

# **RIYAD BANK**

## **BASEL III – PILLAR 3 QUALITATIVE DISCLOSURES 31 DECEMBER 2014**

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## Introduction

This document provides information on the capital adequacy, and risk management processes and policies, at Riyad Bank Group. The information contained in this document is supplementary to information published in the Riyad Bank Annual Report for Year 2014 including the Annual Consolidated Financial Statements and disclosure notes, which are available on the Riyad Bank's 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 disclosures are consistent with the requirements of the Saudi Arabian Monetary Agency (SAMA) and the Basel III 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 III Accord Capital Adequacy Regulations are applicable to Riyad Bank ("the Bank") on a consolidated basis, comprising Riyad Bank and its subsidiaries: Riyad Capital, Ithra' Al-Riyad and Riyad Company for Insurance Agency (collectively called 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 licensed financial company 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'a Al Riyad Real Estate Company is a limited liability company wholly owned by Riyad Bank, and registered in Saudi Arabia. This subsidiary is responsible for managing asset services for real estate

owners and others. It also has the right to buy and sell real estate and similar assets in pursuit of the funding purposes for which it was established.

4. Riyadh Company for Insurance Agency is a limited liability Company wholly owned by Riyadh Bank, and registered in Saudi Arabia. This purpose of the subsidiary is to engage in insurance agency business in the Kingdom of Saudi Arabia. The head office is located in Riyadh.

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

## Table 2: Capital Structure

Shareholders' Equity consists of the following:

1. Pursuant to the approval of the relevant authorities and the Bank's shareholders, in an Extra ordinary General Assembly held on 26 May 2014, the Bank has issued 1,500 million bonus shares to its existing shareholders (one bonus share for each existing share). After the increase the total number of shares have increased from 1,500 million shares to 3,000 million shares and the share capital of the Bank increased from SAR 15 billion to SAR 30 billion. This issue has been effected by transferring all of the accumulated statutory reserves and a part of the retained earnings as of 31 December 2013.
2. Eligible paid-up share capital: consists of ordinary share capital of 3000 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.
3. Reserves consists 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.

Table 3: Capital Adequacy

Riyad Bank provides SAMA with quarterly capital adequacy reports which detail its quarter-end capital adequacy position, and it also submits a forward-looking Internal Capital Adequacy Assessment Plan (ICAAP) on an annual basis. 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. The Bank has a reasonably adequate capital position under these scenarios. The capital adequacy position at end of financial year and quarter-end is set out in the Bank's annual report, and in the interim quarterly consolidated financial statements respectively.

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 Accord. As depicted below the Bank has consistently maintained a strong Capital Adequacy Ratio (CAR):



*\* For the purposes of presentation, the Tier 1, Tier 2 and Total Capital related ratios after 2012 are calculated using the framework and the methodologies defined under the Basel III framework. The comparative ratios for 2012 and earlier years are calculated under Basel II and have not been restated.*

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 III Accord. These include 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

The Risk Management function at Riyad Bank is headed by the Chief Risk Officer (CRO) and includes oversight and management of all aspects of the Bank's risk planning, risk modeling, risk measurement and risk methodology development, and implementation of the capital adequacy rules required by SAMA and the Basel Committee. The Credit Risk management mandate is exercised through the Credit Division, covering all aspects of credit risk. The Risk Management Division covers both financial and operational risks. In addition, the Bank's Capital Management Section, reporting to the CRO, is responsible for overseeing and coordinating the preparation of Internal Capital Adequacy Assessment Plan (ICAAP).

Asset and Liability Committee (ALCO) is responsible for regular reporting to The Board of Directors on the development, implementation and approval of an effective ICAAP / Capital Management operating policy and process, as per The Board of Directors approved Capital Management Framework.

The Compliance function, including regulatory compliance, is separately performed by the Bank's Compliance Department reporting directly to the Bank's Chairman.

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

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

Internal Audit, Finance, Information Technology Governance (ITG) 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. The Bank's Operational Risk Management & Compliance Committee (ORMCC) oversees operational risk, including the 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, assessment, measurement monitoring, and reporting 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 the Annual Compliance Plan for its coverage and relevance. A Board Risk Committee was formed for the Board term starting 1/11/2013 and comprises of three Board members.

***Internal Control:***

In February 2013, Saudi Arabian Monetary Agency (SAMA) issued Internal Control Guidelines for banks operating in the Kingdom with the objective to encourage and help banks in instituting an effective system of internal control commensurate with the nature, complexity, and inherent risk in their activities and enable them to respond to changes in the environment and conditions they operate in.

The Bank, to ensure compliance with this important regulatory requirement engaged an independent consultant to evaluate the internal control framework as stated in the guidelines

In 2014, the Internal Control department led this important initiative to implement the recommendations made in the independent consultant report. Business heads and the control departments have been engaged to ensure efficient, timely and effective implementation of the internal control recommendations. Nominated representatives from the business heads and the key control departments will be actively involved in ongoing testing of controls and reporting to the internal control department. Thereafter the Internal Control Department submits quarterly reports to Operational Risk Management and Compliance Committee and on semi-annual basis to the Board Audit Committee.

Table 3.2: Credit Risk

Credit exposures arise principally in lending, and investment activities. There is also credit risk in off balance sheet financial instruments, such as loan commitments, guarantees, etc. 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.

The Board of Directors has approved a Credit Risk Management (CRM) Framework document. The CRM Framework defines the Bank's credit principles, functional structures, activities and responsibilities that determine how the Bank is organized to identify, assess, measure, approve, monitor, and reporting credit risk across all 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.

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 mitigate the risk of credit management processes,
- Lending is based on client's credit worthiness and his ability to fulfill his Contractual Obligations rather than security/collateral offered, and
- A loan portfolio widely distributed across various economic sectors and risk ratings.

The Board and its Executive Committee and Risk Sub-Committees approves and oversees risk appetite, credit policy, large credits and regularly reviews the existing credit exposures, status and trends in credit quality as well industry and sector credit concentrations. In addition, the Bank's Credit Strategy and Risk Appetite Statement set out

a clear plan for identifying, establishing risk tolerance parameters, along with monitoring and reporting mechanism for credit risk in the Bank.

Credit risk management is closely coordinated with, but independent of, the core revenue generating business units of the Bank. Credit 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, the 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 asset classes. The credit risk system provided by independent external vendors then calculates 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:



*\* For the purposes of presentation, the Credit RWAs, after 2012 are calculated using the framework and the methodologies defined under the Basel III framework. The comparative balances for 2012 and earlier years are calculated under Basel II and have not been restated.*

The Bank is currently in the process of implementing Basel Foundation Internal Ratings Based (FIRB) Approach for Non-Retail credit portfolio, and Advanced Internal Ratings Based (AIRB) Approach for Retail credit portfolio.

**Table 4: Credit Risk - General Disclosures****Structure and Organization of Credit Risk Management:**

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

**Credit Committees**

The Credit Committees are comprised of the Main Credit Committee, Credit Committee and Co-Signature Committees. The Main Credit Committee (MCC) and other Credit Committees operate within Board-delegated credit approval and credit risk authorities. The Credit Committees are responsible for reviewing and approving credit exposures of the Bank within risk-limits, defining criteria required for loan documentation and defining 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 voting and in case of equal votes, the Committee Chairman has 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 Division is responsible for identifying, assessing, reporting and monitoring credit risk throughout the Bank, via the following work functions:

- Credit Review and Approval: reviews and conducts thorough assessments of Credit Applications.
- Special asset management: review watch accounts and manage problematic loans
- Lending Portfolio Services: ensures 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 lending 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 Board Audit Committee and to the Board of Directors on the Bank's activities including credit risk.

**Credit 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 Committees' charters.

Specialized management policies that support the credit framework are approved by the Main Credit Committee.

### ***Credit 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 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. In the event of non-payment for 180 days from the due date, the loan is charged off against profit & loss. 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 2014 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.

### **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 to 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:

Riyad Bank Credit Exposure Authority Levels				
Co-signature committees	Credit Committee	Main Credit Committee	Main Credit Committee, jointly with the Chairman of the Board	Executive committee of the Board and / or the Board of Directors
Low	←	Authority Level	→	High
Commercial	←	Lending Activity	→	Investment

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***

counterparty limits. Use of Treasury credit limits is consolidated into a total credit usage with each financial institution

## ***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. Individual client accounts are monitored for irregularities or unusual behavior, including non-payment of principal, insufficiency of funds or available limits to debit, interest and fees. On a daily basis, the system generates alerts and sends them to the concerned Relationship Managers for action

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 3, 6 and 7 of the audited consolidated financial statements for year-ended 31 December 2014 for information on impaired assets.

**Provisioning Policy:**

The Bank has an established and approved provisioning Policy for retail and non-retail credit exposures . The Policy is consistently applied and the resulting recommended 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 collateralized defaulted personal loans (against shares/mutual funds), and non-retail loans classified as non-performing, 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 alphanumerical 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 Approach

Collateral residual risk is monitored to manage valuation, maturity, enforceability, liquidity and marketability 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/profitability if not paid/lost his relationship. 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 Pillar 2 capital requirements.

The Bank calculates the 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 2014 for detailed commentary and information on Market Risk.

**Market risk:*****Market Risk Governance***

The Bank has an Asset and Liability Committee (ALCO) as one of its executive management committees which reviews its market risk activities (in both Banking and Trading books), liquidity and ensures 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.

***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 Value at Risk (V@R) and gap limits. The Bank monitors positions daily and uses hedging strategies to ensure maintenance of positions within the established 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. The bank has set V@R limits for its non-trading investment portfolios and does not have equities in its trading book.

### 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.

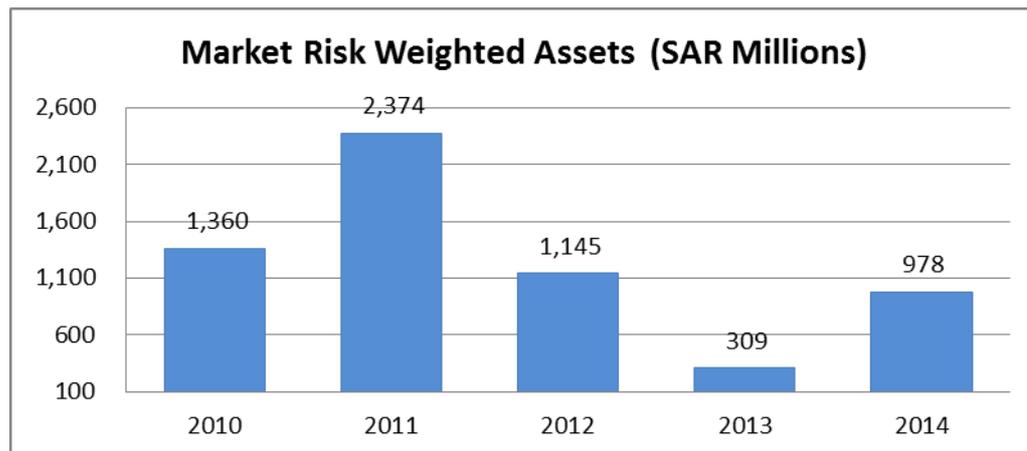
### Liquidity analysis

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. Riyadh Bank is also Basel III compliant with respect to the two liquidity risk ratios of Liquidity Coverage Ratio (LCR) and Net Stable Funding Ratio(NSFR).

### 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 will apply to SAMA to use the Internal Model Approach (IMA) for both traded and non-traded market risk capital charge determination after the current regulator driven "Fundamental Review of the Trading Book" standards is finalized.

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



\* For the purposes of presentation, the Market RWAs after 2012 are calculated using the framework and the methodologies defined under the Basel III framework. The comparative balances for 2012 and earlier years are calculated under Basel II and have not been restated.

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 operational risk prior to it 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, as well as submitting a Semi-Annual Report to the Board Audit Committee. 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***

The Examinations and Investigations function as part of its new risk based methodology undertakes onsite and remote examinations and

investigations of Riyadh Bank's branch network including business area of Consumer Finance (all products such as personal finance, mortgages, credit cards), Investment Centers, Cash Units, Customer Care unit, Tadawul Dept. and Branch Support Services Dept.

All areas are examined to ensure the Bank's operations comply with current policy and procedures and, where applicable, international best practice. The Department has an established follow up process for ensuring that the agreed corrective actions where ever required has been adequately effected. Furthermore, the Department escalates issues where it is found that suggested corrective action has not been undertaken as per the assigned deadline.

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

Fraud Control Department is the focal point for the Bank's implementation in combating embezzlement and fraud against the bank and its customers. Responsibilities include fraud prevention, monitoring & detection, investigations, and reporting of any and all suspicious activities either from external customers or internal staff.

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

The KRI and Process Analysis Department is responsible in providing operational risk oversight through the quantification and assessment of operational risks across the bank's business lines. This is achieved through bank wide deployment and reporting of Key Risk Indicators (KRIs), Risk Control Self-Assessment (RCSA), mandatory risk assessments of all bank products and services and compliance with Basel II requirements for Operational Risk. The major mission of the Department is to facilitate operational risk awareness across the bank via the mitigation and management of bank wide operational risks and to identify control gaps related to all bank processes, products and services.

#### ***Insurance Department***

The Insurance Department within Operational Risk 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.

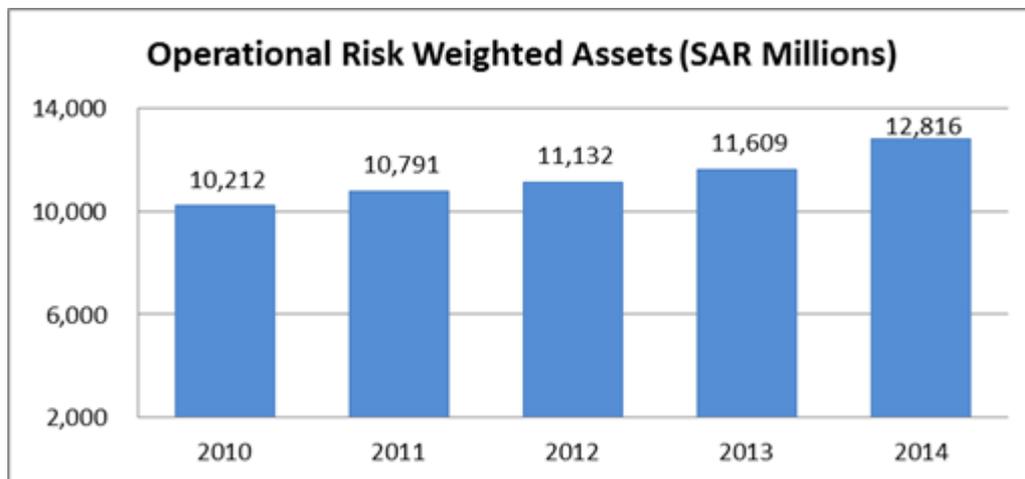
### **Money Laundering Control Department**

The Money Laundering Control Department creates policies to develop effective rules designed to comply with the laws and regulations related to compliance with the Anti-Money Laundering (AML), Combating Terrorist Financing (CTF) and Know Your Customer (KYC) principles in order to protect the Bank and its business from being exploited as a channel for passing the suspicious transactions, and it also monitors the transactions to report the suspicious cases to the competent authorities. It responds to all requests of Saudi Arabian Monetary Agency within the agreed timelines, and it provides training and awareness plans for all Riyadh Bank employees on combating money laundering.

### **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:



*\* For the purposes of presentation, the Market RWAs after 2012 are calculated using the framework and the methodologies defined under the Basel III framework. The comparative balances for 2012 and earlier years are calculated under Basel II and have not been restated.*

**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 Rate 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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