

samba financial group  مجموعة سامبا المالية

Capital Adequacy
and
Risk Management
Report
(Basel III Pillar 3 Disclosure)

as at
31st December 2014

Issued March 2015

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1. Executive Summary

The Capital Adequacy and Risk Management Report for Samba Financial Group (“Samba” or “the bank”) has been prepared in accordance with the public / market disclosure requirements and guidelines in respect of Pillar 3 of Basel III, as published by the Saudi Arabian Monetary Agency (SAMA) in December 2012¹.

The purpose of this disclosure is to inform market participants of the key components, scope and effectiveness of Samba’s risk management systems, risk measurement processes, risk profile and capital adequacy. This is accomplished by providing consistent and understandable disclosure of Samba’s risk profile in a manner that enhances comparability with other institutions.

Samba Financial Group (Samba) has been compliant with Basel requirements since 1st January 2008; and since then Samba has been publishing these reports on a bi-annual basis as of June and December each year.

Samba has adopted the Standardized Approach for Credit Risk, the Standardized Approach for Market Risk and the Standardized and Basic Indicator Approaches for determining the capital requirements for Operational Risk. These approaches have been discussed in detail in the following pages of this report.

This Capital Adequacy and Risk Management Report provides details on Samba Financial Group’s consolidated risk profile with business volumes by customer categories and risk asset classes, which form the basis for the calculation of our capital requirement.

In accordance with the minimum capital requirement calculation methodology as prescribed under Basel III, Samba Financial Group’s capital adequacy as at 31st December 2014 and a comparison thereof with the figures as of 30th June 2014 and 31st December 2013 is as follows:

	Dec 2014	Jun 2014	Dec 2013
Total Capital Adequacy Ratio	19.9%	18.7%	19.4%
Tier 1 Capital Adequacy Ratio	19.2%	17.9%	18.6%

As of 31st December 2014 total Risk Weighted Assets (RWA) amounted to SAR 202,580,614,000 which comprised of 85.8% Credit Risk; 8.2% Market Risk and 6.0% Operational Risk. The interim dividend for 2014 was approved earlier than in June 2014 (thereby excluding it from Tier 1 Capital) which, combined with the higher RWA described above, resulted in a slightly lower Capital Adequacy Ratio in June 2014.

¹ Per SAMA circular 19984 ‘SAMA’s Final Guidance Documents Concerning Implementation of Basel III Pillar 3 Component’ dated 29th December 2012

2. Background

Samba Financial Group is a Saudi Joint Stock company which has been in business in the Kingdom of Saudi Arabia since 1980 (more detailed information is available in the published Annual Financial Statements) and is listed on the Saudi Stock Exchange (Tadawul) under symbol 1090. As a commercial bank registered in the Kingdom of Saudi Arabia, Samba falls under the regulatory supervision of the Saudi Arabian Monetary Agency (SAMA).

Samba provides commercial banking services such as loans, trade finance, consumer finance, credit cards and treasury products to all customer segments including retail (individuals), corporates and government and semi-government institutions. Samba also provides a broad range of Shariah compliant banking products approved by Samba's Shariah Board, an independent body of Shariah Scholars.

Samba operates in overseas markets through branches in London, Dubai and Qatar.

Samba also owns an 84.51% stake in Samba Bank Limited incorporated in Pakistan. Samba Bank Limited is a banking company engaged in commercial banking and related services and is listed on all the stock exchanges in Pakistan.

Information disclosed in this report is at the highest consolidated level i.e. Samba Financial Group including all branches and subsidiaries as at 31st December 2014.

The information provided in this document is not required to be subjected to external audit; however, reconciliation with the financial accounts has been performed.

3. Basel III Components

In December 2012, SAMA issued a circular² requiring banks operating in the Kingdom of Saudi Arabia to report their capital adequacy requirements according to the Basel III guidelines. Basel III is an international initiative (adopted by SAMA) with a view to ensure adequate capitalization of banks on a more robust risk-sensitive basis providing a framework for assessment of risk and calculation of regulatory capital requirement, i.e. the minimum capital that an institution must hold, given its risk profile. Basel III framework is intended to strengthen risk management practices and processes within financial institutions.

SAMA's Basel II / III framework describes the following three pillars which are designed to be mutually re-enforcing and are meant to ensure an adequate capital base which corresponds to the overall risk profile of the bank:

- Pillar 1: Calculation of capital adequacy ratio based on charge for credit, market and operational risks stemming from business operations.
- Pillar 2: Supervisory review process which includes:
 - Internal Capital Adequacy Assessment Process (ICAAP) to assess incremental risk types not covered under Pillar 1;
 - Quantification of capital required for these identified risks;
 - The assurance that the bank has sufficient capital cushion (generated from internal / external sources) to cover these risks over and above the regulatory requirement under Pillar 1.
- Pillar 3: Market discipline through public disclosures that are designed to provide transparent information on capital structure, risk exposures, risk mitigation and the risk assessment process.

These concepts are more fully described in the following pages.

This report represents Samba's market disclosure, under the Pillar 3 requirements, of its risk profile and capital adequacy as at the end of 31st December 2014.

² SAMA Circular 15689 dated December 2012, titled 'SAMA's Final Guidance Document Concerning Implementation of Capital Reforms under Basel III Framework'

3.1. Pillar 1 – Minimum Capital Requirements

Basel II / III, as adopted and implemented by SAMA, cover the minimum regulatory capital requirement for banks for credit, market and operational risks stemming from its business operations. It also sets out the basis for consolidation of entities for capital adequacy reporting requirements, the definition and calculations of Risk Weighted Assets (RWA) and the various options given to banks to calculate these Risk Weighted Assets.

The regulatory capital requirements are calculated according to the following formula (expressed as a percentage):

$$\text{Minimum Capital Requirements} = \frac{\text{Capital Base}}{\text{RWA}}$$

where the Minimum Capital Requirements are to be $\geq 8\%$

The table below describes the approaches available for calculating the RWA for each of the aforementioned risk types:

Credit Risk	Market Risk	Operational Risk
Standardized Approach	Standardized Approach	Basic Indicator Approach
Foundation - Internal Ratings Based Approach (F-IRB)	Internal Models Approach	Standardized Approach
Advanced - Internal Ratings Based Approach (A-IRB)		Advanced Measurement Approach (AMA)

Samba Financial Group has chosen the following approaches for each of the risk types.

a) Credit Risk

Samba Financial Group uses the Standardized Approach at the consolidated level for regulatory reporting purposes. This approach differs from the Basel I regulations in that it allows the use of external ratings, where available, from accredited ratings agencies for the determination of appropriate risk weights, and also includes a wider range of eligible financial collaterals. The RWAs are then calculated according to the following formula:

$$\text{RWA} = \sum \text{Credit Equivalent Amount}^3 \text{ for all asset classes} \times \text{Regulatory Defined Risk Weight}^4$$

b) Market Risk

Samba Financial Group uses the Standardized Approach at the consolidated level for measurement of Market Risk capital requirement. Under this approach, the capital

³ Credit equivalent amount is determined as gross exposure less specific provisions less eligible credit risk mitigants. A credit conversion factor (CCF) or add-on percentage is then applied to off-balance sheet and derivative exposures respectively

⁴ The regulatory defined risk weight is determined by the counterparty asset class and the external rating of the counterparty, where applicable

charge for Market Risk is determined by converting positions in the trading book into risk weighted assets, as per the respective SAMA guidelines⁵.

c) Operational Risk

Samba Financial Group, with the exception of Samba Bank Limited - Pakistan, uses the Standardized Approach for measurement of Operational Risk capital charge. Under this approach a range of beta coefficients (12% - 18%) are applied to the average gross income for the preceding three financial years for each of the eight predetermined business lines to calculate capital charge for Operational Risk.

The Basic Indicator Approach is used in our subsidiary in Pakistan. A fixed alpha coefficient of 15% is applied to the average gross income for the preceding three years to arrive at the operational risk capital charge.

3.2. Pillar 2 – Supervisory Review Process

The Supervisory Review Process (SRP) under Pillar 2 requires banks to employ an Internal Capital Adequacy Assessment Process (ICAAP) aimed at: a) quantifying bank's own internal assessment of the level of capital that it deems appropriate to adequately cover all material risks that it is exposed to; and b) instituting a comprehensive process for business and capital planning to ensure that adequate capital is always available to cover its risk exposures. Banks are also required to identify sources for raising additional capital in case of need and to provide documented plans thereof. As part of this process banks are required to ascertain whether credit, market and operational risk capital charges calculated under Pillar 1 are adequate to cover bank's internal assessment of these risks or not. Furthermore, banks are expected to ascertain additional capital requirements (over and above the Pillar 1 requirements, if any) for credit, market and operational and the Pillar 2 risks that the banks are exposed to (examples of some risks identified in this respect are interest rate risk in the banking book, strategic risk, legal risk, concentration risk, etc.). The ICAAP has to be designed to ensure that banks have sufficient capital cushion to meet regulatory and internal capital requirements during periods of systemic / cyclical economic downturns or during times of financial distress - which involves employing stress testing and scenario analysis techniques.

In compliance with the regulatory requirements, Samba has submitted its detailed ICAAP Plan for the period 2015-2017 to SAMA.

3.3. Pillar 3 – Market Discipline

Under Pillar 3, SAMA prescribes the qualitative and quantitative disclosures which are required to be made to external stakeholders of the bank⁶. The disclosures are designed to enable stakeholders and market participants to assess an institution's risk appetite, risk exposures and risk profile. It encourages the move towards more advanced forms of risk management.

A reporting calendar has also been provided by SAMA to indicate which disclosures are required at the defined intervals. Quarterly requirements are disclosed in the quarterly financial statements and semi-annual / annual disclosures are contained in this report.

⁵ As defined in SAMA circular BCS 355 of 29th December 2004

⁶ Refer footnote on page 5

4. Risk and Capital Management

In this chapter the consolidation principles for capital base within Samba are described, as well as the principles adopted for the management and control of risk and capital.

4.1. Group Structure

Samba Financial Group follows the Accounting Standards for Financial Institutions promulgated by the Saudi Arabian Monetary Agency (SAMA) and International Financial Reporting Standards (IFRS). Samba also prepares its consolidated financial statements to comply with the Banking Control Law and the Regulations for Companies in the Kingdom of Saudi Arabia.

The consolidated financial statements as at 31st December 2014 include the financial statements of the Bank and its following subsidiaries.

Samba Bank Ltd: An 84.51% owned subsidiary incorporated as a banking company in Pakistan and engaged in commercial banking and related services. This entity is listed on all stock exchanges in Pakistan.

Samba Real Estate Company: A wholly owned subsidiary incorporated in Saudi Arabia under commercial registration number 1010234757 issued in Riyadh dated 9th Jumada II, 1428H (24th June 2007). The company has been formed as limited liability company with the approval of SAMA and is engaged in managing real estate projects on behalf of Samba Real Estate Fund and Samba Financial Group.

Samba Capital and Investment Management Company: A wholly owned subsidiary incorporated in Saudi Arabia under commercial registration number 1010237159. It was formed in accordance with the Securities Business Regulations issued by the Capital Market Authority (CMA), requiring banks in Saudi Arabia to transfer their dealing, arranging, managing, advising and custody businesses into a separate legal entity licensed with CMA. This is referred to as Samba Capital.

Co-Invest Offshore Capital Limited: A wholly owned company incorporated under the laws of Cayman Islands for the purpose of managing certain overseas investments.

The aggregation consolidation method is applied to subsidiaries reporting in other regulatory jurisdictions. To this end Samba Bank Limited calculates its Risk Weighted Assets according to the regulations defined by the State Bank of Pakistan.

4.2. Risk and Capital Management Process

Samba is exposed to a broad range of risks in the normal course of its business. The bank's risk and capital assessment policies are designed to identify and quantify these risks, set appropriate limits in line with defined risk appetite, ensuring control and monitoring adherence to the limits. The principal risks associated with Samba's business are credit risk, including cross-border and concentration risks, market risk, liquidity risk, operational risk and reputation / franchise risk.

The Executive Committee of the Samba Board formulates high level strategies and policies, approves specific transactions or programs that may pose material risks to the institution and monitors the bank's risk profile on an ongoing basis. This Committee, which has been appointed and empowered by the Samba Board of Directors, comprises five Board Members.

On 23rd April 2013, the Board of Directors approved the formation of a Board Risk Committee as required by SAMA⁷. This Committee is chaired by a non-executive director and is comprised of a further two directors. Its main function is to assist the Board in overseeing the credit and other risk management processes, including the overall internal control framework and IT/IS related risks.

The process of risk management is supported by a set of independent control functions reporting to the Chief Risk Officer. Individual credit transactions are approved jointly by selected Credit Officers including both Business and independent Risk Management representatives. The Credit Risk Control department reviews approval levels and documentation prior to allowing the availing of facilities. Market Risk Management department reviews limits and provides independent reports about the bank's market risk exposures and liquidity positions, including measurement against stressed events. The Group Risk and Capital Strategy department manages the process of risk appetite definition, portfolio targets, risk measurement and overall limit setting.

The risk governance structure includes the following management committees:

- Asset Liabilities Committee (ALCO), chaired by the General Manager, is responsible for the monitoring and management of liquidity, the balance sheet and market risk resulting from the accrual portfolio.
- Market Risk Policy Committee (MRPC) is the management body within Samba for market and liquidity risk issues, including establishing and updating policies and guidelines, reviewing and approving market risk limits and exceptions.
- Credit Risk Policy Committee (CRPC) has Samba-wide responsibility for maintaining sound and effective credit risk management architecture and process.
- Capital Management Committee (CMC) examines components of the capital plan and proposes the internal capital adequacy targets for approval by the Executive Committee.

Samba Audit Risk Review (ARR) reports functionally to the Audit Committee of the Samba Board and has responsibility for:

- Providing independent evaluation of Samba's risk portfolio and processes.
- Assessing the adequacy of Bank's policies, practices and procedures for risk management.
- Documenting its findings in action-oriented reports for the relevant Board / Management Committees and Senior Management.

⁷ Rules on Credit Risk Management issued by SAMA in January 2013

5. Regulatory Capital Requirements

This chapter describes Samba's capital requirements, calculated on the basis of regulatory guidelines. The risk types under Pillar 1 are in accordance with Basel II / III guidelines issued by SAMA⁸ and contain credit, market and operational risks.

As at 31st December 2014 Samba's overall regulatory capital requirements under Pillar 1 can be broken down as follows.

SAR 000s

Risk Type	Capital Requirement	% of Total Requirement
Credit Risk	13,905,771	85.8 %
Market Risk	1,325,611	8.2 %
Operational Risk	975,067	6.0 %
Total	16,206,449	100.0%

⁸ Refer footnote on page 5

5.1. Capital requirements for Credit Risk

Samba calculates the capital requirements for credit risk according to the Standardized Approach. Under this approach, exposures are assigned to portfolio segments based on the type of counterparty and/or the nature of the underlying exposure.

The major portfolio segments as defined by the Basel guidelines adopted by SAMA are sovereigns, banks, corporates, retail, securitized assets and VIP/HNI (high net-worth individuals). Each segment has a defined risk weight ranging from 0% to 150% depending on tenor, type of exposure, asset class, whether the counterparty has an external rating and whether the exposure is past due.

The following table describes the amount of exposures subject to credit risk and the related capital requirements, by portfolio.

SAR 000s

Portfolio	Amount of Exposures	RWA	Capital Requirements
Sovereigns and Central Banks	54,554,350	106,081	8,486
Banks and Securities Firms	22,927,837	10,067,137	805,371
Corporates	97,524,900	91,213,491	7,297,079
Retail Non-Mortgages	14,586,528	10,939,896	875,192
Mortgages - Residential and Commercial	5,660,634	5,660,634	452,851
Past Due Loans *	1,824,956	1,164,322	93,146
Equities	214,455	214,455	17,156
VIP/HNI	9,964,941	9,909,125	792,730
Others **	17,183,515	3,778,816	302,305
Total - On Balance-Sheet ***	224,442,117	133,053,957	10,644,317
Off Balance-Sheet	56,820,145	30,490,881	2,439,270
Derivatives (including CVA)	6,730,207	10,277,301	822,184
Total	287,992,469	173,822,138	13,905,771

* Includes impaired loans

** Primarily fixed assets, cash, items in the course of collection, investments and sundry assets

*** Exposures are stated in this report at gross values and are therefore not directly comparable with the bank's consolidated financial statements, which are disclosed on a net basis. Items included in the gross values comprise provisions, collaterals, UID (Unearned interest, commission and discount) and interest in suspense

A detailed definition of each portfolio is contained in chapter 6 of this report.

5.2. Capital requirements for Market Risk

Samba uses the Standardized Approach to calculate the regulatory capital requirements relating to general market and specific market risks. The resultant measure of market risk is multiplied by 12.5, the reciprocal of the theoretical 8% minimum capital ratio, to give market risk-weighted exposure on a basis consistent with credit risk-weighted exposure. The principal market risks to which Samba is exposed are foreign exchange risk, interest rate risk and equity price risk associated with its trading, investment and asset and liability management activities. This figure does not include Interest Rate Risk in the Banking Book, as this is considered as part of the Pillar 2 risks (refer chapter 9 of this document).

Brief descriptions of the risk items covered by market risk are given below:

- a. Interest rate risk is the impact on banks earnings and market value of equity due to 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 position risk is the risk that the bank's investments will depreciate due to the dynamics of the equity markets.
- c. Foreign exchange risk is the risk arising from a change in exchange-rates impacting the bank's net asset / liability positions.
- d. Commodity risk refers to the uncertainties of future market values and of the size of the future income, caused by fluctuation in the prices of commodities.

The capital requirements for Market Risk, calculated on assets and positions held in the trading book, are presented in the table below.

SAR 000s

Market Risk Type	RWA	Capital Requirements
Interest Rate - General risk	1,450,325	116,026
Interest Rate - Specific risk	3,309,513	264,761
Equity Position risk	9,142,313	731,385
Foreign Exchange risk	2,581,950	206,556
Commodity risk	86,038	6,883
Total	16,570,138	1,325,611

5.3. Capital requirements for Operational Risk

Samba uses the Standardized Approach, while Samba Bank Limited - Pakistan uses the Basic Indicator Approach, for calculation of regulatory capital requirements with respect to Operational Risk. The Standardized Approach applies a range of beta coefficients (12% - 18%) to the average gross income for the preceding three financial years for each of eight predetermined business lines, while the Basic Indicator Approach applies a standard alpha coefficient of 15% to the overall average gross income (where positive) for the preceding three financial years.

The capital requirements are detailed in the table below.

SAR 000s

Business line	Beta / Alpha Coefficient	Total Capital requirement
<u>Samba Financial Group (Standardized Approach)</u>		
Agency Services	15%	} 966,550
Asset Management	12%	
Commercial Banking	15%	
Corporate Finance	18%	
Payment and Settlement	18%	
Retail Banking	12%	
Retail Brokerage	12%	
Trading and Sales	18%	
<u>Samba Bank Limited - Pakistan (Basic Indicator Approach)</u>		
Overall Gross Income	15%	8,517
Samba Financial Group (Consolidated)		975,067

5.4. Capital Structure

Samba maintains an adequate capital base to cover risks inherent in its business operations. The adequacy of capital is actively managed and monitored using, among other measures, the rules and ratios established under Basel II / III regulations, as adopted by SAMA⁹.

The primary objective of Samba's capital management is to ensure that the bank maintains a sufficient level of capital at all times to meet / exceed all regulatory and internal requirements and achieve a strong credit rating while optimizing shareholder's value.

The total eligible capital (Tiers 1 and 2) calculated in accordance with SAMA guidelines is as follows.

SAR 000s

Common Equity Tier 1 capital: Instruments and reserves		
1	Directly issued qualifying common share capital (and equivalent for non-joint stock companies) plus related stock surplus	12,000,000
2	Retained earnings	12,926,090
3	Accumulated other comprehensive income (and other reserves)	14,925,463
4	Directly issued capital subject to phase out from CET1 (only applicable to non-joint stock companies)	
5	Common share capital issued by subsidiaries and held by third parties (amount allowed in group CET1)	12,901
6	Common Equity Tier 1 capital before regulatory adjustments	39,864,454
Common Equity Tier 1 capital: Regulatory adjustments		
7	Prudential valuation adjustments	
8	Goodwill (net of related tax liability)	23,613
9	Other intangibles other than mortgage-servicing rights (net of related tax liability)	
10	Deferred tax assets that rely on future profitability excluding those arising from temporary differences (net of related tax liability)	13,729
11	Cash-flow hedge reserve	-34,726
12	Shortfall of provisions to expected losses	
13	Securitisation gain on sale (as set out in paragraph 562 of Basel II framework)	
14	Gains and losses due to changes in own credit risk on fair valued liabilities	
15	Defined-benefit pension fund net assets	
16	Investments in own shares (if not already netted off paid-in capital on reported balance sheet)	1,067,451
17	Reciprocal cross-holdings in common equity	
18	Investments in the capital of banking, financial and insurance entities that are outside the scope of regulatory consolidation, net of eligible short positions, where the bank does not own more than 10% of the issued share capital (amount above 10% threshold)	
19	Significant investments in the common stock of banking, financial and insurance entities that are outside the scope of regulatory consolidation, net of eligible short positions (amount above 10% threshold)	
20	Mortgage servicing rights (amount above 10% threshold)	
21	Deferred tax assets arising from temporary differences (amount above 10% threshold, net of related tax liability)	
22	Amount exceeding the 15% threshold	
23	of which: significant investments in the common stock of financials	
24	of which: mortgage servicing rights	
25	of which: deferred tax assets arising from temporary differences	
26	National specific regulatory adjustments	
REGULATORY ADJUSTMENTS APPLIED TO COMMON EQUITY TIER 1 IN RESPECT OF AMOUNTS SUBJECT TO PRE-BASEL III TREATMENT		
OF WHICH: [INSERT NAME OF ADJUSTMENT]		
OF WHICH: ...		
27	Regulatory adjustments applied to Common Equity Tier 1 due to insufficient Additional Tier 1 and Tier 2 to cover deductions	
28	Total regulatory adjustments to Common equity Tier 1	1,070,067
29	Common Equity Tier 1 capital (CET1)	38,794,387
Additional Tier 1 capital: instruments		
30	Directly issued qualifying Additional Tier 1 instruments plus related stock surplus	
31	of which: classified as equity under applicable accounting standards	
32	of which: classified as liabilities under applicable accounting standards	
33	Directly issued capital instruments subject to phase out from Additional Tier 1	
34	Additional Tier 1 instruments (and CET1 instruments not included in row 5) issued by subsidiaries and held by third parties (amount allowed in group AT1)	4,269
35	of which: instruments issued by subsidiaries subject to phase out	
36	Additional Tier 1 capital before regulatory adjustments	4,269
Additional Tier 1 capital: regulatory adjustments		
37	Investments in own Additional Tier 1 instruments	
38	Reciprocal cross-holdings in Additional Tier 1 instruments	
39	Investments in the capital of banking, financial and insurance entities that are outside the scope of regulatory consolidation, net of eligible short positions, where the bank does not own more than 10% of the issued common share capital of the entity (amount above 10% threshold)	
40	Significant investments in the capital of banking, financial and insurance entities that are outside the scope of regulatory consolidation (net of eligible short positions)	
41	National specific regulatory adjustments	
REGULATORY ADJUSTMENTS APPLIED TO ADDITIONAL TIER 1 IN RESPECT OF AMOUNTS SUBJECT TO PRE-BASEL III TREATMENT		
OF WHICH: [INSERT NAME OF ADJUSTMENT]		
OF WHICH: ...		
42	Regulatory adjustments applied to Additional Tier 1 due to insufficient Tier 2 to cover deductions	
43	Total regulatory adjustments to Additional Tier 1 capital	-
44	Additional Tier 1 capital (AT1)	4,269
45	Tier 1 capital (T1 = CET1 + AT1)	38,798,656

⁹ Refer footnote on page 5

Tier 2 capital: instruments and provisions		
46	Directly issued qualifying Tier 2 instruments plus related stock surplus	
47	Directly issued capital instruments subject to phase out from Tier 2	
48	Tier 2 instruments (and CET1 and AT1 instruments not included in rows 5 or 34) issued by subsidiaries and held by third parties (amount allowed in group Tier 2)	4,040
49	of which: instruments issued by subsidiaries subject to phase out	
50	Provisions	1,438,035
51	Tier 2 capital before regulatory adjustments	1,442,075
Tier 2 capital: regulatory adjustments		
52	Investments in own Tier 2 instruments	
53	Reciprocal cross-holdings in Tier 2 instruments	
54	Investments in the capital of banking, financial and insurance entities that are outside the scope of regulatory consolidation, net of eligible short positions, where the bank does not own more than 10% of the issued common share capital of the entity (amount above the 10% threshold)	
55	Significant investments in the capital banking, financial and insurance entities that are outside the scope of regulatory consolidation (net of eligible short positions)	
56	National specific regulatory adjustments	
REGULATORY ADJUSTMENTS APPLIED TO TIER 2 IN RESPECT OF AMOUNTS SUBJECT TO PRE-BASEL III TREATMENT		
OF WHICH: [INSERT NAME OF ADJUSTMENT]		
OF WHICH:		
57	Total regulatory adjustments to Tier 2 capital	0
58	Tier 2 capital (T2)	1,442,075
59	Total capital (TC = T1 + T2)	40,240,731
RISK WEIGHTED ASSETS IN REPECT OF AMOUNTS SUBJECT TO PRE-BASEL III TREATMENT		
OF WHICH: [INSERT NAME OF ADJUSTMENT]		
OF WHICH: ...		
60	Total risk weighted assets	202,580,614
Capital ratios		
61	Common Equity Tier 1 (as a percentage of risk weighted assets)	19.2%
62	Tier 1 (as a percentage of risk weighted assets)	19.2%
63	Total capital (as a percentage of risk weighted assets)	19.9%
64	Institution specific buffer requirement (minimum CET1 requirement plus capital conservation buffer plus countercyclical buffer requirements plus G-SIB buffer requirement expressed as a percentage of risk weighted assets)	
65	of which: capital conservation buffer requirement	
66	of which: bank specific countercyclical buffer requirement	
67	of which: G-SIB buffer requirement	
68	Common Equity Tier 1 available to meet buffers (as a percentage of risk weighted assets)	
National minima (if different from Basel 3)		
69	National Common Equity Tier 1 minimum ratio (if different from Basel 3 minimum)	n/a
70	National Tier 1 minimum ratio (if different from Basel 3 minimum)	n/a
71	National total capital minimum ratio (if different from Basel 3 minimum)	n/a
Amounts below the thresholds for deduction (before risk weighting)		
72	Non-significant investments in the capital of other financials	
73	Significant investments in the common stock of financials	
74	Mortgage servicing rights (net of related tax liability)	
75	Deferred tax assets arising from temporary differences (net of related tax liability)	
Applicable caps on the inclusion of provisions in Tier 2		
76	Provisions eligible for inclusion in Tier 2 in respect of exposures subject to standardised approach (prior to application of cap)	1,438,035
77	Cap on inclusion of provisions in Tier 2 under standardised approach	2,172,777
78	Provisions eligible for inclusion in Tier 2 in respect of exposures subject to internal ratings-based approach (prior to application of cap)	
79	Cap for inclusion of provisions in Tier 2 under internal ratings-based approach	
Capital instruments subject to phase-out arrangements (only applicable between 1 Jan 2018 and 1 Jan 2022)		
80	Current cap on CET1 instruments subject to phase out arrangements	
81	Amount excluded from CET1 due to cap (excess over cap after redemptions and maturities)	
82	Current cap on AT1 instruments subject to phase out arrangements	
83	Amount excluded from AT1 due to cap (excess over cap after redemptions and maturities)	
84	Current cap on T2 instruments subject to phase out arrangements	
85	Amount excluded from T2 due to cap (excess over cap after redemptions and maturities)	

The above table is consistent with the Capital Structure Disclosure - December 2014 report previously disclosed on our website.

5.5. Capital Adequacy Ratio (Pillar 1)

Entity	Total capital ratio %	Tier 1 capital ratio %
Samba Financial Group (consolidated)	19.9%	19.2%
Samba Bank Limited, Pakistan	40.1%	39.3%

Samba has consistently maintained its capital adequacy ratio well above the regulatory minimum of 8%.

6. Credit Risk

In this section, Credit Risk components are disclosed according to the following dimensions:

- a. Basel asset classes used in the calculation of RWA;
- b. Geography, industry, maturity and risk weight buckets as defined by Basel;
- c. The effects of credit risk mitigation;
- d. Status of the loan book (performing / impaired) and corresponding loan loss reserves.

6.1. Asset Classes

Samba has a diversified credit portfolio, which is divided into the following asset classes as defined by SAMA¹⁰:

Sovereigns and Central Banks

Exposures to sovereigns and central banks carry a risk weight ranging between zero and 100 percent, depending on the external rating assigned by the relevant ECAs.

The average risk weight for this portfolio is 0.2%.

Banks and Securities Firms

SAMA has prescribed that exposures falling into this portfolio are to be treated according to Option 2 of the Basel II Accord, i.e. the risk weight is determined on the basis of external rating of the bank or securities firm assigned by a recognized ECAI. A preferential risk weight is assigned to short term exposures, defined as those exposures with a tenor of less than three months.

The average risk weight for this portfolio is 43.9%.

Corporates

This portfolio is assigned a risk weight based on the external rating of the counterparty, wherever available, with whom the exposure is held. Due to the fact that the majority of corporates in Saudi Arabia are not rated by ECAs, a regulatory risk weight of 100% is applied to a large portion of this portfolio.

The average risk weight for this portfolio is 93.5%.

Retail Non-Mortgages

This portfolio consists of loans to individuals, leases, credit cards and other consumer loans. SAMA requires that exposures not meeting certain granularity criteria be assigned a 100% risk weight, whereas the balance of the exposure under this asset class is assigned a flat 75% risk weight.

Mortgages - Residential and Commercial

SAMA has prescribed a risk weight of 100% for this asset class.

¹⁰ Per paragraph 4.1 of 'Basel II - SAMA's Detailed Guidance Document Consultative Draft No.2' issued 6th June 2006

Past Due Loans

Past due loans have been classified according to the regulatory definition, i.e. 90 days and above. These net exposures carry risk weights of either 100% or 150% depending on the level of specific provisions held thereagainst.

The average risk weight for this portfolio is 63.8%.

Equities

Equities include investments in private equity and shares quoted on the public stock exchanges and held in the banking book.

The average risk weight for this portfolio is 100.0%.

VIP/HNI

This portfolio has been defined to include exposures to high net worth individuals that fall outside the scope of Retail exposures. These would therefore include exposures to individuals in excess of SAR 5 million and are not managed on a pooled basis. For regulatory purposes these exposures are assigned a 100% risk weight.

The average risk weight for this portfolio is 99.4%.

Others

The standard risk weight for all other assets is prescribed at 100%. These typically include fixed assets, prepayments and sundry debtors. Cash and cash equivalents are assigned a risk weight of 0%.

The average risk weight for this portfolio is 22.0%.

6.2. Credit Exposure

6.2.1 Gross Credit Exposure

The gross credit exposure as presented in the table below is reflected before applying any credit risk mitigation, such as financial collaterals and guarantees.

SAR 000s

Portfolio	Credit Risk Exposure			Gross Credit Risk Exposure	Average Credit Risk Exposure **
	On Balance-Sheet	Off Balance-Sheet	Derivatives *		
Sovereigns and Central Banks	54,554,350	7,452	-	54,561,801	54,478,632
Banks and Securities Firms	22,927,837	3,444,172	2,991,100	29,363,110	27,744,763
Corporates	97,524,900	53,146,890	3,726,779	154,398,569	152,932,408
Retail Non-Mortgages	14,586,528	375	-	14,586,903	14,508,343
Mortgages - Residential and Commercial	5,660,634	-	-	5,660,634	5,576,503
Past Due Loans ***	1,824,956	-	-	1,824,956	1,963,391
Equities	214,455	-	-	214,455	173,870
VIP/HNI	9,964,941	221,258	12,328	10,198,527	10,465,807
Others ****	17,183,515	-	-	17,183,515	16,865,750
Total	224,442,117	56,820,145	6,730,207	287,992,469	284,709,467

* Samba holds SAR 224 Million as collateral in its favor against these positions from counterparties under margining agreements

** Averaged over the period

*** Includes impaired loans

**** Primarily fixed assets, cash, items in the course of collection, investments and sundry assets

The gross credit exposure for derivative instruments includes the replacement cost (current exposure) representing the cost of replacing the contracts at current market rates should the counterparty default prior to settlement date. It also includes the add-on for potential future exposure which is used to determine the RWA amount for these exposures.

6.2.2 Geographic breakdown of on-balance sheet credit risk exposures

SAR 000s

Portfolios	Geographic Area						Total
	Saudi Arabia	Other GCC	Europe	North America	South East Asia	Other Countries	
Sovereigns and Central Banks	41,351,572	724,937	2,795,030	9,116,312	39,065	527,432	54,554,350
Banks and Securities Firms	6,915,193	6,064,789	5,376,695	3,454,351	8,017	1,108,792	22,927,837
Corporates	85,503,550	8,054,563	1,292,759	1,391,040	55,363	1,227,627	97,524,900
Retail Non-Mortgages	13,981,848	600,003	-	-	-	4,677	14,586,528
Mortgages - Residential and Commercial	5,650,617	-	-	-	-	10,017	5,660,634
Past Due Loans *	1,815,808	7,522	-	-	-	1,626	1,824,956
Equities	213,914	-	-	-	-	541	214,455
VIP/HNI	9,964,941	-	-	-	-	-	9,964,941
Others **	16,767,327	212,058	5,005	-	-	199,125	17,183,515
Total	182,164,770	15,663,872	9,469,488	13,961,704	102,445	3,079,837	224,442,117

* Includes impaired loans

** Primarily fixed assets, cash, items in the course of collection, investments and sundry assets

Approximately 81% of Samba's portfolio is domiciled in Saudi Arabia, the host jurisdiction, thereby shielding it largely from the global financial markets. Through its expansion via acquisition in Pakistan, coupled with the opening of branches in Dubai and Qatar, Samba has sought to geographically diversify its credit risk exposure.

6.2.3 Industry sector breakdown of on-balance sheet credit risk exposures

SAR 000s

Portfolios	Industry Sector												
	Govt and Quasi Govt	Banks and Other Financial Institutions	Agriculture and Fishing	Manufacturing	Mining and Quarrying	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	54,554,350	-	-	-	-	-	-	-	-	-	-	-	54,554,350
Banks and Securities Firms	-	22,927,837	-	-	-	-	-	-	-	-	-	-	22,927,837
Corporates	-	-	4,734,480	21,460,394	3,224,859	9,316,262	11,631,397	19,177,903	15,780,653	10,057,381	-	2,141,571	97,524,900
Retail Non-Mortgages	-	-	-	-	-	-	-	-	-	-	14,586,528	-	14,586,528
Mortgages - Residential and Commercial	-	-	-	-	-	-	-	-	-	-	5,660,634	-	5,660,634
Past Due Loans *	-	-	354	41,044	-	22,118	873,367	66,522	1,402	659,020	127,122	34,007	1,824,956
Equities	-	-	-	-	-	-	-	-	-	-	-	214,455	214,455
VIP/HNI	-	-	-	-	-	-	107,392	8,997,568	-	1,640	-	858,342	9,964,941
Others **	-	-	-	-	-	-	-	-	-	-	-	17,183,515	17,183,515
Total	54,554,350	22,927,837	4,734,834	21,501,438	3,224,859	9,338,380	12,612,156	28,241,993	15,782,055	10,718,041	20,374,284	20,431,890	224,442,117

* Includes impaired loans

** Primarily fixed assets, cash, items in the course of collection, investments and sundry assets

6.2.4 Maturity breakdown of on-balance sheet credit risk exposures

The maturity profiles of credit exposures have been determined on the basis of the remaining period at the reporting date to the contractual maturity date.

SAR 000s

Portfolios	Maturity Breakdown									Total
	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	No Fixed Maturity	
Sovereigns and Central Banks	27,897	4,179,984	23,206,769	7,121	5,176,324	3,330,015	2,429,743	6,550,960	* 9,645,537	54,554,350
Banks and Securities Firms	11,244	115,961	772,580	1,696,568	711,550	4,777,078	796,225	14,046,632	-	22,927,838
Corporates	2,313,682	8,767,868	19,762,173	11,803,497	8,062,819	9,029,693	22,427,973	15,357,195	-	97,524,900
Retail Non-Mortgages	-	1,741,495	712,824	1,038,271	1,978,867	6,370,364	2,652,367	92,341	-	14,586,528
Mortgages - Residential and Commercial	-	46,643	93,261	139,598	278,443	1,090,595	1,009,671	3,002,424	-	5,660,634
Past Due Loans **	-	-	-	-	-	-	-	-	1,824,956	1,824,956
Equities	-	-	-	-	-	-	-	-	214,455	214,455
VIP/HNI	1,024,460	257,831	796,286	4,878,459	2,027,422	13,730	99,000	867,754	-	9,964,942
Others ***	-	-	-	-	-	-	-	-	17,183,515	17,183,515
Total	3,377,284	15,109,783	45,343,893	19,563,513	18,235,425	24,611,474	29,414,978	39,917,304	28,868,463	224,442,117

* Balances with Central Banks

** Includes impaired loans

*** Primarily fixed assets, cash, items in the course of collection, investments and sundry assets

6.2.5. Allocation of on-balance sheet exposures to risk weight buckets

An analysis of the portfolio by the regulatory risk weight buckets is presented in the table below:

SAR 000s

Portfolio	Risk Buckets						Total
	0%	20%	50%	75%	100%	150%	
Sovereigns and Central Banks	54,346,373	39,065	141,289	-	27,623	-	54,554,350
Banks and Securities Firms	-	4,961,268	17,528,382	-	438,187	-	22,927,837
Corporates	-	-	7,138,049	-	90,386,851	-	97,524,900
Retail Non-Mortgages	-	-	-	14,586,528	-	-	14,586,528
Mortgages - Residential and Commercial	-	-	-	-	5,660,634	-	5,660,634
Past Due Loans *	-	-	-	-	1,287,813	537,143	1,824,956
Equities	-	-	-	-	214,455	-	214,455
VIP/HNI	-	-	-	-	9,964,941	-	9,964,941
Others **	13,404,699	-	-	-	3,778,816	-	17,183,515
Total	67,751,072	5,000,333	24,807,720	14,586,528	111,759,321	537,143	224,442,117

* Includes impaired loans

** Primarily fixed assets, cash, items in the course of collection, investments and sundry assets

Exposures attracting 0% risk weight are primarily to Sovereigns and Central Banks which historically demonstrate an extremely low risk. In addition, cash and the positive fair value of derivatives contracts (as they are treated separately according to the current exposure method under Basel regulations - refer paragraph 6.2.6) also fall in the 0% risk weight category.

20% risk weight is applied to highly rated Banks and Corporates, whereas 50% is applied to lesser rated entities in the aforementioned asset classes. Retail exposures attract a 75% risk weight, while the remaining asset classes attract 100% risk weight. Past due exposures whose level of loan loss provisioning is only up to 20% of the outstanding exposure are assigned a 150% risk weight.

6.2.6. Exposures related to Counterparty Credit Risk (CCR)

Counterparty credit risk is the likelihood that bank's counterparty in a foreign exchange, interest, commodity, equity or credit derivative contract will default prior to maturity of the contract and the bank at that time has a claim on the counterparty. Counterparty credit risk is subject to credit limits like other credit exposures and is treated accordingly. Counterparty credit risk mainly arises in the trading book.

General disclosures for exposures related to Counterparty Credit Risk are presented in the table below.

SAR 000s

Particulars	Amount
Gross Positive Fair Value of Contracts	3,284,592
Collateral held:	
-Cash (Under Margining Agreements)	224,000
Exposure Amount (under the applicable method)	
-Current Exposure Method (CEM)	6,730,207
Notional Value of Credit Derivative Hedges	232,604,510
Current Credit Exposure (by type of credit exposure):	
-Interest Rate Contracts	3,009,730
-FX Contracts	3,031,566
-Equity Contracts	665,740
-Commodity/ Other Contracts	23,171

Samba uses the current exposure method to assess the counterparty credit risk in accordance with the credit risk framework and it is measured as the positive mark-to-market value plus the notional principal amount multiplied by the regulatory defined add-on factor. The size of the add-on depends on the contract's remaining lifetime and the underlying asset.

To reduce the exposure towards single counterparties, risk mitigation techniques are widely used. In addition Samba also mitigates the exposures towards large banks and financial institutional counterparties by an increasing use of financial collateral agreements called margining agreements, whereby collateral is topped-up on a regular basis - collateral is placed or received to cover the current exposure beyond certain agreed threshold on either side.

6.3. Credit Risk Mitigation

The gross credit exposures disclosed in the earlier sections have been stated prior to taking credit risk mitigation effects into account. In terms of the regulatory guidelines, not all forms of collateral currently used by Samba are recognized for the purposes of calculation of credit risk capital requirement. These ineligible collaterals include interalia, corporate and personal guarantees and equity shares.

The bank uses the comprehensive method for the treatment of financial collaterals which requires a standard supervisory haircut to be applied to the acceptable collateral to account for currency and maturity mismatches between the underlying exposure and the collateral applied.

The asset classes where Samba holds eligible Basel collateral are disclosed by portfolio in the table below:

SAR 000s

Portfolio	Gross Exposure	Covered by eligible financial collateral
Corporates	154,398,569	1,390,065
Retail Non-Mortgages	14,586,903	94
VIP/HNI	10,198,527	81,050
Total	179,183,999	1,471,209

Eligible financial collaterals under the Standardized Approach include¹¹:

- a. Cash (as well as certificates of deposit or comparable instruments issued by the lending bank);
- b. Bank Guarantees;
- c. Gold; and
- d. Debt securities.

¹¹ Per paragraph 15.4 of Additional Guidance Notes GN-2 contained in the 'Basel II Package of Bank Returns and Guidance Notes Regarding the Standardized Approach' issued on 29th March 2007 by SAMA

6.4. Impaired Credit Facilities and Provisions for Impairment

A specific provision (for accounting treatment of impairment in assets) is made for past due facilities in respect of individually assessed loans or claims. Samba calculates the specific provision according to the guidelines contained in IAS 39¹². These are calculated at counterparty level and the bank considers all the facilities for a counterparty to be defaulted if any one of the facilities of the counterparty is past due. The specific provisions are based on an assessment of the impairment in realizable value of the asset first at the facility level and then aggregated at the counterparty level.

6.4.1 Impaired Loans, Past Due Loans and Allowances (by Industry Sector)

SAR 000s

Industry Sector	Impaired Loans	Past Due (>90 days), not Impaired	Defaulted *	Ageing of Past Due Loans (days)				Specific & Portfolio Allowances
				Less than 90	90 - 180	180 - 360	Over 360	
Government and quasi government	-	-	-	-	-	-	-	-
Banks and financial institutions	-	-	-	3,397	-	-	-	236,770
Agriculture and fishing	354	-	354	12,575	-	-	354	11,968
Manufacturing	41,044	-	41,044	221,817	-	-	41,044	230,416
Mining and quarrying	-	-	-	-	-	-	-	13,723
Electricity, water, gas and health services	22,118	-	22,118	-	-	-	22,118	81,032
Building and construction	811,286	62,081	873,367	545,595	118,598	62,513	692,256	1,000,626
Commerce	66,522	-	66,522	61,288	0	79	66,443	245,012
Transportation and communication	1,402	-	1,402	-	-	-	1,402	59,321
Services	659,020	-	659,020	7,053	-	-	659,020	410,053
Consumer loans and credit cards	23,993	103,129	127,122	606,072	-	-	127,122	221,998
Others	34,007	-	34,007	11,922	625	334	33,047	156,721
Total	1,659,746	165,210	1,824,956	1,469,719	119,223	62,927	1,642,807	2,667,640

* In accordance with the Basel definition of default, all exposures which are 90 days or more past due are tagged as defaulted. These defaulted exposures include the impaired loans

¹² IAS 39: Financial Instruments: Recognition and Measurement' as issued by the International Accounting Standards Board

6.4.2 Impaired Loans and Allowances (by geographic area)

SAR 000s

Geographic area	Impaired loans	Specific and portfolio allowances
Saudi Arabia	1,572,652	2,563,088
Other GCC & Middle East	6,735	25,693
Europe	169	163
Other Countries	80,190	78,696
Total	1,659,746	2,667,640

6.4.3 Reconciliation of changes in the Allowances for Loan Impairment

SAR 000s

Particulars	Specific and portfolio allowances
Balance, beginning of the year	2,926,541
Charge-offs / Recoveries taken against the allowances during the period	(368,876)
Amounts set aside (or reversed) during the period	105,847
FX Translation difference (overseas Subsidiary)	4,128
Balance, end of the period	2,667,640

7. Market Risk

Market Risk is the risk that Samba's earnings or capital, or its ability to support its business strategy, will be impacted by changes in market rates or prices related to interest rates, equity prices, credit spreads, foreign exchange rates and commodity prices.

Samba has established risk management policies and limits within which exposure to market risk is monitored, measured and controlled by the Market Risk Management (MRM) division with strategic oversight exercised by ALCO. MRM is responsible for developing and implementing market risk policy and risk measuring / monitoring methodologies and for reviewing all new trading and investment products and product limits prior to ALCO approval. MRM has the primary responsibility to measure, report, monitor and control Market Risk in Samba. MRM is independent of Treasury business and reports into Risk Management.

Samba classifies market risk into the following categories:

Risk Item	Description
FX Risk	Foreign Exchange Risk is the risk arising from a change in exchange rates on bank's net asset / liability / off balance-sheet positions.
Interest Rate Risk (Trading Book)	Interest Rate Risk is the risk of holding or taking positions in debt securities and other interest rate related / fixed income instruments in the trading book and is two-fold: Specific Risk: Risk of loss caused by an adverse price movement of a debt instrument or security principally due to factors related to the issuer. General Market Risk: Risk of loss arising from adverse changes in market conditions.
Equity Risk	Equity Risk is the risk that the equity investments held in the trading book will depreciate due to equity market dynamics.
Options Risk	Is the implicit risk from an open option position arising from the option's sensitivity to a number of factors (Delta, Gamma and Vega risks).
Commodity Risk	Is the uncertainty of future market values and of the size of the future income arising from commodity trading positions due to price fluctuation.
Interest Rate Risk (Banking Book)	Interest Rate Risk (in the Banking Book) is the current or prospective risk to both the earnings and capital arising from the impact of adverse movements in interest rates on mismatches in asset-liability structure.

7.1. Sensitivity Analysis of Interest Rate Risk in the Banking Book

Sensitivity analysis of the Interest Rate Risk in the Banking Book (IRRBB) is presented in the table below.

SAR 000s

200bp Interest Rate Shocks for currencies with more than 5% of Assets or Liabilities	
Rate Shocks	Change in earnings
Upward rate shocks:	
SAR	(585,768)
USD	(729,602)
EUR	(416,488)
Downward rate shocks:	
SAR	471,329
USD	548,063
EUR	95,905

8. Operational Risk

Operational Risk is defined as the risk of loss resulting from inadequate or failed internal processes, people, systems and/or external events. It is evident that operational risk is inherent in all activities within the organisation, in outsourced activities and in all interactions with external parties. Management of Operational Risk requires robust internal controls coupled with quality supervision and management.

In Samba, Operational Risk Management (ORM) is an integrated function with all the underlying Operational Risk elements like Anti-Fraud, Quality Assurance, Business Continuity and Policy & Procedure forming a part of the operational risk management chain. Operational risk is embedded in each business area and risk mitigation techniques are applied to each activity. All products / services are covered in Self-Assessment Grids which are independently tested periodically and monitored on a global basis. Any exceptions and quality deficiencies are documented and monitored for resolution on Samba-wide basis. These are complemented by comprehensive reviews by Internal Audit / Quality Assurance unit. The analysis of operational risk related events, potential risk indicators and other early-warning signals are in focus when developing the processes. The exceptions / issues are highlighted and resolved at the senior level in Group Risk & Compliance Committee (GRCC). The global Key Risk Indicators (KRIs) for the top ten components of Operational Risk are monitored and the exceptions along with the heat-map are escalated to the Senior Management for resolution.

Mitigating techniques include a robust Information Security framework, strong Anti-Fraud / Compliance regime, comprehensive Physical / Access security and Certified Business Continuity plans together with crisis management preparedness and a broad insurance coverage for handling major incidents.

Each business area in Samba is primarily responsible for managing its own operational risk. Operational Risk Management Division develops and maintains a framework for identifying, assessing, monitoring and controlling operational risk and supports the line organisation in implementing the framework. Automation for operational risk management includes Loss Database, Risk & Control Self-Assessment process, KRIs and Corrective Action tracking. The techniques and processes for managing operational risk are structured around the risk sources as described in the definition of operational risk. This approach improves the comparability of risk profiles throughout the organisation including Samba's branches and subsidiaries. It also supports the focus on limiting and mitigating measures in relation to the sources, rather than the symptoms.

As described in chapter 5.3 the capital requirement for operational risk is calculated according to the Standardised approach, in which all of the institution's activities are divided into eight standardised business lines and the total capital requirement for operational risk is calculated as the sum of the capital requirements for each of the business lines. The risk for each business line is the beta coefficient multiplied by the average of the gross income from the preceding three financial years, where the beta coefficients differ between business lines and are in the range of 12% to 18%. Consequently, the operational risk capital charge is updated on an annual basis. The

Basic Indicator approach is used in Samba Bank Limited, a majority owned subsidiary incorporated in Pakistan.

9. Other Risks (Pillar 2)

In line with industry best practices, working papers issued by Basel Committee on Banking Supervision and SAMA directives¹³, Samba has integrated its capital planning and risk appetite definitions into its regular business budgeting and planning process.

The current ICAAP process encompasses the calculation of expected risk impact resulting from business strategies for the ensuing three year period and helps to evaluate whether Samba's capital funds are sufficient to support the level of risk. It also considers the impact on capital as a result of stress conditions and addresses means to raise capital should it fall below the stipulated levels.

For this purpose, two levels of risk are used as per regulatory guidelines:

- "Pillar 1" risks, which include Credit, Market and Operational risks. For these risks the minimum regulatory capital ratio is 8%.
- "Pillar 2" risks, which follow a wider definition and include additional risks such as Interest Rate Risk in the Banking Book, Concentration Risk, Strategic Risk and Legal Risk, etc. Banks are required to declare potential other risks to which they might be exposed to SAMA at the beginning of every year and are expected to maintain sufficient capital cushion at all times to cover these risks.

Samba Management has defined such Pillar 2 risks and has submitted its ICAAP Plan to SAMA outlining its minimum target levels of capital after setting aside additional capital cushion for such risks and is monitored through Supervisory Review Process.

The three year plan / strategy have been tested against these targets. Samba's plan demonstrates an adequate cushion over and above the minimum regulatory capital requirement and should remain within the set targets. Any potential large inorganic growth or deterioration in the economic environment will be addressed at the appropriate time. These projections have also been stress-tested to possible and hypothetical recessionary scenarios. Under these scenarios Samba would remain at all times within the regulatory minimum.

As part of this process a Capital Management Committee comprising of senior executive management reviews actual quarterly capital ratios against the above targets and initiates corrective actions if certain internal trigger levels are breached. The committee also has the mandate to evaluate the capital impact of major strategic decisions like acquisitions or major expansion, etc.

Samba Financial Group's Integrated Capital Plan for 2015 with high-level forecasts for subsequent years - 2016 and 2017 has already been submitted to Saudi Arabian Monetary Agency (SAMA), which has authority to assess the adequacy of the planning process.

The plan shows that Samba's current and foreseen capital endowment is suitable to support its business strategy in the forecasted years. A set of adequate tools is in place to monitor this process going forward and the exercise has strengthened the awareness of risk appetite and capital needs within all business units in Samba.

¹³ Per 'SAMA's Draft Guidelines on the Internal Capital Adequacy Assessment Plan (ICAAP)' issued by SAMA in December 2007

10. Glossary

Some important phrases that have been referenced in this report carry respective meaning or definition as detailed below:

Add-On

Basel II defined factor to reflect the potential future increase in exposure stemming from derivative transactions.

ALCO (Asset and Liability Management Committee)

A Committee within the governance process which is responsible for the development (and follow-up of implementation) of the ALM framework. The activities of the ALCO entail asset allocation, setting internal limits, decision-making on investments for the ALM positions, the use of ALM opportunities to stimulate specific commercial initiatives, the monitoring of the impact on and of the policies of the business units, and reporting on the ALM profile.

ALM (Asset and Liability Management)

The ongoing process of formulating, implementing, monitoring and revising strategies for on-balance-sheet as well as the off-balance-sheet liquidity items, in order to achieve an organisation's financial objectives, given the organisation's risk tolerance and other constraints.

Asset Class

A classification of credit exposures according to the SAMA Basel II regulatory guidelines. The main classes are Sovereigns, Bank and Financial Institutions, Corporates, Retail and VIP/HNI. Classification depends on the type of obligor, the total annual sales of the obligor, the type of product and/or the exposure value.

Banking Book

Banking book is defined as all positions in the group that are not in the trading book. A trading book consists of positions in financial instruments and commodities held either with trading intent or in order to hedge other elements of the trading book. To be eligible for trading book capital treatment, financial instruments must either be free of any covenants restricting their tradability or be able to be hedged completely. In addition, positions should be frequently and accurately valued, and the portfolio actively managed.

Beta-factor

The capital charge for a business line in the context of operational risk is approximated by multiplying the gross income of that business line with the beta (β) factor. The β factor serves as a proxy for the industry-wide relationship between the operational risk loss experience for a given business line and the aggregate level of

gross income of that business line. Under standardized approach of operational risk the β factors are regulatory given.

Business Risk

The potential negative deviation from the expected economic value of the organisation due to changes in the volumes and operational margins resulting from changes in the business environment coupled with inappropriate or inadequately implemented strategies.

CAR (Capital Adequacy Ratio)

Total eligible Capital as proportion of Risk-weighted Assets (the result must be at least 8% according to the Basel regulations).

CDO (Collateralised Debt Obligation)

A type of asset-backed security and/or a structured credit product. CDOs are constructed from a portfolio of fixed-income assets.

CDS (Credit Default Swap)

A privately negotiated bilateral agreement where one party (the protection-buyer or risk-shedder) pays a premium to another party (the protection-seller or risk-taker) in order to secure protection against any potential losses that may be incurred through exposure to a reference entity or investment as a result of an unforeseen development (or 'credit event').

CLO (Collateralised Loan Obligation)

CDOs holding only loans as underlying assets.

Credit Risk

Credit Risk is the potential shortfall relative to the value expected consequent on non-payment or non-performance by an obligor (a borrower, guarantor, counterparty to an inter-professional transaction or issuer of a debt instrument), due to that party's insolvency or lack of willingness to pay. Credit Risk can also arise due to events or measures taken by the political or monetary authorities of a particular country. The latter risk is also referred to as 'country risk'.

EAD (Exposure at Default)

The amount expected to be outstanding if and when an obligor defaults. At the time of default, it is equal to the actual amount outstanding, and therefore is no longer an expectation.

ECAI (External Credit Assessment Institution)

Institutions providing independent credit ratings which have been determined by SAMA to meet the eligibility criteria defined in the Basel II regulations.

Haircuts

The difference between the market value of a security and its collateral value. Haircuts are taken in order to account for a possible decline in the market value of a collateralising security upon liquidation.

ICAAP (Internal Capital Adequacy Assessment Process)

The internal process a bank should have in place for assessing its overall capital adequacy in relation to its risk profile, as well as its strategy for maintaining adequate capital levels in the planning period.

Interest Rate Risk

The potential negative deviation from the expected net asset value of the trading book or the financial investment book due to changes in the level of or in the volatility of interest rates.

IRB (Internal Ratings Based)

An approach defined in the Basel regulations to calculate the credit-risk-related capital requirements, where a financial institution uses its own models based on its own historical experience. There are two possibilities: the IRB Foundation or the IRB Advanced approach. When applying the IRB Foundation approach, internal estimates of the Probability of Default (PD) are used to calculate minimum capital requirements. The IRB Advanced approach also assesses internal estimates of Loss Given Default (LGD) and Exposure At Default (EAD). Under IRB Foundation Approach LGD is provided by the supervisory authority.

Liquidity Risk

The potential that an organisation will be unable to meet its obligations as they fall due because of the inability to liquidate assets or obtain adequate funding (liability liquidity risk) or the risk that it cannot easily unwind or offset specific exposures without significantly lowering market prices because of inadequate market depth or market disruptions (asset liquidity risk).

Market Risk

Market Risk is the potential negative deviation from the expected economic value of a financial instrument caused by fluctuations in market prices i.e. interest rates, exchange rates and equity or commodity prices.

Market Value

The cost that would be incurred or the gain that would be realised if an outstanding contract was replaced at current market prices (also called replacement value).

MTM (Mark-to-Market)

The act of assigning a fair market value to an asset.

Operational Risk

The potential negative deviation from the expected economic value of the organisation resulting from inadequate or failed internal processes, people and systems or from external events. This definition includes legal, IT and tax risk.

OTC (Over-the-Counter)

An over-the-counter contract is a bilateral contract where two parties agree on how a particular trade or agreement is to be settled in the future. It is usually a direct contract between a financial institution and its client. It contrasts with exchange trading, which occurs via corporate-owned facilities constructed for the purpose of trading (i.e. exchanges).

RWA (Risk-Weighted Asset)

An exposure weighted according to the 'riskiness' of the asset concerned. 'Riskiness' depends on factors such as the probability of default of the obligor, the amount of collateral or guarantees and the maturity of the exposure.

SAMA (Saudi Arabian Monetary Agency)

The regulatory authority responsible for the supervision of banks and financial institutions operating in the Kingdom of Saudi Arabia.

Samba (Samba Financial Group)

Samba or Samba Financial Group is interchangeably used in this report and connotes reference to the consolidated legal entity - the Samba Financial Group.

Trading Book

The trading book consists of positions in financial instruments and commodities held either with trading intent or in order to hedge other elements of the trading book. Positions held for trading intent are those held intentionally for resale in the short term and/or with the intent of benefiting from actual or expected price movements in the short term or to lock in an arbitrage profit.

End of Report