National Commercial Bank

Qualitative and Quantitative Pillar 3 Disclosures
As of 31 December 2010

Contents

1.0 Scope of Application

1.1 Introduction

The Pillar 3 disclosures and the related regulations apply to the National Commercial Bank (the Bank) at a consolidated level. Please refer to note 1.1 of the *Audited Financial Statements for the year ended 31 December 2010* for details on the incorporation and activities of the Bank.

1.2 Basis of Consolidation

The Bank does not have any subsidiaries other than banking, securities and financial entities, accordingly, there is no difference in the basis of consolidation used in the *Audited Financial Statements for the year ended 31 December 2010* and that used for regulatory purposes.

SCOPE OF APPLICATION (SAMA reference table 1)	
Capital Deficiencies (Table 1, (e))	
Particulars	**Amount (SR '000)**
The aggregate amount of capital deficiencies in subsidiaries not included in the consolidation i.e. that are deducted:	Nil

For Regulatory Capital purposes, banking, securities and other financial entities and insurance investments, if significant (exceeding 10% of the outstanding equity shares) are deducted at 50 percent from Tier 1 capital, and 50 percent from Tier 2 capital.

(i) Entities (within the group) fully consolidated for regulatory purposes

Following is a list of the consolidated subsidiaries of the Bank.

(1) NCB Capital Company

(2) Türkiye Finans Katılım Bankası A.Ş.

(3) Eastgate Capital Holdings Inc. (Eastgate)

(4) The Capital Partnership Group Limited (TCP)

Please refer to note 1.2 of the *Audited Financial Statements for the year ended 31 December 2010* for details on the incorporation and activities of the subsidiaries of the Bank.

(ii) Entities (within the group) deducted for regulatory purposes

(1) Al-Ahali Takaful Company

The Bank has a 30% ownership in Al-Ahali Takaful Company. Al-Ahali Takaful Company (the Company) is a Saudi Joint Stock Company registered in the Kingdom of Saudi Arabia under Commercial Registration No. 4030171573 dated 21 Rajab 1428H, corresponding to 4 August 2007. The object of the Company is to transact cooperative insurance operations and related activities in the Kingdom of Saudi Arabia. The Company was listed on the Saudi stock market on 18 August 2007. The Company commenced its commercial operations on 4 February 2008.

(2) Arabian Financial Services Company

The Bank has 13% ownership in Arabian Financial Services (AFS) company. It is the region's leading provider of electronic-payments and consumer-finance outsourcing services.

(3) Saudi Traveller Cheques Company

The Bank has 25% ownership in the Saudi Travellers Cheques Company (STCC). Saudi Riyal Travellers Cheques are issued by the company which was jointly established by the banks of Saudi Arabia.

(4) The Saudi Credit Bureau

The Bank has 10.94% ownership in the Saudi Credit Bureau (SIMAH). It is the first and sole licensed national credit bureau offering consumer and commercial credit information services to respective members in the Kingdom of Saudi Arabia.

(iii) Entities (within the group) neither consolidated nor deducted

All other equity investments are risk weighted at 100%.

1.3 Transferability of Capital

There are no restrictions, or other major impediments, on transfer of funds or regulatory capital within the group.

2.0 Capital Structure

The capital of the bank consists of the following:

(1) Eligible paid-up share capital

The authorized, issued and fully paid share capital of the Bank excluding Treasury shares[1] consists of 1,496 million shares of SR 10 each. All these shares carry equal voting rights and are not redeemable. These shares rank junior to all other claims on the Bank.

(2) Eligible reserves

Eligible reserves comprise statutory reserves, other reserves, retained earnings, minority interest and eligible portfolio (collective) provisions. Eligible reserves are mainly created by accumulated appropriations of profit and are maintained for future growth.

Goodwill, intangible assets and other prescribed deductions are deducted from eligible capital.

[1] The bank acquired its own equity shares from a customer as a result of partial set-off of debt. Treasury shares are deducted from equity and accounted for at cost, being the value of set-off.

Following table gives the capital structure of the Bank.

TABLE 2: CAPITAL STRUCTURE		
Capital Structure (Table 2, (b) to (e))		
Components of capital	**Amount**	**Amount**
Core capital - Tier I:		
Eligible paid-up share capital		15,000,000
Eligible reserves		10,655,725
Treasury Shares		(177,093)
Minority interests in the equity of subsidiaries		1,584,435
Retained earnings		5,303,766
IAS type adjustments (cumulitave change in fair value)		1,318,720
Others (Forign currency exchange reserve)		(828,860)
Deductions from Tier I:		(1,682,283)
Intangible assets and goodwill	(1,657,421)	
Significant minority investments at 10% and above at 50% deduction:	(24,862)	
Banking and securities entities not fully consolidated	(15,002)	
Insurance organizations	(9,860)	
Total Tier I		**31,174,410**
Supplementary capital - Tier 2:		
Qualifying general provisions		1,609,528
Deductions from Tier II:		(24,862)
Significant minority investments at 10% and above at 50% deduction:	(24,862)	
Banking and securities entities not fully consolidated	(15,002)	
Insurance organizations	(9,860)	
Total Tier II		**1,584,666**
Total eligible capital		**32,759,076**
Capital to cover market risks - Tier III		
Short Term Subordinated Debt		
Tier I and Tier II Capital Available for Market Risk		20,362,081

3.0 Capital Adequacy

The bank defines capital as the resources necessary to cover unexpected losses and thus NCB, at all times, maintains a sufficient capital to cover risks inherent in its business operations and to maintain a strong credit rating.

The Bank has an Internal Capital Adequacy Assessment Process (ICAAP) by which it examines its risk profile from both regulatory and economic capital point of view and ensures that the level of capital supply:

- remains sufficient to support the Bank's risk profile;
- exceeds the Bank's formal, minimum regulatory capital requirements by a predefined buffer;
- is capable of withstanding stressed scenarios;
- remains consistent with the Bank's strategic and operational plans.

Within the framework of the ICAAP, an annual Capital Plan is prepared. The Capital Plan is reviewed by the senior management and approved by the Executive Committee of the Board of Directors of the Bank and is submitted to SAMA in accordance with their directives.

Regulatory and economic capital assessments are used for the management of risk and capital within the Bank. The economic capital assessment is the more risk-sensitive measure and it takes into account the correlation between different risks.

The economic capital models employed at the Bank are calibrated to quantify the level of capital that is sufficient to absorb potential losses over a one-year time horizon at a 99.9 percent degree of confidence.

The Bank identifies and manages the risks it faces through defined internal control procedures and stress testing. It assesses and manages the following risks via the capital planning process:

- Credit risk
- Market risk
- Operational risk
- Liquidity risk
- Interest rate risk
- Concentration risk
- Macroeconomic and business cycle risk
- Strategic risk
- Reputation risk
- Settlement and Pre-settlement Risks

Scenario analysis and stress testing

The Bank regularly assesses eligible capital supply against stressed losses under a range of scenarios. Stress scenarios are developed using historical losses, qualitative and quantitative techniques, and are employed to estimate the impact on capital requirements. The Senior Management is regularly informed of the results of the stress tests to ensure that the Bank has sufficient capital and that any unacceptable risks are mitigated. These scenarios are regularly reviewed and updated to account for the changing market conditions.

The Bank's Capital Plan shows that the Bank's current and projected capital is adequate to bear any stressed losses and to support its current activities and future strategies and operational plans.

Following table gives the Bank's Capital Adequacy Ratios (CAR) as of 31st of December 2010.

CAPITAL ADEQUACY – CAR (SAMA reference table 3)		
Capital Adequacy Ratios (TABLE 3, (f))		
Particulars	Total capital ratio	Tier 1 capital ratio
	%	
Top consolidated level	18.0%	17.1%

4.0 Credit risk

Credit risk is the risk of financial loss resulting from the failure of a borrower or counterparty to honor its financial or contractual obligations. Credit exposures arise principally in credit-related risk that is embedded in loans and advances and investments. There is also credit risk in foreign exchange and derivative transactions, as well as off-balance sheet financial instruments, such as loan commitments. Among the risks the Bank engages in, credit risk generates the largest regulatory capital requirement.

Following table gives exposures subject to credit risk and related capital charges as of 31st of December 2010.

CAPITAL ADEQUACY – Credit Risk (SAMA reference table 3)						
Amount of Exposures Subject To Standardized Approach of Credit Risk and related Capital Requirements (TABLE 3, (b))						
Portfolios	Amount of exposures (On Balance Sheet) (SR '000)	Capital requirements (SR '000)	Amount of exposures (Off Balance Sheet + Derivatives) (SR '000)	Capital requirements (SR '000)	Total Amount of Exposure (SR '000)	Total Capital requirements (SR '000)
Sovereigns and central banks:	95,398,765	137,913	-	-	95,398,765	137,913
SAMA and Saudi Government	77,876,735	137,913	-	-	77,876,735	137,913
Others	17,522,029	-	-	-	17,522,029	-
Multilateral Development Banks (MDBs)	14,008,105	-	-	-	14,008,105	-
Public Sector Entities (PSEs)	-	-	-	-	-	-
Banks and securities firms	8,907,184	363,060	4,882,615	197,296	13,789,799	560,356
Corporates	100,473,258	5,407,905	23,477,468	1,759,671	123,950,725	7,167,576
Retail non-mortgages	37,535,950	2,251,217	9,486,608	498,488	47,022,558	2,749,706
Small Business Facilities Enterprises (SBFE's)	2,961,889	177,713	-	-	2,961,889	177,713
Mortgages	2,895,742	125,005	-	-	2,895,742	125,005
Residential	2,833,215	120,003	-	-	2,833,215	120,003
Commercial	62,527	5,002	-	-	62,527	5,002
Securitized assets	-	-	-	-	-	-
Equity	3,385,793	270,863	-	-	3,385,793	270,863
Others	16,141,268	1,075,681	2,438,982	309,895	18,580,250	1,385,576
Total	**278,746,065**	**9,631,644**	**40,285,673**	**2,765,351**	**319,031,737**	**12,396,995**

Following tables give exposures subject to credit risk as of 31st of December 2010 and the average exposure during the year then ended.

CREDIT RISK (SAMA reference table 4)		
Credit Risk Exposure (Table 4, (b))		
Portfolios	**Total gross credit risk exposure (SR '000)**	**Average gross credit risk exposure over the period (SR '000)**
Sovereigns and central banks:	95,398,765	89,245,981
SAMA and Saudi Government	77,876,735	74,499,317
Others	17,522,029	15,720,961
Multilateral Development Banks (MDBs)	14,008,105	13,072,100
Banks and securities firms	13,789,799	13,714,686
Corporates	123,950,725	116,964,313
Retail non-mortgages	47,022,558	45,193,865
Small Business Facilities Enterprises (SBFE's)	2,961,889	2,621,425
Mortgages	2,895,742	2,801,875
Residential	2,833,215	2,742,439
Commercial	62,527	59,437
Securitized assets	-	-
Equity	3,385,793	3,455,393
Others	18,580,250	16,992,903
Total	**319,031,737**	**301,441,116**

4.1 Strategies

The principal objective of credit risk management is to ensure a high quality credit portfolio and the minimization of losses. This objective is accomplished by:

- maintaining a strong culture of responsible lending, supported by a robust risk policy and control framework;
- challenging business originators effectively in defining and implementing risk appetite; and
- ensuring independent, expert scrutiny and approval of credit risks and their mitigation.

4.2 Organization Structure

Corporate Sector

The Head of Risk Management – Corporate & Private Banking (HRM CPB) within the Credit Risk function supports the Group Chief Risk Officer (CRO), as head of the Risk function, in overseeing credit risks at the highest level. The Credit Risk function primarily comprises: undertaking independent reviews and approval of larger and higher-risk credit proposals, setting a risk appetite framework and developing and maintaining the Bank's credit policy.

The credit risk function includes Senior Credit Officers based regionally. These officers including the HRM-CPB, fulfill an essential role as independent risk control and approving units as distinct from business line management. They objectively scrutinize and approve credit proposals within the limits set by the credit policy of the Bank.

Above certain risk-based thresholds approval of the Credit Committee and Board is required to extend facilities to the customer.

Retail Sector

The Head of Risk Management – Retail & Consumer Banking within the Credit Risk function supports the Group Chief Risk Officer (CRO), and is comprised of two departments, Policy and Portfolio Management & Risk Analytics, to manage the overall risk profile of the consumer lending business.

The Credit Policy Department is responsible for consumer credit risk management including setting the risk appetite framework and developing and maintaining the Bank's credit policies. The Consumer Lending business is governed by the Individual Banking Sector Credit Policy Manual (IBSCP) which is approved by the Board of Directors. The IBSCP manual defines the policies and procedures for the handling of all activities related to consumer lending, which includes the development of product programs prepared by the business and vetted and issued by the Credit Policy Department and approved by the Bank's Assurance Providers Group.

The Portfolio Management & Risk Analytics Department handles all portfolio and risk analytic activities, including application and behavioral scoring models related to the consumer portfolio.

Portfolio Management & Risk Analytics

Portfolio Management & Risk Analytics unit, as part of its Credit Risk function, is responsible for reporting on risk matters to senior management and to regulators, providing credit analytics, calculating and reporting the Bank's regulatory and economic capital and performing stress tests. It owns and develops credit risk models. It prepares quarterly risk reports for the Senior Management and the Risk Management Committee of the Board.

4.3 Risk reporting and monitoring – risk rating systems

The Bank's exposure to credit risk arises from a wide range of asset classes, customers and product types. A breakdown of the Bank's loans and advances to major economic sectors is provided in note 7.4 of the *Audited Financial Statements for the year ended 31 December 2010*.

To measure and manage the risk in these exposures, both to individually assessed customers and to those aggregated into portfolios, the Bank employs risk rating systems and other methodologies (such as analysis of past dues). The main characteristics of the Bank's credit risk rating system are set out in note 33 of the *Audited Financial Statements for the year ended 31 December 2010*.

Following table gives a geographic breakdown of exposures as of 31st of December 2010.

CREDIT RISK (SAMA reference table 4)						
Geographic Breakdown (Table 4, (c))						
Portfolios	**Geographic area**					
	Saudi Arabia	**Other GCC & Middle East**	**Europe**	**Turkey**	**Others countries**	**Total**
Sovereigns and central banks:	77,876,735	6,306,750	970,582	4,544,724	5,699,973	95,398,765
SAMA and Saudi Government	77,876,735					77,876,735
Others		6,306,750	970,582	4,544,724	5,699,973	17,522,029
Multilateral Development Banks (MDBs)	1,875,000		8,015,605		4,117,500	14,008,105
Public Sector Entities (PSEs)						
Banks and securities firms	6,800,643	2,643,520	1,433,356	925,596	1,986,684	13,789,799
Corporates	82,655,792	6,835,474	12,592,137	11,269,390	10,597,932	123,950,725
Retail non-mortgages	38,602,824			8,419,735		47,022,558
Small Business Facilities Enterprises (SBFE's)						
Mortgages	844,695			2,051,047		2,895,742
Residential	782,168			2,051,047		2,833,215
Commercial	62,527					62,527
Securitized assets						
Equity	3,385,793					3,385,793
Others	10,633,419	1,570,073	2,064,833	1,447,347	2,864,579	18,580,250
Total	**222,674,902**	**17,355,817**	**25,076,513**	**28,657,839**	**25,266,667**	**319,031,737**

Following table gives an industry sector breakdown of exposures as of 31st of December 2010.

CREDIT RISK (SAMA reference table 4)												
Industry Sector Breakdown (Table 4, (d))												
Portfolios	Industry sector (SR '000)											
	Government and quasi government	Banks and other financial institutions	Agriculture and fishing	Manufacturing	Electricity, water, gas and health services	Building and construction	Commerce	Transportation and communication	Services	Consumer loans and credit cards	Others	Total
Sovereigns and central banks:	95,398,764											95,398,764
SAMA and Saudi Government	77,876,735											77,876,735
Others	17,522,029											17,522,029
Multilateral Development Banks (MDBs)		14,008,105										14,008,105
Public Sector Entities (PSEs)												0
Banks and securities firms		13,789,799										13,789,799
Corporates		23,474,429	688,397	17,918,943	5,485,728	11,443,270	33,755,567	10,424,963	16,840,132		3,919,296	123,950,725
Retail non-mortgages			29,619	675,311	47,390	296,189	799,710	77,009	207,332	44,060,669	829,329	47,022,558
Small Business Facilities Enterprises (SBFE's)			29,619	675,311	47,390	296,189	799,710	77,009	207,332		829,329	2,961,889
Mortgages										2,895,742		2,895,742
Residential										2,833,215		2,833,215
Commercial										62,527		62,527
Securitized assets												0
Equity		2,262,413		270,864			830,466		11,000		11,050	3,385,793
Others		10,747,645					11,800	9,105			7,811,701	18,580,250
Total	**95,398,764**	**64,282,390**	**718,016**	**18,865,117**	**5,533,118**	**11,739,459**	**35,397,543**	**10,511,077**	**17,058,464**	**46,956,411**	**12,571,376**	**319,031,737**

Following table gives a maturity breakdown of exposures as of 31st of December 2010.

CREDIT RISK (SAMA reference table 4)									
Residual Contractual Maturity Breakdown (Table 4, (e))									
Portfolios	Maturity breakdown (SR '000)								
	Less than 8 days	8-30 days	30-90 days	90-180 days	180-360 days	1-3 years	3-5 years	Over 5 years	Total
Sovereigns and central banks:	17,068,621	4,258,584	23,276,954	6,817,443	2,547,800	9,833,800	9,903,520	21,692,043	95,398,765
SAMA and Saudi Government	9,424,823	3,650,301	19,526,354	5,843,661	2,183,880	8,429,171	8,488,933	20,329,612	77,876,735
Others	7,643,798	608,283	3,750,599	973,782	363,920	1,404,629	1,414,587	1,362,431	17,522,029
Multilateral Development Banks (MDBs)						2,590,605	6,418,750	4,998,750	14,008,105
Public Sector Entities (PSEs)									
Banks and securities firms	7,065,364	1,999,222	2,145,934	653,421	757,588	611,887	484,387	71,996	13,789,799
Corporates	10,961,893	5,569,550	21,021,265	10,659,595	8,358,130	16,331,508	24,013,723	27,035,062	123,950,725
Retail non-mortgages	4,393,210	2,476,923	8,160,477	4,427,327	3,645,601	6,482,363	8,791,317	8,645,341	47,022,558
Small Business Facilities Enterprises (SBFE's)	226,770	203,211	535,953	535,497	575,264	715,992	169,203		2,961,889
Mortgages	56,598	11,849	134,650	54,959	51,429	321,746	926,262	1,338,250	2,895,742
Residential	56,598	11,849	134,650	54,959	51,429	321,746	926,262	1,275,723	2,833,215
Commercial								62,527	62,527
Securitized assets									
Equity								3,385,793	3,385,793
Others	6,639,523	1,084,364	1,030,886	720,031	1,532,641	727,649	665,082	6,180,075	18,580,250
Total	**46,185,208**	**15,400,492**	**55,770,165**	**23,332,776**	**16,893,189**	**36,899,557**	**51,203,041**	**73,347,309**	**319,031,737**

4.4 Internal methodologies for calculating economic capital requirements

The Bank's credit risk rating framework incorporates probability of default (‘PD’) of an obligor and loss severity expressed in terms of exposure-at-default (‘EAD’) and loss-given-default (’LGD’). These measures are used to calculate expected loss and capital requirements.

For Corporate business, obligor PD is estimated using a 16-grade Customer Risk Rating scale for performing customers. These grades represent varying degrees of strength of financial condition and qualitative factors. The Customer Risk Ratings are mapped to a PD value range.

For retail business, the portfolios are analyzed by pools and models are available to provide PD and LGD estimates based on historical experience.

4.5 Credit risk management policy, past due and impaired, specific and general allowances

A discussion on the bank's credit risk management policy is included in note 33 of the *Audited Financial Statements for the year ended 31 December 2010*.

The bank considers all the facilities for a counterparty to be defaulted if any one of the facilities of the counterparty is past due more than 90 days.

The approaches followed for specific and general allowances (portfolio provision) are explained in note 2.5 and 3.15 of the *Audited Financial Statements for the year ended 31 December 2010*.

Following table gives an industry sector breakdown of impaired and past due loans and related allowances (provisions) as of 31st December 2010.

CREDIT RISK (SAMA reference table 4)										
Impaired Loans, Past Due Loans and Allowances (Table 4, (f))										
Industry sector	Impaired loans (SR '000)	Defaulted (SR '000)	Aging of Past Due Loans (days) (SR '000)				Specific allowances (SR '000)			General allowances (SR '000)
			Less than 90	90-180	180-360	Over 360	Charges during the period	Charge-offs during the period	Balance at the end of the period	
Government and quasi government										
Banks and other financial institutions	37,589	37,589		12	18	37,560	(8,112)	(50,147)	37,541	
Agriculture and fishing	12,563	12,563	1,455	1,397	2,157	9,009	(4,089)	(402)	8,406	
Manufacturing	315,836	315,836	250,449	155,608	29,952	130,276	(169,305)	(70,597)	219,625	
Mining and quarrying	1,824	1,824	11,845	232	358	1,234	996		996	
Electricity, water, gas and health services	40,400	40,400	7,154	2,488	8,524	29,389	8,031	(453)	35,113	
Building and construction	1,158,548	1,158,548	533,592	29,220	966,129	163,199	469,690	(24,859)	1,115,408	
Commerce	2,626,161	2,626,161	476,212	55,135	368,962	2,202,063	842,334	(7,185)	2,354,937	
Transportation and communication	44,846	44,846	112,463	2,291	4,742	37,813	(6,294)	(1,932)	39,213	
Services	141,758	141,758	36,130	11,751	13,163	116,843	25,283	(18,875)	75,475	
Consumer loans and credit cards	469,957	469,957	2,338,458	293,313	127,313	49,331	716,842	(674,133)	404,889	
Others	313,127	313,127	57,130	6,256	105,484	201,387	(31,994)		135,876	
Total	**5,162,610**	**5,162,610**	**3,824,887**	**557,703**	**1,626,803**	**2,978,104**	**1,843,383**	**(848,584)**	**4,427,478**	**1,609,528**

Following table gives a geographic breakdown of impaired and past due loans and related allowances (provisions) as of 31st December 2010.

CREDIT RISK (SAMA reference table 4)							
Impaired Loans, Past Due Loans And Allowances (Table 4, (g))							
Geographic area (SR '000)	Impaired loans (SR '000)	Aging of Past Due Loans (days) (SR '000)				Specific allowances (SR '000)	General allowances (SR '000)
		Less than 90	90-180	180-360	Over 360		
Saudi Arabia	4,540,055	3,233,488	380,113	1,505,872	2,654,069	4,011,731	1,454,323
Other GCC & Middle East	37,500				37,500	37,500	
Turkey	585,055	591,399	177,590	120,931	286,535	378,248	155,205
Others countries							
Total	**5,162,610**	**3,824,887**	**557,703**	**1,626,803**	**2,978,104**	**4,427,478**	**1,609,528**

Following table gives the movement in specific and general allowances for the year ended 31st December 2010.

CREDIT RISK (SAMA reference table 4)		
Reconciliation Of Changes In The Allowances For Loan Impairment (Table 4, (h))		
Particulars	**Specific allowances (SR '000)**	**General allowances (SR '000)**
Balance, beginning of the year	3,432,680	1,190,656
Charge-offs taken against the allowances during the period	(848,584)	
Amounts set aside (or reversed) during the period	1,843,386	418,869
Other adjustments:	0	0
- exchange rate differences		
- business combinations		
- acquisitions and disposals of subsidiaries		
- etc.		
Transfers between allowances		
Balance, end of the year	4,427,478	1,609,528

4.6 Application of the standardized approach for credit risk

The Bank uses the Standardized approach of Basel II to calculate the risk weighted assets and required Regulatory Capital for Pillar -1 (including credit risk, market risk and operational risk). It requires banks to use risk assessments prepared by External Credit Assessment Institutions (ECAI) to determine the risk weightings applied to rated counterparties. For counterparties not rated externally the assigned risk weightings are in accordance with SAMA guidelines.

Following table gives a breakdown by risk weightings (buckets) of the Bank's exposures after the impact of credit risk mitigation (CRM), as of 31st December 2010.

CREDIT RISK: DISCLOSURES FOR PORTFOLIOS SUBJECT TO THE STANDARDIZED APPROACH (SAMA reference table 5)										
Allocation Of Exposures To Risk Buckets (Table 5, (b))										
Particulars	**Risk buckets (SR '000)**									**Deducted**
	0%	**20%**	**35%**	**50%**	**75%**	**100%**	**150%**	**Other risk weights**	**Unrated**	**(SR '000)**
Sovereigns and central banks:	107,506,697					1,833,708				
SAMA and Saudi Government	89,126,737									
Others	18,379,960					1,833,708				
Multilateral Development Banks (MDBs)	14,008,105									
Public Sector Entities (PSEs)										
Banks and securities firms		368,459		13,242,772		309,376				
Corporates		17,532,986		9,688,268		81,243,968				
Retail non-mortgages					45,828,429					
Small Business Facilities Enterprises (SBFE's)					2,961,889					
Mortgages			2,051,047			844,694				
Residential			2,051,047			782,168				
Commercial						62,526				
Securitized assets										
Equity						3,385,792				49,724
Others	3,060,208	1,860,047		7,952		15,109,849	1,149,378			

4.7 Credit Risk Mitigation

Risk mitigation is an important aspect of the Bank's effective credit risk management and it takes many forms.

The Bank in the ordinary course of lending activities holds collaterals as security to mitigate credit risk in the loans and advances. The collaterals are held mainly against commercial and individual loans and are managed against relevant exposures at their net realizable values. The Bank monitors the market value of collateral obtained periodically and requests additional collateral in accordance with the terms of the underlying agreements.

These collaterals mostly include time and other cash deposits, financial guarantees from other banks, local and international equities, real estate and other fixed assets

The Bank’s policy is set out in note 33 of the *Audited Financial Statements for the year ended 31 December 2010*.

In terms of the regulatory guidelines, not all forms of collateral currently used by the Bank are recognized for the purposes of the calculation of the credit risk capital requirement. The bank uses the Basel II 'comprehensive method' for the treatment of financial collaterals which requires a standard supervisory haircut to be applied to the collateral to account for currency and maturity mismatches between the underlying exposure and the collateral applied.

Eligible financial collaterals under the Standardized Approach as per SAMA guidelines is restricted to:

a. Cash (as well as certificates of deposit or comparable instruments);
b. Gold; and
c. Debt securities

Non-financial collaterals mainly include guarantees.

Following table gives the eligible collateral held by the bank as of 31st December 2010.

CREDIT RISK MITIGATION (CRM): DISCLOSURES FOR STANDARDIZED APPROACH (SAMA reference table 7)		
Credit Risk Exposure Covered By CRM (Table 7, (b) and (c))		
Portfolios	Covered by	
	Eligible financial collateral (SR '000)	Guarantees / credit derivatives (SR '000)
Sovereigns and central banks:		
SAMA and Saudi Government		
Others		
Multilateral Development Banks (MDBs)		
Public Sector Entities (PSEs)		
Banks and securities firms		4,836,893
Corporates	1,516,021	13,969,483
Retail non-mortgages	1,194,129	
Small Business Facilities Enterprises (SBFE's)		
Mortgages		
Residential		
Commercial		
Securitized assets		
Equity		
Others		3,067
Total	**2,710,150**	**18,809,443**

4.8 Use of External Credit Assessment Institutions (ECAIs)

The Bank uses the following External Credit Assessment Institutions (ECAIs)

i) Standards and Poor's Rating Group
ii) Moody's Investor Service
iii) Fitch Group

External Credit Assessment Institutions risk assessments are used by the Bank as part of the determination of risk weightings for the following classes of exposure:

- Sovereign and Central Banks;
- Banks and Securities Firms; and
- Corporates.

The process used to transfer credit assessment ratings to the banks' counterparties is as follows. A data file containing external ratings is downloaded from a specialist third party supplier (Bloomberg). The rating records from the External Credit Assessment Institutions specified above are then linked with the Bank's counterparty records. As the majority of the bank's corporate borrowers are not rated by external agencies, for regulatory capital calculations under the Basel II 'Standardised Approach' these are treated as 'unrated' exposures. The use of external ratings within the Corporate exposure class mainly relates to its investments in corporate bonds.

The alignment of the alphanumerical scale of agencies used with risk buckets is based on the guidance issued by SAMA.

4.9 Exposure related to counterparty credit risk

Economic and Regulatory Capital is calculated for counterparty credit exposures on the Bank's derivatives portfolio using the 'Current Exposure Method' within the Basel II Standardised Approach. Limits for corporate and banking counterparty credit exposures including derivatives are approved by the relevant authority. Group Risk Management of the Bank is responsible for monitoring adherence to these limits on a daily basis.

Following table gives the exposures to counterparty credit risk for derivatives as of 31st of December 2010.

GENERAL DISCLOSURES FOR EXPOSURES RELATED TO COUNTERPARTY CREDIT RISK (CCR) (SAMA reference table 8)	
General Disclosures (Table 8, (b) and (d))	
Particulars	**Amount (SR '000)**
Gross positive fair value of contracts	402,813
Netting Benefits	
Netted Current Credit Exposure	
Collateral held:	
-Cash	
-Government securities	
-Others	
Exposure amount (under the applicable method)	2,574,513
-Current Exposure Method (CEM)	2,574,513
Notional value of credit derivative hedges	
Current credit exposure (by type of credit exposure):	2,574,513
-Interest rate contracts	222,531
-FX contracts	608,165
-Equity contracts	
-Credit derivatives	
-Commodity/other contracts	1,743,816

The Bank usually does not take collateral nor is it required to provide collateral in connection with its over-the-counter derivatives activity. Credit reserves are created in accordance with impairment of financial assets policy stated in note 3.15 of the *Audited Financial Statements for the year ended 31 December 2010*.

GENERAL DISCLOSURES FOR EXPOSURES RELATED TO COUNTERPARTY CREDIT RISK (CCR) (SAMA reference table 8)				
Credit Derivative Transactions (Table 8, (c))				
Credit derivative transactions	Proprietary activities		Intermediation activities	
	Protection bought	Protection sold	Protection bought	Protection sold
Total return swaps				
Credit default swaps				
Credit options				
Credit linked notes			Nil	
Collateralized debt obligations				
Collateralized bond obligations				
Collateralized loan obligations				
Others				
Total				

Note: The total amount of CDOs and CLOs held by the Bank as of 31 December 2010 was SR 631,398 K

4.10 Securitization

The Bank is not involved in any securitization activities which transfer credit risk away from the Bank to other entities.

5.0 Market Risk

Market risk is the risk that changes in market prices, such as special commission rate, credit spreads (not relating to changes in the obligor's / issuer's credit standing), equity prices and foreign exchange rates, will affect the Bank's income or the value of its holdings of financial instruments.

For risk capital computations, the Bank separates its exposure to market risk between trading and non-trading portfolios. Trading portfolios mainly are held by the Treasury division and include positions arising from market making and proprietary position taking, together with financial assets and liabilities that are managed on a fair value basis.

5.1 Strategies

The objective of market risk management is to manage and control market risk exposures within acceptable parameters, while optimizing the return on risk.

5.2 Organization Structure

Overall authority for market risk is vested in the Risk Management Committee of the Board of Directors. The Bank's Group Risk Management is responsible for the development of detailed risk management policies (subject to review and approval by the Board of Directors) and for the day-to-day review of their implementation.

The Bank has an independent market risk management and control function which is responsible for measuring market risk exposures in accordance defined policies and monitoring and reporting these exposures against the prescribed limits on a daily basis.

5.3 Risk reporting and monitoring

The Bank uses tools such as Value-at-Risk (VaR) and other measures to monitor and limit market risk exposures. The scope and nature of risk reporting and measurement systems used are explained in detail in note 34 of the *Audited Financial Statements for the year ended 31 December 2010*.

Stress testing

As VaR is a measure based on historical volatilities and correlations, which may break down during stressed market conditions, the Bank also performs stress testing to evaluate the potential impact on portfolio values of more extreme, although plausible, events or movements in a set of financial variables. Consideration is given to the actual market risk exposures, along with market events, in determining the stress scenarios.

Stress testing is performed by the Group Risk Management at a portfolio level, based on historical and stressed scenarios which are regularly reviewed and updated. The stress testing results are regularly reported to the Senior Management and the Risk Management Committee of the Board and provide them with an assessment of the financial impact such events would have on the capital and profitability of the Bank.

5.4 Risk Mitigation – Hedging

The Bank's hedging and risk mitigation strategies primarily comprise the use of traditional market instruments, such as swaps and cash instruments, to address risk factors arising at portfolio level. The Market Risk Management function is responsible for monitoring the continuing effectiveness of the hedges.

5.5 Internal methodologies for calculating economic capital requirements

The principal tool used by the Bank to calculate economic capital requirements for market risk is Value at Risk (VaR). The key assumptions used in the VaR model are explained in note 34.1 of the *Audited Financial Statements for the year ended 31 December 2010*.

5.6 Application of the standardized approach for market risk

The Bank uses the Standardized approach of Basel II to calculate the required Regulatory Capital for market risk which covers general market and specific risks. Brief descriptions of the risk items covered by market risk are described below:

a. Interest rate risk is the impact on banks earnings and equity of changes in interest rates; the risk is two-fold:
- Specific Risk: risk of loss caused by an adverse price movement of a debt instrument or security due principally to factors related to the issuer.
- General Market Risk: risk of loss arising from adverse changes in market conditions.

b. Equity risk is the risk that the bank's investments will depreciate due to equity market dynamics.

c. Foreign exchange risk is the risk arising from a change in exchange-rates on bank's net asset / liability positions.

d. Commodity risk refers to the uncertainties of future market values and of the size of the future income, caused by the fluctuation in the prices of commodities.

The primary market risks to which the Bank is exposed are foreign exchange risk and interest rate risk associated with its trading book that is marked-to-market daily (mainly derivatives).

Following table gives the capital requirement for market risk as of 31st of December 2010.

CAPITAL ADEQUACY – Market Risk (SAMA reference table 3)					
Capital Requirements For Market Risk (822, Table 3, (d) & Table 10, (b))					
	Interest rate risk (SR '000)	Equity position risk (SR '000)	Foreign exchange risk (SR '000)	Commodity risk (SR '000)	Total (SR '000)
Standardised approach	32,941	-	627,999	-	660,940

6.0 Operational risk

The Bank defines operational risk as the risk of loss resulting from inadequate or failed processes, people, systems or external events.

Operational risks are inherent in the Bank's operations and are typical of all banking and financial institutions. Major sources of operational risks include flaws and gaps in business processes, breakdown of systems and technological infrastructures, negative human actions and behaviors, adverse exposure caused by interaction with external parties and entities, including the harmful impacts of social and environmental changes.

6.1 Strategies

The operational risk framework of the Bank was established mainly to:

- Understand and report the operational risks being taken by the Bank
- Capture and report operational risk incidents and losses
- Understand and minimize the frequency and impact of operational risk incidents
- Manage and control the operational risk incidents

The Operational Risk Department [ORD] formulates policies and procedures, issues operational guidelines, designs incident reporting templates, implements system tools to record incidents and losses, liaises with the Business Units, Regulators, Senior Management, and Internal Audit to ensure compliance to the framework.

6.2 Organization Structure

The operational risk management function was established as a unit of the Group Risk Management that primarily coordinates the implementation of the framework.

Operational risks management is a primary duty of the business units.

Enforcement and oversight of the operational risk framework implementation are assured by the Board, the senior management, risk management committees, operational risk committees, the Sector Heads, and Division Heads. The Group Audit of the Bank reviews proper adherence to ensure strict compliance of the business units to the operational risk policies and procedures promulgated. The operational risk department regularly provides feedback reports of operational risk activities, divisional and consolidated operational risk profiles, summary of operational risk losses, control effectiveness, and status of action plans.

6.3 Risk reporting and monitoring

The main activities comprising the operational risk framework are:

- Loss data collection
- Risk and control assessment
- Advanced operational risk techniques
  - Key risk indicators
  - Stress testing & scenario analysis
  - Measurement of residual risks

<u>Loss data collection</u>

To effectively manage the risk incidents, a business coordinator, also called divisional operational risk manager [DORM] role was established. The DORM is the main contact point within the business with regards to operational risk. He is in charge of coordinating the resolution and initiation of controls and action plans to rectify the causes of operational risk incidents. He coordinates with the performers of processes and owners of risks within the business units. There are also nominated risk coordinators to support the DORM. The business unit heads are responsible to enforce the controls and actions to improve the weak processes, to eliminate the causes and reduce the adverse effects of operational risks. The recording of operational risk incident using the system tool, i.e., SAS OpRisk Monitor, is assigned to the loss data agent or user. He is responsible for providing all the required and correct information surrounding the operational risk incidents. All records of operational risk incidents are subsequently validated by the DORM and finally, by the ORD.

Risk and Control Assessment [RCA]

The RCA activity covers the business units across the Bank. The activity aims to uncover the inherent and probable risks along with the effectiveness of existing controls so that weak processes can be improved. Further requirement for risk assessment includes assessing new products and services, launching of new business lines, outsourcing contracts, and service level agreements. The aim is to ensure that all bank activities potentially exposed to operational risks are given early safeguard measures before any damage could occur. During 2010, the risk and control assessment of the whole bank was undertaken to generate the operational risk profile that was submitted to management to implement action plans and to improve controls to mitigate operational risks.

Key Risk Indicator [KRI] Monitoring

One of the advanced operational risk management techniques, KRI is a measure demonstrating the likelihood of the impact of the risk changing its behavior. It is a tool in identifying vulnerabilities before they occur, acting as an early warning system. The business units define, monitor, and analyze the trends of the KRI and formulate action plans as appropriate. This activity was fully implemented in 2010.

Stress Testing and Scenario Analysis

Stress testing and scenario analysis are more advanced risk management techniques. The Bank defines stress testing as a risk management technique to evaluate the potential effects on its financial condition, of a specific event and movements in a set of financial variables. The focus of stress testing relates to exceptional but plausible events. The process will help to identify and manage situations that could cause extraordinary losses and determine whether the bank can absorb large potential losses. By viewing risks in more complex environment, this will support decisions in determining whether control structures in place are adequate or require reinforcements. This activity was implemented in 2010 and ORD will integrate the results with the planning process of businesses in 2011.

Measurement of Residual Risks

In due time, the business units will be able to fully understand the nature of operational risks affecting their processes and how to manage them effectively by applying the proper controls. By allowing for the effects of controls to inherent risks, the residual risk position of the businesses can be fairly measured. This activity was implemented.

6.4 Application of the standardized approach for operational risk

The Bank uses the Standardized Approach of Basel II to calculate the required Regulatory Capital as well as Economic Capital for operational risk. This approach requires banks to divide its activities into eight business lines: corporate finance, trading and sales, retail banking, commercial banking, payment and settlement, agency services, asset management, and retail brokerage. A range of beta coefficients (12%-18%) is then applied to the average gross income for the preceding three financial years for each of the eight business lines to calculate the required regulatory capital.

Following table gives the capital requirement for operational risk as of 31st of December 2010.

CAPITAL ADEQUACY – Operational Risk (SAMA reference table 3)	
Capital Requirements for Operational Risk (Table 3, (e))	
Particulars	Capital requirement (SR '000)
Standardized approach	1,536,405
Total	**1,536,405**

7.0 Equities in Banking Book

The Bank's equity investments are intended to be held for an unspecified period of time, and may be sold in response to the Bank's needs. Quoted equity investments are valued based on market prices whereas unquoted equity investments are carried at cost. Impairment provisions, if required, are created in accordance with the accounting policies mentioned in note 3.15 of the *Audited Financial Statements for the year ended 31 December 2010*.

Following table gives the value of equity investments as of 31st of December 2010.

EQUITIES: DISCLOSURES FOR BANKING BOOK POSITIONS (SAMA reference table 13)					
Value Of Investments (Table 13, (b))					
	Un-quoted investments		Quoted investments		
	Value disclosed in Financial Statements (SR '000)	Fair value (SR '000)	Value disclosed in Financial Statements (SR '000)	Fair value (SR '000)	Publicly quoted share values (if materially different from fair value) (SR '000)
Investments	853,850	N/A	2,531,944	2,531,944	

Following table gives an industry sector breakdown of equity investments as of 31st of December 2010.

EQUITIES: DISCLOSURES FOR BANKING BOOK POSITIONS (SAMA reference table 13)		
Types And Nature of Investments (Table 13, (c))		
Investments	Publicly traded (SR '000)	Privately held (SR '000)
Government and quasi government		
Banks and other financial institutions	2,261,079	1,334
Agriculture and fishing		
Manufacturing	270,864	
Mining and quarrying		
Electricity, water, gas and health services		
Building and construction		
Commerce		830,466
Transportation and communication		
Services		11,000
Others		11,050
Total	**2,531,943**	**853,850**

Following table gives the realized and unrealized gains on equity investments as of 31st of December 2010.

EQUITIES: DISCLOSURES FOR BANKING BOOK POSITIONS (SAMA reference table 13)	
Gains / Losses Etc. (Table 13, (d) and (e))	
Particulars	**Amount (SR '000)**
Cumulative realized gains (losses) arising from sales and liquidations in the reporting period	91,574
Total unrealized gains (losses)	756,538
Total latent revaluation gains (losses)	
Unrealized gains (losses) included in Capital	756,538
Latent revaluation gains (losses) included in Capital	

Following table gives an industry sector breakdown of capital requirements on equity investments as of 31st of December 2010.

EQUITIES: DISCLOSURES FOR BANKING BOOK POSITIONS (SAMA reference table 13)	
Capital Requirements (Table 13, (f))	
Equity grouping	**Capital requirements (SR '000)**
Government and quasi government	
Banks and other financial institutions	180,993
Agriculture and fishing	
Manufacturing	21,669
Mining and quarrying	
Electricity, water, gas and health services	
Building and construction	
Commerce	66,437
Transportation and communication	
Services	880
Others	884
Total	**270,863**

8.0 Interest Rate Risk in Banking Book

An explanation of the nature of Interest Rate Risk in the Banking Book, the Bank's processes to monitor and manage this risk and a sensitivity analysis is given in the note 34.2.1 of the *Audited Financial Statements for the year ended 31 December 2010*.

Following table gives the impact of a 200 basis points change in interest rates on the bank's earnings by major currencies based on outstanding position as of 31st December 2010.

INTEREST RATE RISK IN THE BANKING BOOK (IRRBB) (SAMA reference table 14)	
200bp Interest Rate Shocks for currencies with more than 5% of Assets or Liabilities (Table 14, (b))	
Rate Shocks	Change in earnings (SR '000)
Upward rate shocks:	
SAR	1,273,280
USD	(328,580)
GBP	(15,700)
EUR	(109,000)
TRY	(37,120)
Downward rate shocks:	
SAR	(1,273,280)
USD	328,580
GBP	15,700
EUR	109,000
TRY	37,120

Summary of Pillar 3 Qualitative disclosure requirements.

Reference	Description	Section	Page
Table 1	Scope of Application	1.0	1
Table 2	Capital Structure	2.0	4
Table 3	Capital Adequacy	3.0	6
Risk Exposure and Assessment	General Qualitative Disclosure Requirements	4.1 – 4.5, 5.1 – 5.5, 6.1 – 6.3, 7.0 & 8.0	10-18 25-26 28-29 32-36
Risk Exposure and Assessment	Credit Risk	4.3, 4.4 & 4.6	11, 15, 18
Table 4	Credit Risk: General Disclosures for All Banks	4.5	15
Table 5	Credit Risk: Disclosures for Portfolios Subject to the Standardized Approach and Supervisory Risk Weights in the IRB Approaches	4.8	22
Table 6	Credit Risk: Disclosures for Portfolios Subject to IRB Approaches	Not Applicable	
Table 7	Credit Risk Mitigation : Disclosures for Standardized and IRB Approaches	4.4	15
Table 8	General Disclosure for Exposure Related To Counterparty Credit Risk	4.9	22
Table 9	Securitization : Disclosure For Standardized and IRB Approaches	4.10	24
Table 10	Market Risk : Disclosure For Banks Using the Standardized Approaches	5.6	27
Table 11	Market Risk : Disclosures For Banks Using the Internal Models Approach (IMA) for Trading Portfolios	Not Applicable	
Table 12	Operational Risk	6.1 – 6.4	28-31
Table 13	Equities : Disclosures for Banking Book Positions	7.0	32-35
Table 14	Interest Rate Risk in the Banking Book (IRRBB)	8.0	36

Summary of Pillar 3 Quantitative disclosure requirements.