National Commercial Bank

Qualitative and Quantitative Pillar 3 Disclosures
As of 31 December 2011

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 2011* 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 2011* 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)

(5) Real Estate Development Company

Please refer to note 1.2 of the *Audited Financial Statements for the year ended 31 December 2011* 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 Travelers Cheques are issued by the company which was jointly established by the banks of Saudi Arabia.

(4) The Saudi Credit Bureau

The Bank has 11% 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)) (SR '000)		
Components of capital	**Amount**	**Amount**
Core capital - Tier I:		
Eligible paid-up share capital		15,000,000
Eligible reserves		12,105,333
Treasury Shares		(177,093)
Minority interests in the equity of subsidiaries		1,420,036
Retained earnings		6,722,860
IAS type adjustments (cumulative change in fair value)		1,918,274
Others (Foreign currency exchange reserve)		(1,404,155)
Deductions from Tier I:		(1,267,130)
Intangible assets and goodwill	(1,230,943)	
Significant minority investments at 10% and above at 50% deduction:	(36,187)	
Banking and securities entities not fully consolidated	(15,002)	
Insurance organizations	(21,185)	
Total Tier I		**34,318,126**
Supplementary capital - Tier 2:		
Qualifying general provisions		2,044,893
Deductions from Tier II:		(36,187)
Significant minority investments at 10% and above at 50% deduction:	(36,187)	
Banking and securities entities not fully consolidated	(15,002)	
Insurance organizations	(21,185)	
Total Tier II		**2,008,706**
Total eligible capital		**36,326,832**
Capital to cover market risks - Tier III		
Short Term Subordinated Debt		
Tier I and Tier II Capital Available for Market Risk		22,748,205

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 2011.

CAPITAL ADEQUACY – CAR (SAMA reference table 3)		
Capital Adequacy Ratios (TABLE 3, (f))		
Particulars	**Total capital ratio**	**Tier 1 capital ratio**
	%	
Top consolidated level	18.2%	17.2%

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 2011.

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:	97,390,708	183,192	-	-	97,390,708	183,192
SAMA and Saudi Government	75,688,120	-	-	-	75,688,120	-
Others	21,702,588	183,192	-	-	21,702,588	183,192
Multilateral Development Banks (MDBs)	14,387,500	-	-	-	14,387,500	-
Public Sector Entities (PSEs)	-	-	-	-	-	-
Banks and securities firms	11,867,816	460,896	8,533,087	346,027	20,400,902	806,923
Corporates	109,696,330	6,076,257	30,491,747	2,297,862	140,188,078	8,374,119
Retail non-mortgages	42,598,654	2,555,828	5,227,585	236,290	47,826,240	2,792,118
Small Business Facilities Enterprises(SBFE's)	3,136,974	188,218	-	-	3,136,974	188,218
Mortgages	3,983,971	219,871	-	-	3,983,971	219,871
Residential	3,218,652	158,645	-	-	3,218,652	158,645
Commercial	765,319	61,226	-	-	765,319	61,226
Securitized assets	-	-	-	-	-	-
Equity	2,930,924	234,474	-	-	2,930,924	234,474
Others	15,430,955	947,493	139,037	20,436	15,569,992	947,493
Total	**298,286,858**	**10,678,011**	**44,391,456**	**2,900,616**	**342,678,314**	**13,578,627**

Following tables give exposures subject to credit risk as of 31st of December 2011 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:	97,390,708	103,816,929
SAMA and Saudi Government	75,688,120	84,561,562
Others	21,702,588	20,766,142
Multilateral Development Banks (MDBs)	14,387,500	15,756,896
Public Sector Entities (PSEs)		
Banks and securities firms	20,400,902	17,625,398
Corporates	140,188,078	137,269,696
Retail non-mortgages	47,826,240	46,533,889
Small Business Facilities Enterprises (SBFE's)	3,136,974	3,251,678
Mortgages	3,983,971	3,253,563
Residential	3,218,652	3,012,279
Commercial	765,319	241,285
Securitized assets	-	-
Equity	2,930,924	3,100,426
Others	15,569,992	16,898,958
Total	**342,678,314**	**344,255,756**

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 with individual obligor and industry concentration limits; 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 and with industry specialization Kingdom-wide. 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.

Approval of the Credit Committee and/or- Board is required to extend facilities to the customer above certain risk-based thresholds.

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 Consumer Finance Islamic Credit Policy (CFICP) Manual which is approved by the Board of Directors. The CFICP 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 behavioural scoring models related to the consumer portfolio.

Portfolio Risk Analytics

Portfolio 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 2011*.

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 32 of the *Audited Financial Statements for the year ended 31 December 2011*.

Following table gives a geographic breakdown of exposures as of 31st of December 2011.

CREDIT RISK (SAMA reference table 4)						
Geographic Breakdown (Table 4, (c))						
Portfolios	Geographic area (SR '000)					
	Saudi Arabia	Other GCC & Middle East	Europe	Turkey	Others countries	Total
Sovereigns and central banks:	75,688,120	8,056,314	989,319	3,994,177	8,662,778	97,390,708
SAMA and Saudi Government	75,688,120					75,688,120
Others		8,056,314	989,319	3,994,177	8,662,778	21,702,588
Multilateral Development Banks (MDBs)	2,681,250		5,118,750		6,587,500	14,387,500
Public Sector Entities (PSEs)						
Banks and securities firms	8,027,861	4,564,220	2,942,222	565,097	4,301,503	20,400,902
Corporates	92,593,801	7,904,497	16,570,364	13,883,094	9,236,322	140,188,078
Retail non-mortgages	39,406,812			8,419,428		47,826,240
Small Business Facilities Enterprises (SBFE's)				3,136,974		3,136,974
Mortgages	2,083,073			1,900,898		3,983,971
Residential	1,317,754			1,900,898		3,218,652
Commercial	765,319					765,319
Securitized assets						
Equity	2,930,924					2,930,924
Others	9,554,383	1,150,070	1,613,916	2,235,889	1,015,733	15,569,992
Total	**232,966,224**	**21,675,101**	**27,234,571**	**30,998,582**	**29,803,837**	**342,678,314**

Following table gives an industry sector breakdown of exposures as of 31st of December 2011.

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:	97,390,708											97,390,708
SAMA and Saudi Government	75,688,120											75,688,120
Others	21,702,588											21,702,588
Multilateral Development Banks (MDBs)		14,387,500										14,387,500
Public Sector Entities (PSEs)												
Banks and securities firms		20,400,902										20,400,902
Corporates		16,016,373	554,186	22,919,569	5,842,913	21,582,101	42,983,738	9,368,368	15,927,690		4,993,140	140,188,077
Retail non-mortgages			31,370	1,125,967	50,192	313,697	846,983	81,561	219,588	44,278,519	878,362	47,826,240
Small Business Facilities Enterprises (SBFE's)			31,370	1,125,967	50,192	313,697	846,983	81,561	219,588		467,615	3,136,974
Mortgages										3,983,971		3,983,971
Residential										3,218,652		3,218,652
Commercial										765,319		765,319
Securitized assets												
Equity		1,843,300		247,848			817,726		11,000		11,050	2,930,924
Others		10,247,289									5,322,703	15,569,992
Total	**97,390,708**	**62,895,364**	**585,555**	**24,293,384**	**5,893,105**	**21,895,798**	**44,648,447**	**9,449,929**	**16,158,278**	**48,262,490**	**11,205,256**	**342,678,314**

Following table gives a maturity breakdown of exposures as of 31st of December 2011.

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:	15,223,082	8,838,730	5,014,695	7,660,962	13,626,152	13,470,115	5,680,911	27,876,061	97,390,708
SAMA and Saudi Government	11,289,278	8,151,418	3,848,341	6,311,862	11,772,914	8,452,231	2,285,866	23,576,210	75,688,120
Others	3,933,804	687,312	1,166,354	1,349,100	1,853,238	5,017,884	3,395,045	4,299,851	21,702,588
Multilateral Development Banks (MDBs)						4,525,000	4,893,750	4,968,750	14,387,500
Public Sector Entities (PSEs)									
Banks and securities firms	5,169,035	2,037,715	3,349,285	1,560,977	5,724,429	1,173,768	1,173,768	211,925	20,400,902
Corporates	15,048,982	5,247,001	22,268,487	17,022,386	11,083,075	17,328,669	28,523,817	23,665,661	140,188,078
Retail non-mortgages	2,161,984	1,757,214	8,156,778	6,324,939	3,748,514	6,373,376	10,351,803	8,951,632	47,826,240
Small Business Facilities Enterprises (SBFE's)	205,708	236,354	553,558	599,383	630,160	714,389	163,127	34,295	3,136,974
Mortgages				2,730	11,978	165,139	631,848	3,172,276	3,983,971
Residential				2,730	11,978	165,139	631,848	2,406,957	3,218,652
Commercial								765,319	765,319
Securitized assets									
Equity								2,930,924	2,930,924
Others	3,745,827	425,168	722,879	368,340	874,682	432,025	113,408	8,887,662	15,569,992
Total	**41,348,911**	**18,305,828**	**39,512,125**	**32,940,333**	**35,068,829**	**43,468,093**	**51,369,305**	**80,664,891**	**342,678,314**

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 32 of the *Audited Financial Statements for the year ended 31 December 2011*.

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 2011*.

Following table gives an industry sector breakdown of impaired and past due loans and related allowances (provisions) as of 31st December 2011.

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	37,585	37,585	-	11	8	37,566	14	(12)	37,543	
Agriculture and fishing	8,597	8,597	42,458	446	357	7,794	(907)	(543)	6,956	
Manufacturing	272,636	272,636	183,916	23,182	18,579	230,875	27,765	(33,596)	213,794	
Mining and quarrying	-	-	194,801	-	-	-	(996)	-	-	
Electricity, water, gas and health services	35,708	35,708	45,991	1,060	849	33,798	(2,756)	(1,331)	31,027	
Building and construction	1,078,641	1,078,641	358,134	14,921	19,473	1,044,247	(41,810)	(30,777)	1,042,821	
Commerce	2,218,365	2,218,365	890,624	165,646	235,960	1,816,759	265,063	(483,830)	2,136,170	
Transportation and communication	59,224	59,224	133,370	1,077	23,955	34,193	20,794	(4,445)	55,562	
Services	80,566	80,566	198,443	1,464	3,823	75,279	6,388	(6,873)	74,988	
Consumer loans and credit cards	282,872	282,872	1,640,512	191,225	59,975	31,672	560,000	(767,060)	197,829	
Others	197,074	197,074	38,455	3,515	2,816	190,743	72,730	(33,559)	175,047	
Total	**4,271,269**	**4,271,269**	**3,726,703**	**402,548**	**365,796**	**3,502,924**	**906,285**	**(1,362,026)**	**3,971,737**	**2,044,894**

Following table gives a geographic breakdown of impaired and past due loans and related allowances (provisions) as of 31st December 2011.

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	3,725,932	3,026,841	341,323	316,725	3,067,884	3,613,362	1,910,787
Other GCC & Middle East	37,500				37,500	37,500	
Turkey	507,837	699,862	61,225	49,071	397,541	320,875	134,107
Others countries							
Total	**4,271,269**	**3,726,703**	**402,548**	**365,796**	**3,502,924**	**3,971,737**	**2,044,894**

Following table gives the movement in specific and general allowances for the year ended 31st December 2011.

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	4,427,478	1,609,528
Charge-offs taken against the allowances during the period	(1,362,026)	
Amounts set aside (or reversed) during the period	906,285	435,366
Other adjustments:		
- exchange rate differences		
- business combinations		
- acquisitions and disposals of subsidiaries		
- etc.		
Transfers between allowances		
Balance, end of the year	3,971,737	2,044,894

Charge-offs and recoveries that have been recorded directly to the income statement are SAR 1,455K and SAR (113)K respectively.

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 2011.

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:	106,350,807					2,289,898				
SAMA and Saudi Government	86,938,117									
Others	19,412,690					2,289,898				
Multilateral Development Banks (MDBs)	14,387,500									
Public Sector Entities (PSEs)										
Banks and securities firms		1,008,558		19,655,648		3,381				
Corporates		22,233,519		8,865,293		94,231,197				
Retail non-mortgages					48,236,505					
Mortgages			1,900,898			2,083,073				
Residential			1,900,898			1,317,754				
Commercial						765,319				
Securitized assets										
Equity						2,930,924				72,374
Others	4,079,902	3,050,556		22,122		10,402,380	946,155			

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 32 of the *Audited Financial Statements for the year ended 31 December 2011*.

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 2011.

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		4,495,630
Corporates	1,997,888	15,901,505
Retail non-mortgages	1,290,941	
Small Business Facilities Enterprises (SBFE's)		
Mortgages		
Residential		
Commercial		
Securitized assets		
Equity		
Others	2,042	2,520
Total	**3,290,871**	**20,399,655**

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 2011.

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	465,956
Netting Benefits	
Netted Current Credit Exposure	
Collateral held:	
-Cash	
-Government securities	
-Others	
Exposure amount (under the applicable method)	832,305
-Current Exposure Method (CEM)	832,305
Notional value of credit derivative hedges	
Current credit exposure (by type of credit exposure):	832,305
-Interest rate contracts	93,322
-FX contracts	738,983
-Equity contracts	
-Credit derivatives	
-Commodity/other contracts	

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 2011*.

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		Nil		
Credit linked notes				
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 2011 was SR 180,123 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 Group's income or the value of its holdings of financial instruments.

For risk capital computations, the Group 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 Board of Directors. The 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 Group 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 regular basis.

5.3 Risk reporting and monitoring

The Group 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 33 of the *Audited Financial Statements for the year ended 31 December 2011*.

Stress testing

As VaR is a measure based on historical volatilities and correlations, which may break down during stressed market conditions, the Group 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 Group.

5.4 Risk Mitigation – Hedging

The Group'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 Group 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 33.1 of the *Audited Financial Statements for the year ended 31 December 2011*.

5.6 Application of the standardized approach for market risk

The Group 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 given below:

a. Interest rate risk is the impact on Group's 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 Group's investments will depreciate due to equity market dynamics.

c. Foreign exchange risk is the risk arising from a change in exchange-rates on Group'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 Group 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 2011.

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)
Standardized approach	287,222	-	337,542	-	624,764

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 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.

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

6.2 Organization Structure

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

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

6.3 Risk reporting and monitoring

Operational Risk Framework

The main elements comprising the operational risk framework are:

- Governance
- Loss data collection
- Risk and control self assessment
- Key risk indicators
- Stress testing & scenario analysis
- Measurement of residual risks
- Control testing

Governance

The board of directors approves, monitors and reviews the operational risk framework, policies and practices of the group. Reports are presented to this committee on a regular basis. An independent specialist group Operational Risk Management function is responsible for establishing the framework for operational risk management, and promotes consistent and sound operational risk management policies and practices across the group. This is in line with regulatory and stakeholder expectations.

The Operational Risk Committee (ORC) promotes and monitors the effectiveness of the operational risk management framework and develops and implements practices supporting operational risk policies and practices. Business unit senior management is responsible for the management of operational risk within their business units. This is achieved by ensuring that the operational risk management framework, policies and practices, as established by group Operational Risk Management, are embedded within the business unit.

Risk and Control Self-Assessment [RCSA]

The RCSA 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. The risk and control self-assessment of the business units 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.

Loss data collection

A good system tool is a standard regulatory requirement to support collection, analysis and management of operational risk incidents. For this, SAS OpRisk Monitor is being used and considered to be the industry's "top" system tool for operational risk. We have considered major risks and appropriate measures have been taken to mitigate and manage the exposure to these risks within acceptable levels. Analyses and processes are in place for the monitoring and escalation of recorded events. All records of operational risk incidents are subsequently validated by the ORD.

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.

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.

Control Testing

Testing Key Control determines the extent to which staffs follow prescribed policies and procedures in actual practice. It compares procedures as executed against required or expected procedures. Testing provides objective evidence on how well controls are executed. Control testing procedures must be adopted by every business unit and incorporated into their regular activities.

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 2011.

CAPITAL ADEQUACY – Operational Risk (SAMA reference table 3)	
Capital Requirements for Operational Risk (Table 3, (e))	
Particulars	Capital requirement (SR '000)
Standardized approach	1,768,633
Total	**1,768,633**

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 2011*.

Following table gives the value of equity investments as of 31st of December 2011.

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	841,109	N/A	2,089,816	2,089,816	

Following table gives an industry sector breakdown of equity investments as of 31st of December 2011.

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	1,841,968	1,332
Agriculture and fishing		
Manufacturing	247,848	
Mining and quarrying		
Electricity, water, gas and health services		
Building and construction		
Commerce		817,726
Transportation and communication		
Services		11,000
Others		11,050
Total	**2,089,816**	**841,109**

Following table gives the realized and unrealized gains on equity investments as of 31st of December 2011.

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	29,718
Total unrealized gains (losses)	411,891
Total latent revaluation gains (losses)	
Unrealized gains (losses) included in Capital	411,891
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 2011.

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	147,464
Agriculture and fishing	
Manufacturing	19,828
Mining and quarrying	
Electricity, water, gas and health services	
Building and construction	
Commerce	65,418
Transportation and communication	
Services	880
Others	884
Total	**234,474**

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 33.2.1 of the *Audited Financial Statements for the year ended 31 December 2011*.

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 2011.

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	1,519,378
USD	(1,105,269)
GBP	(15,938)
EUR	(27,195)
JPY	(6,190)
TRY	(73,291)
Downward rate shocks:	
SAR	(1,519,378)
USD	1,105,269
GBP	15,938
EUR	27,195
JPY	6,190
TRY	73,291

Summary of Pillar 3 Qualitative disclosure requirements.

Reference	Description	Section	Page
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Table 3	Capital Adequacy	3.0	6
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Risk Exposure and Assessment	Credit Risk	4.3, 4.4 & 4.6	11, 15, 18
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Table 11	Market Risk : Disclosures For Banks Using the Internal Models Approach (IMA) for Trading Portfolios	Not Applicable	
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Summary of Pillar 3 Quantitative disclosure requirements.

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Table 8, (b) and (d)	General Disclosures (for exposure related to counterparty credit risk)	4.9	23
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Table 13, (d) and (e)	Equities : Gains/Losses etc.	7.0	34
Table 13, (f)	Equities : Capital Requirements	7.0	35
Table 14, (b)	200 bps Interest Rate Shocks for currencies with more than 5% of Assets or Liabilities	8.0	36