal also provide valuable contributions in managing overall risk.

Asset and Liability Committee (ALCO) oversees market, liquidity, and strategic business risks assumed by the Group in the course of carrying on its business. Bank's Operational Risk Management & Compliance Committee (ORMCC) oversees operational risk, including operational control environment, and regulatory compliance. ORMCC also reviews the Bank's annual compliance plan for its coverage and relevance, and on a monthly basis monitors progress towards implementing the compliance plan. Risk is inherent in the Group's activities and is managed through a process of ongoing identification, measurement and monitoring, subject to risk limits and other controls. The Board Audit Committee receives and reviews regular reports on risk and controls across the Bank, including

review of Annual Compliance Plan for its coverage and relevance.

**Table 3.2: Credit Risk**

Credit exposures arise principally in lending activities that lead to loans and advances, and investment activities. There is also credit risk in off balance sheet financial instruments, such as loan commitments. The Bank uses internal credit rating tools to assess credit standing of its counterparties and assigns credit ratings accordingly. The Bank also uses external credit ratings, issued by the major Credit Rating Agencies, where available. A potential credit loss might arise due to lack of proper credit analysis of the borrower's credit worthiness, inability to service the debt, lack of appropriate documentation etc.

Within Riyad Bank, the Board of Directors has approved a Credit Risk Management (CRM) Framework document that is consistent with the Bank-wide Risk Management Framework. The CRM Framework defines the Bank's credit principles, functional structures, activities and responsibilities that determine how the Bank is organized to identify, measure, approve and monitor credit risk for all of the Bank's business units.

The CRM Framework and credit risk governance structure are designed to provide comprehensive controls and continuing management of credit risk inherent in the Bank's business activities. The structure is based on:

- The Board Credit Strategy Statement,
- Clear definitions of Credit Risk and Credit Loss, and
- Documented and approved core Credit Risk Management Principles. The Core Credit.

Risk Principles for lending are:

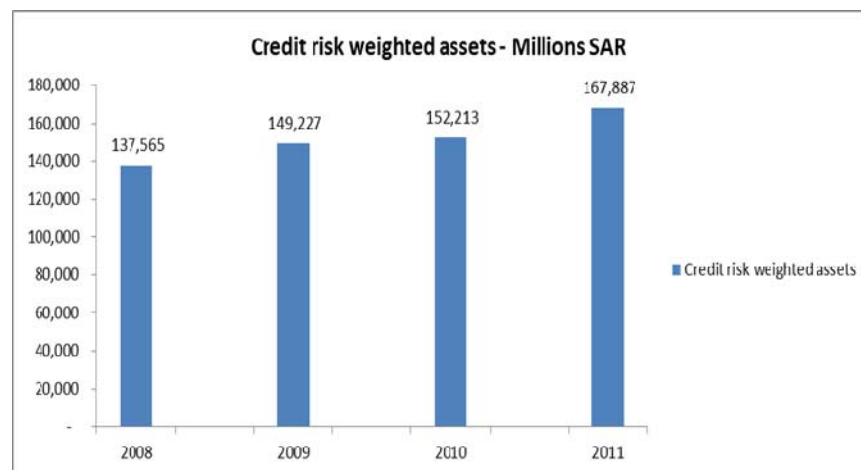
- Credit exposures shall only be provided to clients within a sound credit review and approval process,
- Independence of credit risk management and separation of key functions,
- Proper internal controls to cover the granting and management of credit risk,
- Lending is based on the client's ability to pay rather than security / collateral offered,
- Quality of our loan portfolio, and
- A loan portfolio widely distributed across various economic sectors and risk ratings.

The Board through its Executive Committee is involved in risk appetite determination, policy development, approval of large credits and continuing review of existing credit exposures, review of status and trends in credit quality and industry and sector credit concentrations.

Credit risk management is closely coordinated with, but independent of, the core revenue generating business units of Riyad Bank. Credit Policy Division is responsible for managing and monitoring credit risk

### **Credit Risk Weighted Assets for Capital Allocation**

Effective 1 January 2008, with the approval of SAMA, Riyad Bank adopted the Standardized Approach for measurement of credit risk for capital adequacy purposes. Credit risk capital assessment is calculated by extracting all credit risk exposures and risk categories and mapping this to appropriate Basel II asset classes. The credit risk system provided by independent external vendors then calculates credit risk weighted assets for capital allocation purposes; the table below provides Bank's Credit risk weighted assets under the Standardized Approach as per SAMA guidelines:

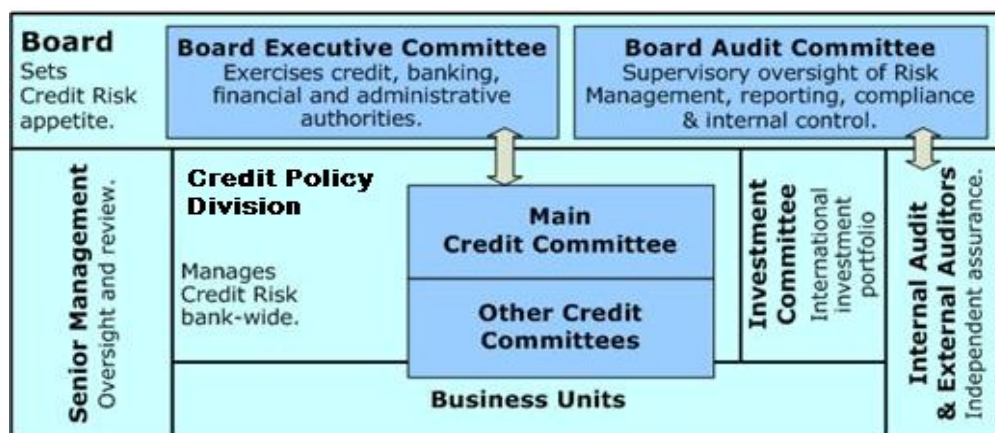


The Bank is currently in the process of implementing Basel-II FIRB Non-Retail and AIRB Retail Credit Risk approaches.

<b>Table 4: Credit Risk - General Disclosures</b>
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### Structure and Organization of Credit Risk Management

The Credit Risk Management function within Riyad Bank is shown in the diagram below:



#### Credit Committees

The Credit Committees are comprised of Co-Signature Committees, a Credit Committee and Main Credit Committee. The Main Credit Committee (MCC) and other Credit Committees operate within Board-delegated credit approval and credit risk authorities. Credit Committees are responsible for reviewing and approving credit exposures of the Bank within risk-limits, stating criteria required for loan documentation and stating methods of follow-up and supervision.

The MCC is chaired by the Chief Executive Officer of the Bank, has senior executives as members, and is the highest management level credit authority. The Committee's decisions are determined by the majority of the present votes and in case of equal votes, the Committee chairman's vote is the casting vote.

#### Investment Committee

The Investment Committee, chaired by the Chairman of the Board, oversees the Bank's total proprietary domestic and international investments. It is responsible for the setting of investment guidelines which govern the asset allocation and management process of the Investment Portfolio. The Committee reviews and approves the asset allocation mix of the Portfolio, within Board approved portfolio size and specified limits. The Committee aims to ensure that the portfolio remains well diversified at all times, and provides optimal returns for an approved level of risk.



### **Credit Risk Management**

Credit Policy Division is responsible for managing and controlling credit risk throughout the Bank, via the following work functions:

- Credit Review and Approval: reviews and conducts thorough re-assessment of Credit Applications.
- Lending Portfolio Services: ensure that credit decisions have been taken by the appropriate authority and in accordance with the SAMA's regulations and the Bank's policy. This function is also responsible for completion of documents and collateral enforceability as per the facility agreements prior to facility disbursement, and monitors the appropriate utilization of approved facilities; such function at our London Branch and Houston Agency is performed by their respective dedicated units that are subject to Bank's internal control and compliance standards.
- Credit Strategy and Policy: manages the Bank's credit policies and loan portfolio, and makes recommendations on strategic matters.
- Remedial Management: manages non-performing accounts.
- Credit Risk Management: manages credit application requirements, credit reporting and credit risk rating.

### **Audit Function**

The Internal Audit Department reports directly and independently to the Board of Directors. The Loan Review team within Internal Audit conducts a continual review of the corporate and commercial credit portfolios. It monitors compliance with the Bank's risk management policies and reports important issues to the Board of Directors. External Auditors conduct audits and provide independent assurance to the Audit Committee on the Bank's activities including credit risk.

### **Control Environment**

#### **Framework**

The Credit Risk Management Framework sets out the principles, structures, functions and activities and responsibilities for credit risk management at all levels of the Bank, while complying with the rules and regulations of domestic and international regulators and other authorities.

#### **Policies**

Board approved Frameworks, Committee Charters and Limits provide the highest level of internal authority for credit risk management and control and set out areas of risk to be avoided, guidelines on acceptable risks and general methods to manage and mitigate credit risk.

Management Policies, Procedures and Methodologies support the Board approved framework, limits and committee charters. Specialized management policies that support the credit framework are approved by the Main Credit Committee.

### ***Internal Control***

Riyad Bank's Policies and Procedures require the use of effective internal controls. Control activities in place are designed to reduce the risk of error, mistake, fraud, loss or other negative impact on the Bank and its customers. Riyad Bank's organizational structure supports the control culture as it separates the group business units which transact business with customers, from support units responsible for independently controlling, measuring, monitoring, and reporting on credit risk. Segregation of duties is built into the work practices of the Bank at all levels. Assurance on the effectiveness of internal control is obtained from various sources including Credit Policy Division, Risk Management Division, Internal Audit Department, regulatory reviews and external audit.

### **Credit Risk Profile**

Riyad Bank's credit exposure can be classified in two broad risk categories: Retail Credit Risk and Non-retail credit risk.

#### ***Retail Credit Risk***

Retail credit risk is the risk of non-collection of amounts due by retail banking customers on due dates. This typically covers risks associated with personal loans, residential mortgage loans, credit card products, and other products offered to individuals.

Retail Banking risk acceptance is primarily based on the application of fixed criteria using well defined scoring methodologies. Post approval monitoring and supervision by Consumer Finance Risk Management is handled on a portfolio level basis.

Consumer lending risks are mitigated by stipulating a maximum cap on Personal Loans, Credit Card Products, Auto Leasing and Residential Mortgage Loans. In addition, a debt-burden analysis is undertaken to assess the repayment ability of Retail borrowers.

The retail credit risk group monitors trends in the consumer finance credit portfolio and reviews sector concentration limits on credit exposures to ensure risk diversification. Comprehensive review and reporting by the Consumer Finance Loans Administration group ensures strong credit monitoring and control over the portfolio.

Portfolio provisions are made on a portfolio basis for Personal Loans, Credit Card Products and Residential Mortgage Loans in line with the Bank's provisioning policy. Interest is accrued until 180 days past due, after which the loan is charged off. A Consumer Collection Department follows up on all delinquent loans.

### **Non-Retail Credit Risk**

Non-retail lending is defined to cover all credit risks arising from non-retail activities. This would typically include corporate loans, inter-bank loans, loans to government or semi-government entities, trade finance, structured and project finance, corporate or government leasing, syndicated loans, corporate guarantees, corporate overdrafts, and lending to small and medium sized enterprises. Non-retail lending represents the majority of total credit exposure by total asset size for Riyad Bank (please refer to the audited consolidated financial statements for year-ended 31 December 2011 and relevant notes to the accounts for more detail). A summary of credit risk assessment policies under major credit risk classifications is as follows:

### **Country Risk**

All off-shore business activities are supported by appropriate country limits put in place in line with the Board's approved country exposure limits.

Approved country limits are reviewed at least once a year and more often if market, economic or political conditions change rapidly. Country risk quality is monitored on a daily basis. All exceptions are escalated to senior management for consideration and decision.

### **Financial Institutions Risk**

Riyad Bank has a dedicated Financial Institutions' credit risk management unit which ensures prudent and timely risk identification, quantification, monitoring, and reporting of exposures to financial institutions' counterparties.

The Bank's Financial Institutions risk appetite is set by the Board approved Financial Institutions Credit Risk, Country Risk and Settlement Risk Matrices. Ratings are used for counterparty classification. Each category contains allowed products and total credit risk ceilings which are linked to Riyad Bank and counterparty equity.

Financial Institutions' exposures are monitored on a daily basis. Limits are reviewed on an annual basis or more often if market conditions change rapidly. Limit breaches are reported to management immediately. The Bank has not reported any material financial institutions' defaults.

**Investment Portfolio Risk**

The Bank holds a proprietary Investments Portfolio which operates within clearly defined risk benchmarks as approved by the Investment Committee. While the Board establishes the portfolio size and the specified limits, the Committee sets the policy framework and strategic asset allocation. An independent external consultant provides support with the asset allocation process. The external Fund Managers' performance and their compliance with the operating guidelines are closely monitored on an ongoing basis. An in-depth quantitative and qualitative review of the externally managed portfolio is performed by an independent consultant on a quarterly basis.

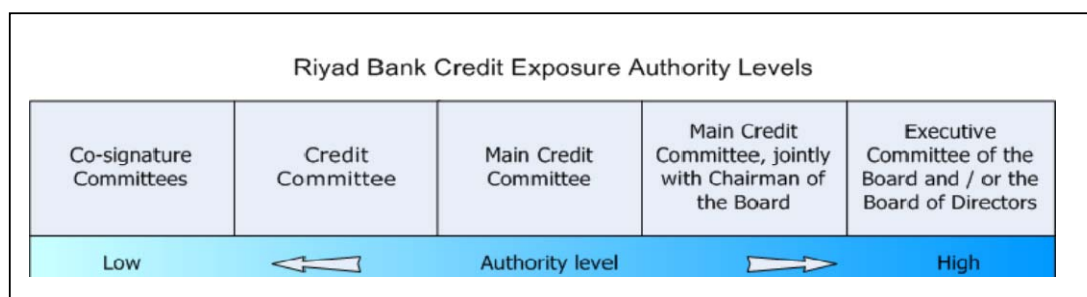
**Corporate Lending Risk**

Riyad Bank manages corporate credit risk prudently by ensuring timely risk identification, quantification, calibration, monitoring and credit exposure reporting.

The Bank's risk appetite is set mitigate and minimize potential erosion of earnings or capital due to avoidable losses in the banking and trading books or from frauds and operational inefficiencies. In addition, the Bank defines its portfolio strategy for each sector. Concentration limits are set in terms of single customer exposure and industry concentration.

Credit exposure to customers is governed by three types of limits: country, sector, and individual or group of related clients. The approved limit structure is governed by the Bank's credit policy which sets out limits, sub-limits, and cross limits. The nature and size of the approved limits are based on the borrowers' risk ratings and need.

The Bank approved authority level is shown in the diagram below:



Corporate counterparties are assessed in tandem with the Bank's risk appetite benchmarks and well defined credit-granting criteria which include a clear indication of the Bank's target market and a thorough understanding of the borrower as well as the purpose and structure of the credit and its source of repayment.

All credit extensions are made on an arm's length equivalent basis. Credit risks to related parties are covered by collateral as per regulatory requirements and are appropriately monitored. All credit applications are risk rated as per the Bank's Credit Risk Rating System.

Risk is monitored on a facility basis, total exposure (single name) basis, and portfolio basis (across entire portfolio and by facility type).

### ***Corporate Internal Rating Structure***

The Bank uses a combined rating system. First, credit quality of the borrower is assessed through obligor credit risk rating models/scorecards built on an externally developed credit rating platform. The resulting "Obligor Risk Rating" of the borrower is based on well documented quantitative (financials) and qualitative (business analysis) criteria. Next an internal rating is assigned on a 12 point scale, based on a range of definitions and criteria given for each rating grade and by taking into account the specific nature of the facility requested, collateral offered, account behavior and other credit specific factors. Both ratings are documented in the credit applications and are submitted to the appropriate credit approving authority.

Rating changes are approved by the Credit Rating Committee and / or Credit Rating Review Committee. Loan Quality Review and Internal Audit monitors the in-house rating process through regular reviews of the ratings process and the ratings assigned to individual borrowers.

### ***Treasury Credit Risk***

All Treasury transactions require pre-approved country and counterparty limits. Use of Treasury credit limits is consolidated into a total credit usage with each financial institution counterparty and/or country /region and is monitored by Credit Policy Division.

## **Risk Mitigants**

### ***Corporate and Retail Risk Mitigants***

Collateral gives the Bank priority over other lenders and unsecured creditors. Collateral is never the principal rationale for lending decision, but is viewed as an alternative source of repayment in the event that a business fails or enters into bankruptcy.

The Bank has explicit policy guidelines on collateral acceptance that determine collateral valuation, enforceability, marketability and liquidity. Acceptable collateral security includes time deposits, real estate, shares, mutual funds and guarantees. Other retail lending risk mitigation techniques commonly used are salary assignment and Credit Bureau reports that outline borrower's prior credit history which is mandatory for all retail loan applications. Retail lending collaterals usually include shares, mutual funds, guarantees or residential property linked directly to the borrower.

### ***Past-due Loans***

Past-due loans are loans where all or part of the credit exposure payable by the counterparty has not been repaid on the due date. Credit Control and Follow-up monitors individual client accounts for irregularities or unusual behavior, including non-payment of principal, insufficiency of funds or available limits to debit, interest and fees.

Loans are considered to be in default if past due by more than 90 days, on any material portion of its credit obligations to the bank (or the banking group of which it is a part).

Remedial Management participates in the development of remediation plans jointly with Relationship Managers.

### ***Impaired Assets***

Please refer to note 3k, 6 and 7 of the audited consolidated financial statements for year- ended 31 December 2011 for information on impaired assets.

### ***Provisioning Policy***

The Bank has an established and approved Policy for provisioning for credit risk for both retail and non-retail exposures. The Policy is consistently applied and resulting suggested provisions are presented to the Board Audit Committee on a quarterly basis.

Provisions are calculated and set after a detailed and comprehensive review process involving business areas, Remedial Management, Loan Recovery Department, Chief Risk Officer, Executive Management, Internal Audit and Audit Committee on a quarterly basis. The provision calculation methodology is regularly audited by the Bank's Internal Audit Department. Provisions are also reviewed quarterly by the Bank's external auditors.

Riyad Bank provisions consist of portfolio and specific provisions. Specific provisions are created for non-retail loans classified as non-performing and collateralized defaulted personal loans, based on individual review on a periodical basis of credit exposures less the present value of expected recoverable amounts. Consumer loans are charged off when they become 180 days past due. Portfolio provisions, for both retail and non-retail loans, are estimated by the Bank using a well-defined methodology in line with the IAS39 requirements covering corporate, consumer and credit card performing exposures and applying a range of provision ratios which reflect the impairment on each portfolio category.

**Table 5: Credit Risk - Disclosures for Portfolios Subject to the Standardized Approach and Supervisory Risk Weights in the IRB approaches**

**External Credit Assessment Institutions**

The Bank uses Moody's, Standard & Poor's, Fitch and Capital Intelligence as External Credit Assessment Institutions (ECAIs).

Eligible ECAIs are used for Sovereigns, Central Banks, Banks, Securities Firms and Corporate exposures. If a given exposure is rated by two External Credit Assessment Institutions, then the lower rating is applied; in case any exposure is rated by three External Credit Assessment Institutions, the two lowest ratings are referred to and the higher of these two ratings is applied.

The Bank does not rely on public issue ratings.

ECAIs use alphanumeric scales to represent risk levels. Riyad Bank uses Saudi Arabian Monetary Agency's prescribed External Credit Assessment Institutions' mapping tables issued for Sovereign and Central Banks, Banks and Securities Firms, as well as for Corporate exposures.

**Table 6: Credit Risk: Disclosure for Portfolios Subject to IRB Approaches**

Not Applicable.

**Table 7: Credit Risk Mitigation - Disclosures for Standardized and IRB Approaches****Collaterals**

Collateral residual risk is monitored to manage valuation, maturity, enforceability, liquidity and marketability risks. Credit Documentation & Security is responsible for the management and administration of collaterals and their respective residual risks.

Acceptable collaterals are detailed as per Bank's policy. Different classes of collaterals are subject to independent policy guidelines and periodic valuation. Real Estate, Shares, Mutual Funds and Non-rated Corporate Guarantees are not considered as eligible credit risk mitigants by local regulators and are excluded while calculating regulatory capital of the Bank.

**Table 8: General Disclosure for Exposure Related to Counterparty Credit Risk****Credit Concentration Risk**

Credit Concentration risk refers to exposures that are large enough to jeopardize any Bank's core operations if not paid. Such credit risk concentrations may include: economic sectors, locations, collaterals, tenors, on and off balance sheet exposures etc. Credit Concentration Risk at the Bank is managed prudently. The Monte Carlo Simulation technique is used for measuring the capital charge for concentrated portfolio risk to meet Basel II Pillar 2 capital requirements.

The Bank calculates Credit Concentration Risk Capital charge under current as well as stress test scenarios. Capital charge calculation for credit concentration risk without stress testing determines capital requirements for the current economic cycle without giving any consideration to any additional external events that may have a significant negative impact on the Bank's credit portfolio. The stress tested credit concentration risk economic capital charge ensures that the revised capital is adequate to support the risk profile of the Bank in both normal conditions and during distressed periods.

Concentrated exposures are modeled using a Value at Risk (V@R) calculation. This is done by using Monte Carlo simulation to derive a loss distribution. The 99.97 % percentile value is used as the required



confidence level and the Mean (Expected Loss) is subtracted from V@R to obtain unexpected loss. This number is used as the additional capital to be held.

**Table 9: Securitization: Disclosures for Standardized and IRB Approaches**

Not Applicable.

**Table 10: Market Risk - Disclosure for Banks using the Standardized Approach**

Please refer note 29 of the audited consolidated financial statements for year-ended 31 December 2011 for detailed commentary and information on Market Risk.

**Market risk – Banking book**

***Interest rate risk***

Interest Rate Risk arises from the possibility that the changes in interest rates will affect either the fair values or the future cash flows of the financial instruments. The Board has established interest rate gap limits for stipulated periods. The Bank monitors positions daily and uses hedging strategies to ensure maintenance of positions within the established gap limits.

***Equity price risk***

Equity price risk refers to the risk of decrease in fair values of equities in the Bank's non- trading investment portfolio as a result of reasonable possible changes in levels of equity indices and the value of individual stocks.

***Foreign currency exposure***

The Bank manages exposure to effects of fluctuations in prevailing foreign currency exchange rates on its financial position and cash flows. The Board of Directors sets limits on the level of exposure by currency and in total for overnight positions, which are monitored daily.

***Liquidity analysis***

Liquidity risk is the risk that the Bank will be unable to meet its net funding requirements. Liquidity risk can be caused by market disruptions or credit downgrades, which may cause certain sources of funding to become unavailable. To mitigate this risk, management has diversified funding sources and assets are managed with liquidity

in mind, maintaining an appropriate balance of cash, cash equivalents and readily marketable securities.

### Market Risk Weighted Assets for Capital Allocation

Riyad Bank uses the Standardized Approach in determining its regulatory Market risk capital and weighted assets. The Bank has recently implemented systems and processes that would enable it to adopt the more advanced Internal Model Approach (IMA).

The table below provides Bank's Market risk weighted assets under the Standardized Approach as per SAMA guidelines:



### Market Risk Structure

The Bank has an Asset and Liability Committee (ALCO) as one of its executive management committees, to review its market risk activities (in both Banking and Trading books), liquidity and to ensure strategies exist for the management of the Bank's assets, liabilities and capital. The committee meets on a monthly basis and is chaired by the CEO.

#### Table 11: Market Risk: Disclosures for Banks using the Internal Models Approach

Not Applicable

#### Table 12: Operational Risk

### Operational Risk Management: Strategies & Processes

Riyad Bank's operational risk strategy is to ensure that the Bank is safeguarded against all major operational risks while also ensuring that losses incurred as a result of operational risks are kept to a minimum. The Bank has developed and put in place robust proactive risk mitigation strategies supported by risk management

frameworks, policies and procedures aimed at detecting and controlling risks prior to becoming a threat. Organizational units have clearly defined risk and control objectives to ensure any failure of people, system or processes is managed proactively and as efficiently as possible.

### **Structure and Organization of Operational Risk Management**

A centralized Operational Risk Management function headed by the Senior Vice President of Operational Risk oversees the impacts of operational risks upon Riyad Bank. Operational Risk summary reports are prepared jointly by the Departments within Operational Risk Department and are reviewed on a monthly basis by the Operational Risk Management and Compliance Committee which is chaired by the CEO. Operational Risk Management is responsible for managing and controlling operational risk throughout the Bank, via the following work functions:

#### ***Operational Loss & Analytics Department***

A dedicated Operational Loss Management Analytics Department records, analyses and reports all operational losses incurred. The Department mitigates risk through appropriate cost-effective insurance programs, managing insurance claims and risk management surveys. The Department assesses the adequacy of risk treatment and assists business management to improve the effectiveness of internal controls by developing appropriate mitigation strategies.

#### ***Examinations and Investigations Department***

An Examinations and Investigations Department undertakes onsite and remote examinations and investigations to ensure the Bank's operations comply with current policy and procedures.

#### ***Fraud Control Department***

The Fraud Control Department uses computer-based analytical tools to analyze account and transaction data to detect and prevent fraud and error. It specializes in identifying unusual and suspicious transaction activity, prepares and analyzes exception reports. The Department also monitors overdraft trends, cash trends, dormant accounts, and reconciliations.

#### ***Key Risk Indicators (KRIs) & Risk Control Self-Assessment (RCSA)***

A KRI and Process Analysis Department develops appropriate Operational Risk Management policies, frameworks, methodologies, strategies and risk identification methods in line with Basel II

Operational Risk requirements. The Department also identifies, measures and reports on Key Risk Indicators (KRIs) in order to provide early warning alert capability, assesses the level of risk and adequacy of risk treatment using Risk Control Self-Assessment (RCSA) tools. In addition, before their launch all new products and services undergo a comprehensive operational risk assessment as part of the Bank's Solution Delivery Life Cycle (SDLC) which ensures complete oversight of operational risk assessment across the organization.

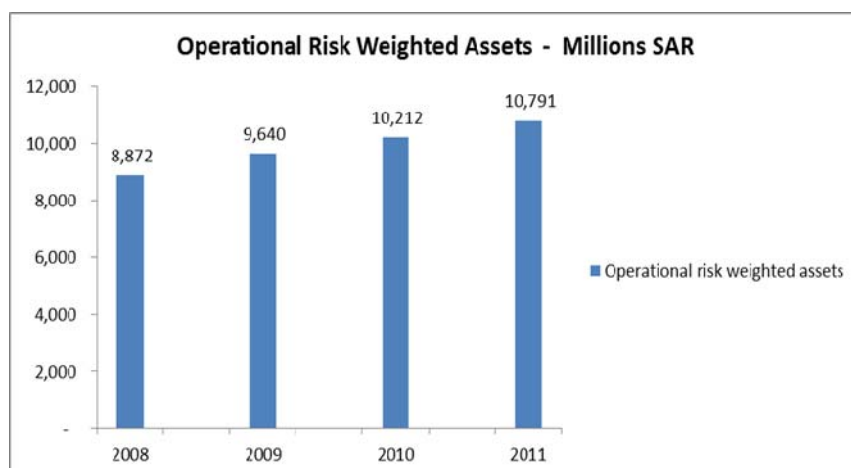
### ***Insurance Department***

An Insurance Department within Operational Risk Department is responsible in managing all bank-wide insurance policies and claims. It is also responsible for ensuring that appropriate level of cover is maintained for insurable risks across the Bank's business areas, and for the design, placement and administration of the Bank's Insurance Plan through a cost-effective insurance program that provides protection against insurable risks. In delivering these objectives, the Department tracks & manages all claims as well as settlements with insurers and negotiates with Insurers and Brokers on all terms such as cost, coverage, limitations, exclusions and deductibles, to obtain suitable deals.

### ***Operational Risk Weighted Assets for Capital Allocation***

Riyad Bank currently uses the Standardized measurement methodology in determining its regulatory Operational risk capital and risk weighted assets, and is gradually preparing itself to move towards the Advanced Measurement Approach (AMA).

The table below provides Bank's risk weighted assets for Operational risk under the Standardized measurement methodology as per SAMA guidelines:



**Table 13: Equities - Disclosures for Banking Book**

### positions

The Bank holds equity investments both for capital gains and strategic purposes. All investment securities are initially recognized at fair value, including any incremental direct transaction costs associated with the investment. After initial recognition these investments are measured at fair value. For an available for sale equity investment where the fair value has not been hedged, any gain or loss arising from a change in its fair value is recognized directly in 'Other reserves' under shareholders' equity until the investment is derecognized or impaired, at which time the cumulative gain or loss previously recognized in shareholders' equity is included in the consolidated income statement for the year. Investments in associates are initially recognized at cost and subsequently accounted for under the equity method of accounting.

#### Table 14: Interest Rate Risk in the Banking Book (IRRBB)

Interest Risk in the Banking Book (IRRBB) is the risk to Riyad Bank's earnings and capital that arises out of customers' demands for interest rate related products with various re-pricing profiles. As Riyad Bank engages in such activities as lending, balance sheet funding and capital management, it may be exposed to the inherent Interest Rate, Foreign Exchange and Liquidity risks.

The objective of the Bank in managing its interest rate risk is to secure a stable net interest income over at least a 12 month period and over the long term.

#### **Management**

Riyad Bank manages Interest Rate Risk in the Banking Book (IRRBB) within its established Net Interest Income at Risk (NII@R) limit that is measured and monitored by Risk Management Division and reported to the Asset and Liability Committee and to the Board.

#### **Measurement**

Interest Rate Risk in the Banking Book (IRRBB) in Riyad Bank is treated as a Pillar 2 Risk as per SAMA guidelines; the Bank uses the "Duration" method to measure its IRRBB for Pillar 2 capital. The Bank has also implemented a Value at Risk (V@R) model it intends to use to measure interest rate risk and will obtain the necessary regulatory approval to use V@R to measure and report IRRBB capital charge.

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