National Commercial Bank

Qualitative and Quantitative Pillar 3 Disclosures
As of 31 December 2012

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 2012* 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 2012* 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.(TFK)

(3) Eastgate Capital Holdings Inc. (Eastgate)

(4) Real Estate Development Company

Please refer to note 1.2 of the *Audited Financial Statements for the year ended 31 December 2012* 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		13,623,678
Treasury Shares		(177,093)
Minority interests in the equity of subsidiaries		1,700,514
Retained earnings		8,547,274
IAS type adjustments (cumulative change in fair value)		1,857,342
Others (Foreign currency exchange reserve)		(1,147,570)
Deductions from Tier I:		(1,204,767)
Intangible assets and goodwill	(1,172,098)	
Significant minority investments at 10% and above at 50% deduction:	(32,669)	
Banking and securities entities not fully consolidated	(11,484)	
Insurance organizations	(21,185)	
Total Tier I		**38,199,378**
Supplementary capital - Tier 2:		
Qualifying general provisions		2,494,970
Deductions from Tier II:		(32,669)
Significant minority investments at 10% and above at 50% deduction:	(32,669)	
Banking and securities entities not fully consolidated	(11,484)	
Insurance organizations	(21,185)	
Total Tier II		**2,462,301**
Total eligible capital		**40,661,679**
Capital to cover market risks - Tier III		
Short Term Subordinated Debt		
Tier I and Tier II Capital Available for Market Risk		24,363,114

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 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 2012.

CAPITAL ADEQUACY – CAR (SAMA reference table 3)		
Capital Adequacy Ratios (TABLE 3, (f))		
Particulars	Total capital ratio	Tier 1 capital ratio
	%	
Top consolidated level	17.5%	16.5%

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 2012.

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:	108,709,643	83,754	-	43	108,709,643	83,797
SAMA and Saudi Government	75,950,541	-	-	-	75,950,541	-
Others	32,759,102	83,754	-	43	32,759,102	83,797
Multilateral Development Banks (MDBs)	8,993,688	-	-	-	8,993,688	-
Public Sector Entities (PSEs)	-	-	6,030	241	6,030	241
Banks and securities firms	12,953,246	438,630	7,614,905	305,051	20,568,151	743,681
Corporates	132,492,313	7,543,237	35,258,635	2,554,482	167,750,948	10,097,719
Retail non-mortgages	49,211,636	2,944,316	3,132,848	155,597	52,344,484	3,099,913
Small Business Facilities Enterprises(SBFE's)	3,740,996	216,483	1,966,944	113,898	5,707,940	330,381
Mortgages	14,631,462	781,238	871,118	34,845	15,502,579	816,083
Residential	8,624,584	482,878	369,287	14,771	8,993,870	497,649
Commercial	6,006,878	298,361	501,831	20,073	6,508,709	318,434
Securitized assets	-	-	-	-	-	-
Equity	2,907,935	232,635	-	-	2,907,935	232,635
Others	17,751,766	1,163,867	179,615	60,629	17,931,381	1,224,496
Total	**347,651,687**	**13,187,678**	**47,063,151**	**3,110,888**	**394,714,838**	**16,298,565**

Following tables give exposures subject to credit risk as of 31st of December 2012 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:	108,709,643	94,586,729
SAMA and Saudi Government	75,950,541	73,361,222
Others	32,759,102	27,835,853
Multilateral Development Banks (MDBs)	8,993,688	9,561,813
Public Sector Entities (PSEs)	6,030	14,134
Banks and securities firms	20,568,151	23,430,911
Corporates	167,750,948	161,763,519
Retail non-mortgages	52,344,484	52,073,323
Small Business Facilities Enterprises (SBFE's)	5,707,940	4,789,677
Mortgages	15,502,579	9,584,566
Residential	8,993,870	6,323,212
Commercial	6,508,709	3,261,354
Securitized assets	-	-
Equity	2,907,935	2,897,319
Others	17,931,381	16,591,455
Total	**394,714,838**	**370,503,768**

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, and defines the policies and procedures for the handling of all activities related to consumer lending.

The Retail 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 7.5 of the *Audited Financial Statements for the year ended 31 December 2012*.

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 notes 7.4 and 31 of the *Audited Financial Statements for the year ended 31 December 2012*.

Following table gives a geographic breakdown of exposures as of 31st of December 2012.

TABLE 4 (STA): CREDIT RISK: GENERAL DISCLOSURES								
Geographic Breakdown (Table 4, (c))								
Portfolios	Geographic area							
	Saudi Arabia	Other GCC & Middle East	Europe	North America	South East Asia	Turkey	Other countries	Total
Sovereigns and central banks:	75,950,541	10,148,187	788,118	9,871,186	1,022,084	9,277,789	1,651,738	108,709,643
SAMA and Saudi Government	75,950,541							75,950,541
Others		10,148,187	788,118	9,871,186	1,022,084	9,277,789	1,651,738	32,759,102
Multilateral Development Banks (MDBs)	3,193,688		937,500	3,737,500			1,125,000	8,993,688
Public Sector Entities (PSEs)						6,030		6,030
Banks and securities firms	9,479,290	4,339,331	1,175,808	451,715	604,209	726,566	3,791,233	20,568,151
Corporate	112,125,439	9,587,559	2,997,968	21,687,091	570,651	14,080,856	6,701,383	167,750,948
Retail non-mortgages	45,517,266	531	249	768		6,825,027	644	52,344,484
Small Business Facilities Enterprises (SBFE's)		499		762		5,706,053	626	5,707,940
Mortgages	4,954,697		8,604			10,535,041	4,237	15,502,579
Residential	3,479,856		3,782			5,507,905	2,326	8,993,870
Commercial	1,474,841		4,821			5,027,136	1,911	6,508,709
Securitized assets								
Equity	2,907,935							2,907,935
Others	10,605,156	1,179,853	1,636,911	2,896,502		1,601,633	11,326	17,931,381
Total	**264,734,011**	**25,255,460**	**7,545,158**	**38,644,762**	**2,196,943**	**43,052,941**	**13,285,562**	**394,714,838**

Following table gives an industry sector breakdown of exposures as of 31st of December 2012.

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:	108,709,643											108,709,643
SAMA and Saudi Government	75,950,541											75,950,541
Others	32,759,102											32,759,102
Multilateral Development Banks (MDBs)		8,993,688										8,993,688
Public Sector Entities (PSEs)	6,030											6,030
Banks and securities firms		20,568,151										20,568,151
Corporates		24,472,530	772,932	27,020,653	11,132,385	29,607,288	38,982,669	11,947,917	15,554,139		8,260,434	167,750,948
Retail non-mortgages		1,142	248,114	2,142,733	13,544	353,845	732,992	100,599	93,139	48,658,376		52,344,484
Small Business Facilities Enterprises (SBFE's)		1,108	248,076	2,141,998	13,544	353,653	732,865	100,556	92,888	2,023,253		5,707,940
Mortgages										15,502,580		15,502,580
Residential										8,993,871		8,993,871
Commercial										6,508,710		6,508,710
Securitized assets												
Equity		1,878,126		207,050			811,759		11,000			2,907,935
Others		14,018,975									3,912,406	17,931,381
Total	**108,715,673**	**69,932,612**	**1,021,046**	**29,370,437**	**11,145,928**	**29,961,133**	**40,527,421**	**12,048,516**	**15,658,278**	**64,160,956**	**12,172,840**	**394,714,838**

Following table gives a maturity breakdown of exposures as of 31st of December 2012.

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:	29,050,803	8,684,179	9,089,495	11,824,588	7,039,260	7,854,079	2,602,414	32,564,826	108,709,643
SAMA and Saudi Government	23,518,271	8,395,000	7,012,242	9,810,346	5,522,718	2,739,897	721,979	18,230,088	75,950,541
Others	5,532,532	289,179	2,077,253	2,014,242	1,516,542	5,114,182	1,880,434	14,334,737	32,759,102
Multilateral Development Banks (MDBs)					187,500	3,814,938	1,991,250	3,000,000	8,993,688
Public Sector Entities (PSEs)			6,030						6,030
Banks and securities firms	5,813,110	2,075,255	5,364,778	2,015,028	1,797,904	1,879,840	1,155,387	466,849	20,568,151
Corporates	15,425,488	14,526,955	28,856,191	19,222,069	14,191,188	32,726,729	21,714,841	21,087,486	167,750,948
Retail non-mortgages	1,060,507	798,727	1,466,405	1,432,219	2,145,467	9,546,289	34,529,757	1,365,113	52,344,484
Small Business Facilities Enterprises (SBFE's)	279,104	367,287	1,005,250	986,965	1,323,654	1,362,754	242,886	140,041	5,707,940
Mortgages	72,245	108,474	317,307	592,172	1,258,712	3,588,229	2,407,721	7,157,719	15,502,579
Residential	39,452	46,803	122,717	250,882	449,798	1,551,473	1,453,153	5,079,592	8,993,870
Commercial	32,792	61,670	194,590	341,290	808,914	2,036,757	954,568	2,078,127	6,508,709
Securitized assets									
Equity								2,907,935	2,907,935
Others	9,088,728		516,405		34,461	104,640	24,151	8,162,996	17,931,381
Total	**60,510,881**	**26,193,590**	**45,616,610**	**35,086,076**	**26,654,492**	**59,514,745**	**64,425,520**	**76,712,923**	**394,714,838**

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 31 of the *Audited Financial Statements for the year ended 31 December 2012*.

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 of the *Audited Financial Statements for the year ended 31 December 2012*.

Following table gives an industry sector breakdown of impaired and past due loans and related allowances (provisions) as of 31st December 2012.

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	42,649	42,649	97	3,973	-	38,676	4,921		42,464	-
Agriculture and fishing	23,275	23,275	14,999	11,210	81	11,983	6,077	(990)	12,043	-
Manufacturing	342,014	342,014	299,152	102,222	10,466	229,325	103,169	(20,888)	296,075	-
Mining and quarrying	6,410	6,410	5,867	5,882	2	527	-		-	-
Electricity, water, gas and health services	34,227	34,227	1,227	2,589	-	31,639	(5,087)	(4)	25,936	-
Building and construction	1,531,934	1,531,934	703,071	425,982	47,242	1,058,710	464,152	(12,341)	1,494,631	-
Commerce	2,258,505	2,258,505	634,502	149,394	90,837	2,018,274	49,650	(31,861)	2,153,959	-
Transportation and communication	106,612	106,612	134,642	18,844	26,929	60,839	34,040	(1,433)	88,169	-
Services	141,152	141,152	75,182	10,947	37,270	92,935	14,174	(2,711)	86,451	-
Consumer loans and credit cards	314,838	314,838	1,918,673	225,811	48,793	40,234	570,888	(522,347)	246,370	-
Others	147,742	147,742	59,492	12,105	16,345	119,292	(25,389)	(35,596)	114,062	-
Total	**4,949,358**	**4,949,358**	**3,846,904**	**968,959**	**277,966**	**3,702,434**	**1,216,594**	**(628,171)**	**4,560,160**	**2,494,969**

Following table gives a geographic breakdown of impaired and past due loans and related allowances (provisions) as of 31st December 2012.

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	4,160,795	2,719,078	671,140	272,991	3,216,664	3,979,730	2,313,899
Other GCC & Middle East	37,500				37,500	37,500	
Turkey	751,063	1,127,826	297,819	4,975	448,270	542,930	181,070
Others countries							
Total	**4,949,358**	**3,846,904**	**968,959**	**277,966**	**3,702,434**	**4,560,160**	**2,494,969**

Following table gives the movement in specific and general allowances for the year ended 31st December 2012.

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	3,971,737	2,044,894
Charge-offs taken against the allowances during the period	(628,171)	
Amounts set aside (or reversed) during the period	1,196,735	441,775
Other adjustments:		
- exchange rate differences	19,859	8,300
- business combinations		
- acquisitions and disposals of subsidiaries		
- etc.		
Transfers between allowances		
Balance, end of the year	4,560,160	2,494,969

Charge-offs and recoveries that have been recorded directly to the income statement are SAR 6,142K and SAR (337,063)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 2012.

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:	121,806,275	-	-	1,262,297	-	415,776	-	-	-	-
SAMA and Saudi Government	90,725,246	-	-	-	-	-	-	-	-	-
Others	31,081,029	-	-	1,262,297	-	415,776	-	-	-	-
Multilateral Development Banks (MDBs)	8,993,688	-	-	-	-	-	-	-	-	-
Public Sector Entities (PSEs)	6,030	-	-	-	-	-	-	-	-	-
Banks and securities firms	-	3,484,686	-	17,139,441	-	-	-	-	-	-
Corporates	379,322	26,035,431	-	10,363,123	-	116,341,981	-	-	-	-
Retail non-mortgages	30,590	463,386	-	51,784	51,642,217	12,603	-	-	-	-
Mortgages	-	-	-	10,496,960	516	4,952,173	-	-	-	-
Residential	-	-	-	5,485,512	-	3,477,860	-	-	-	-
Commercial	-	-	-	5,011,448	516	1,474,313	-	-	-	-
Securitized assets	-	-	-	-	-	-	-	-	-	-
Equity	-	-	-	-	-	2,907,935	-	-	-	65,338
Others	3,731,065	17,666	-	38,970	1,315	13,062,720	1,048,903	27,983	-	-

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 31 of the *Audited Financial Statements for the year ended 31 December 2012*.

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 2012.

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		4,217,108
Corporates	3,866,614	14,807,339
Retail non-mortgages	590,200	7,123
Small Business Facilities Enterprises (SBFE's)	125,828	
Mortgages	52,930	
Residential	30,498	
Commercial	22,432	
Securitized assets		
Equity		
Others	-	2,520
Total	**4,509,744**	**19,034,090**

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 2012.

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	389,634
Netting Benefits	
Netted Current Credit Exposure	
Collateral held:	
-Cash	
-Government securities	
-Others	
Exposure amount (under the applicable method)	878,816
-Current Exposure Method (CEM)	878,816
Notional value of credit derivative hedges	
Current credit exposure (by type of credit exposure):	878,816
-Interest rate contracts	99,294
-FX contracts	779,522
-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 3.14 of the *Audited Financial Statements for the year ended 31 December 2012*.

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 2012 was SR 186,898 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 banking books. Trading book is mainly held by the Treasury division and includes 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, monitoring and reporting market risk exposures according to defined policies and 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 32 of the *Audited Financial Statements for the year ended 31 December 2012*.

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 main 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 32.1 of the *Audited Financial Statements for the year ended 31 December 2012*.

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 2012.

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	261,394	-	231,195	-	492,590

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] strategy for managing the effectiveness of Operational Risk Framework as follows:

- Proactive approach through Risk & Control Self-Assessment process.
- Reactive approach through Loss & Events Data Collection, Analysis & Measurement.
- Maintain culture and awareness programs.
- Introduce comprehensive monitoring and reporting tools.
- Develop and implement practices supporting operational risk management.

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 2012.

CAPITAL ADEQUACY – Operational Risk (SAMA reference table 3)	
Capital Requirements for Operational Risk (Table 3, (e))	
Particulars	**Capital requirement (SR '000)**
Standardized approach	1,776,690
Total	**1,776,690**

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 3.14 of the *Audited Financial Statements for the year ended 31 December 2012*.

Following table gives the value of equity investments as of 31st of December 2012.

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	835,487	N/A	2,072,448	2,072,448	

Following table gives an industry sector breakdown of equity investments as of 31st of December 2012.

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	1,876,448	1,678
Agriculture and fishing		
Manufacturing	196,000	11,050
Mining and quarrying		
Electricity, water, gas and health services		
Building and construction		
Commerce		811,759
Transportation and communication		
Services		11,000
Others		
Total	**2,072,448**	**835,488**

Following table gives the realized and unrealized gains on equity investments as of 31st of December 2012.

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	34,361
Total unrealized gains (losses)	446,533
Total latent revaluation gains (losses)	
Unrealized gains (losses) included in Capital	446,533
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 2012.

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	150,250
Agriculture and fishing	
Manufacturing	16,564
Mining and quarrying	
Electricity, water, gas and health services	
Building and construction	
Commerce	64,941
Transportation and communication	
Services	880
Others	
Total	**232,635**

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 32.2.1 of the *Audited Financial Statements for the year ended 31 December 2012*.

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 2012.

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	659,600
USD	(643,600)
GBP	(659)
EUR	(27,160)
JPY	422
TRY	24,402
Downward rate shocks:	
SAR	(659,600)
USD	643,600
GBP	659
EUR	27,160
JPY	(422)
TRY	(24,402)

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.