ALINMA BANK
(A Saudi Joint Stock Company)

BASEL III Pillar 3 Disclosures for FY 2014

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1. Overview

The Pillar 3 Disclosure for financial year ended 31st December 2014 for Alinma Bank (the Bank) complies with the Saudi Arabian Monetary Agency (SAMA) Disclosure Requirements (Pillar 3)," which is based on the guidelines issued by the Basel Committee on Banking Supervision (BCBS).

2. Scope of Application

The report is prepared after full-consolidation of the Bank and the following fully-owned subsidiaries (the Bank):

Subsidiary	Bank Ownership	Establishment date
Alinma Investment Company	100%	07 Jumada II 1430H (corresponding to May 31, 2009)
Al Tanweer Real Estate Company	100%	24 Sha'aban 1430H (corresponding to August 15, 2009)
Alinma Cooperative Insurance Agency	100%	29 Rabi Awaal 1435H (corresponding to January 30,2014)

3. Medium and Location of Disclosure

The Bank's Pillar 3 disclosure will be made available under the Financial Reports (Basel III section) of the Bank's website at www.alinma.com and as a separate report in the annual financial reports, after the notes to the financial statements.

4. Basis and Frequency of Disclosure

This Pillar 3 disclosure document has been designed to be in compliance with the SAMA's Pillar 3 Guidelines, and is to be read in conjunction with the Bank's Financial Statements for financial year ended 31st December 2014. The Qualitative Disclosure Requirements are reported annually.

5. Capital Structure

The Paid-up capital of the bank is SAR 15 billion consisting of 1.5 billion shares with a nominal value of SAR 10 per share. As of December 31, 2014, the shareholders' equity totals SAR 17.939 billion.

5.1. Subsidiaries and Associates

Alinma Investment Company: Based in Riyadh, the company is authorized to deal in securities as principal as well as agent, and to provide underwriting, custodianship, asset management, margin lending, advisory

and arranging services. The Company has an authorized capital of SAR 1,000 million and paid-up capital of SAR 250 million wholly subscribed by the Bank.

Al-Tanweer Real Estate Company: Based in Riyadh, formed as an SPV to facilitate mortgage financing and to only hold on behalf of the Bank, the title for real-estate pledged as collateral against commercial financing extended by the Bank. The company has an Paid-up capital of SAR 100,000 wholly subscribed by the bank.

Alinma Cooperative Insurance Agency: Acts as insurance agent for Alinma Tokio Marine (an associated company) with a capital base of SAR 3 million,

Tokio Marine Saudi Arabia: Based in Jeddah, the company is authorized to conduct insurance business in accordance with SAMA guidelines. The Bank has acquired 28.75% stake in company's capital of SAR 200 million. It commenced commercial operations on 18th June 2012.

5.2. Capital Transferability

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

6. Capital Adequacy

The table below illustrates the various approaches that are adopted at Alinma bank for capital requirements calculation under Basel III in relation to the various risk types under Pillar 1:

Credit Risk	Market Risk	Operational Risk
The Standardized Approach (TSA)	The Standardized Approach (TSA)	Basic Indicator Approach (BIA)

For Operational Risk, the Bank is ready to migrate from BIA to TSA in calculating the capital charge. The overall result of the pilot testing shows that:

- The regulatory operational risk capital using TSA is insignificantly lower than BIA;
- In TSA, the capital charge is allocated per business lines (the biggest part is in CBG).

In 2015, the bank will continue using the BIA pending SAMA approval for adopting the TSA. The Bank will also continue to collect loss data history and compare those against the allocated capital per business lines in preparation for the Advance Measurement Approach (AMA) that the Bank is planning to implement in the long term.

The Capital Adequacy Ratio (CAR) of the Bank as at 31st December 2014 stood at 26 %.

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7. Capital Management

A strong capital position is essential to make the Bank at par with its competitors. The forward looking capital strategy focuses on long-term stability, which aims to improve the Bank's profitability and resiliency. The following are the key objectives:

- Support the material risks facing the Bank;
- Optimize risk and return;
- Withstand market shocks and stress conditions.

Strategic and business plans & ICAAP are drawn up annually covering at least three years horizon:

- To accommodate the growth of core financing and investment of the various business units (Corporate Banking includes Commercial and SME Segment, Retail Banking and Treasury);
- To maintain stable sources of funding, liabilities and equity, to support the asset growth to maintain strong liquidity position;
- To keep the capital requirements within the local regulatory thresholds.

8. Internal Capital Adequacy Assessment Process (ICAAP)

ICAAP main objective is to make sure that there is enough capital vis-à-vis the overall risk profile of the Bank under normal and stressed condition. The ICAAP report is submitted to SAMA annually, Stress Testing is due semi- annually, and the capital requirements are refreshed quarterly as part of the various regulatory reports.

8.1. Risk Assessment under ICAAP Framework

Under the ICAAP, the following risk types covered:

- Pillar I - Credit Risk, Market Risk and Operational Risk;
- Pillar II - Residual Risks, Profit Rate Risk in Banking Book (PRRBB), Liquidity Risk, Strategic risk & Reputational risk, Macroeconomic and Business Cycle Risk and Credit Concentration Risk and Sharia Non-Compliance Risk.

8.2. Models and Methodology Employed

The Bank is using risk assessment techniques consistent with best/industry practice in the Kingdom. Where risks are not be easily quantified, expert judgment is adopted. The Bank's ICAAP has an established risk governance which include the following:

- Oversight through the Board's Risk Committee and EXCOM;
- Risk Policies governing the systems, procedures and internal controls;
  Effective risk monitoring and mitigation through the Credit, Market and Operational Risk Management Team with the RMG;
- Regular management reporting.
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8.3. Stress Testing

The Bank is performing stress testing semi-annually to test the overall risk profile's resilience under extreme but plausible conditions arising from macroeconomic, strategic, political and business environmental factors.

Under the Alinma Bank Stress Testing Policy and Framework, the potential unfavorable effects of stress scenarios on the Bank's profitability, asset quality, liquidity, risk weighted assets and capital adequacy are modeled. The stress scenarios are designed to assess the resiliency, solvency, liquidity and profitability . Among others, the following are the key risk (stressed) indicators:

- Assets quality – increase/decrease in nonperforming assets measured in terms of ratio to financing assets;
- Profitability – increase/decrease in the accounting profit/loss;
- Capital adequacy – measured in terms of changes in total amount of capital and the Capital Adequacy Ratio (CAR);
- Liquidity position – measured in terms of changes in key liquidity indicators. The Stress Test Working Group comprising various risk management teams tables the stress testing reports at the Senior Management and Board committees (RMC, and EXCOM) and discusses the results with regulators during annual bilateral meetings.

9. Risk Management

The risk landscape in which the Bank operates is evolving and a robust risk governance framework is required to keep the Bank abreast to these changes. In line with this, the Bank has following risk management's core principles on accountability, independence, structure and scope.

- The risk management approach has three lines of defense namely risk taking business units, risk control units and internal audit;
- The risk taking units are responsible for the day-to-day management of risks whereas the risk control units are responsible for setting-up the tools and methodologies for the risk identification, measurement, monitoring, control and testing. Complementing this is internal audit which provides independent assurance of the effectiveness of the risk management approach;
- The Chief Risk Officer, Chief Credit Officer, and the Credit Risk Managers assume the responsibility by independently reviewing and co-signing the approval through the Credit Committee, of all major credit proposals of the bank which are prepared and recommended by the Business Units. Moreover, Risk Management Group (RMG) oversees all the lines of business vis-à-vis the overall risk profile of the Bank;
- RMG ensures that the risk policies of the Bank are implemented, consistent and current vis-à-vis the overall risk profile and risk appetite thresholds;
- Risk management is functionally and organizationally independent to business;
- The Board is overall responsible for the risk oversight.

10. Risk Appetite Policy

The Risk Appetite Policy covers the Bank's risk taking-capacity, its desired financial position, the strength of its core earnings and the protection of its reputation and brand. The risk appetite is set and approved at the Board's Risk Committee, tracked and monitored at the business units and reported to the management, through the CRO regularly.

10.1. Credit Risk Management

Credit risk arises when the counterparty fails to fulfill his contractual obligation with the Bank. Towards this end, the Bank is performing robust due diligence for all its customers using internal rating system to determine the Obligor Risk Rating (ORR) to assess the obligor's probability of default. Ratings by the major credit rating agencies are also considered, if available.

Through the Credit Risk Officers, the Chief Credit Officer and the Chief Risk Officer, the Credit risk is controlled through continuous monitoring and assessment of the obligor or counterparty's ability to meet obligations customer's visits and regular review of their financial position and business status. The credit process seeks to identify early warning indicators as preventive measures. Credit limits are set to control the obligor's exposure in terms of type of transaction, tenor, repayment terms. Collaterals are also required as additional protection.

The Bank controls concentrations in the portfolio mix in terms of economic activity, geography, collateral or products. Alinma diversifies the portfolio through customer acquisition across economic sectors, diversifying the type of financing in terms of the short term working capital financing and the typically booking longer term fixed capital expenditure and project financing needs of its clients. Obligors and Sector Concentrations are being monitored by the RMG as well as the funding concentrations (Large Fund Providers) in the Treasury. Among others, the following type of concentrations are monitored regularly:

- Business Segments;
- Economic Sectors;
- Single Customer Groups/ Obligor /Counterparty;
- Banks & Non-Bank Financial Institutions;
- Risk Rating;
- Types of Collaterals (specifically those secured by real estate).

The bank regularly revised its credit polices to align with the actual economic, market and legal landscape.

10.2. Market Risk Management

Market risks are influenced by various factors including market volatility, business direction, macroeconomic factors. This is being controlled by setting market risk's limits and implementing risk policies along the regulatory requirements, Sharia guidelines and statutory regulations. The Market Risk Management Team under the RMG is independently monitoring the market risk exposure of the bank and preparing a regular report to ALCO, through the CRO. Among others, the following are monitored:

- Capital Adequacy Ratio (CAR);
- Liquidity coverage Ratio;
- Net Stable Funding Ratio (NSFR);
- Financing-to- Deposits Ratio;
- Currency Risk;
- Value-at-Risk (VAR);
- Economic Value of Equity (EVE);

- Funding Concentrations;
- Liquidity Gap Report;
- Treasury Investments Limits.

10.3. Operational Risk Management

The Bank's operational risk appetite is stratified using the following factors:

- Gauge of Materiality;
- Risk and Control Self-Assessment (RCSA);
- Loss Data History;
- Stress Testing Result.

The risk appetite is set at the entity level and distributed granularly at the unit level and further at the risk level through the KRI exercise.

11. Credit Risk

11.1. Overview

Credit risk is the potential failure of the counterparty to meet its obligations as per the agreed terms.
The following are the risk taking units:

- Corporate Banking Group (CBG);
- Retail Banking Group (RBG);
- Treasury Group (TG).

11.2. Provisions for Loans/Financing

The bank makes provisions according to guidelines set by SAMA. It therefore creates specific provisions for impaired accounts based on an assessment of the likelihood that the specific obligor will not meet his obligations. The bank also makes collective provisions on the remaining assets of the portfolio based on assessment of the probability of default and the loss in case of default. The periodic specific and collective provisioning strategies are reviewed and agreed by the Chief Credit Officer, the Chief Risk Officer, the Heads of the Business Units, the Chief Finance Officer and by the CEO.

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12. Market Risk

12.1. Introduction

Market risk is the risk that the probability that the fair value or the future cash flows of a financial instrument will fluctuate due to changes in market variables such as equity prices, profit rates, foreign exchange rates, and commodity prices.

12.2. Management of Market Risk

ALCO is responsible for monitoring the market risk exposure through the approved Risk Appetite and Treasury Risk Policies.

The objective is to manage volatility in earnings, control the liquidity risk at the Bank level with reporting to the Senior Management, ALCO, Board's Risk Committee, ExCom, Board of Directors and regulators.

12.2.1. Currency Risk

Currency risk is the risk that financial assets that are denominated in foreign currency lose value, or financial liabilities that are denominated in foreign currency gain value. The Treasury Risk Policy has set limits on net open positions by currency groups. There are limits for USD, Other G10 Currencies, GCC Currencies, and all the other currencies. The Bank has negligible exposure in foreign exchange because its assets and liabilities are mainly denominated in Saudi Riyals (SAR) and to a smaller extent in United States Dollars (USD) or in USD-pegged currencies.

12.2.2. Equity Price Risk

Equity price risk refers to the risk of decrease in fair values of the Bank's investments in equities. The Bank's portfolio of securities available for sale is regularly marked to market and positive/negative changes are taken into the Bank's equity, and the comprehensive income.

12.3. Capital Treatment for Market Risk

Alinma Bank computes the minimum capital requirements in market risk using the Standardized Approach. Similarly, capital charge is also calculated for Profit rate risk, foreign currency risk and liquidity risks.

Operational Risk

Operational risk is the risk of loss resulting from inadequate or failed internal processes, people and systems or from external events. Almost the entire bank operations carry the Operational Risk with varying severity.

The Bank has an independent Operational Risk Team under Risk Management Group monitoring and controlling the Operational Risks of the Bank. Functions of this unit are guided by the Operational Risk Policy and Framework. In addition, the Bank has implemented Business Continuity and Disaster Recovery program.

12.4. Management and Monitoring of Operational Risk

The ORM Framework is designed to maintain dependency between the risk management and the risk owners represented by the various business groups within the bank. While keeping the responsibility of managing the business within the business groups common grounds were established to involve the operational risk management team in facilitating the risk identification, measurement and assessing of risks and relevant controls, including documenting and tracking the risk mitigation plans, or risk acceptance.

During the year, the operational risk management team has conducted specialized data gathering through meetings with business heads and senior management endeavoring to gain a clear understanding of business directions by cascading the relevant business unit strategic objectives. The approach is designed to associate the management directions, with the allocated operational risk appetite, and the risk profile.

In preparation for and before commencing the risk identification and assessment activity across the bank, a comprehensive risk awareness program was developed and implemented involving management, risk champions and respective risk owners.

Covering all business and support units within the bank specific risk profiles containing key and significant risks presented at their residual values was arrived at after detailed assessment and testing of the respective controls. A detailed risk heat-map is formed in consultation with business group management to draw their attention to significant and key risks that requires management attention and action on a priority basis.

12.5. Measurement of Operational Risk (OR) Capital Charge

Operational Risk capital charge is calculated using the Basic Indicator Approach (BIA) as per SAMA and BASEL III regime. The BIA for operational risk capital charge calculation applies an alpha (15%) to the average of positive gross income that was achieved over the previous three years by the Bank. The Bank aims to move towards the Standardized Approach (SA) for Operational Risk Capital Charge Calculation in 2014. In this context, the Bank will formally seek SAMA approval for adopting the TSA for 2014. The Bank will also continue to collect loss data history and compare those against the allocated capital per business lines in preparation for the Advance Measurement Approach (AMA) that the Bank is planning to implement in the long term.

13. Sharia Non-compliance Risk

Being an Islamic bank, the Bank is exposed to the risk of Sharia non-compliance. In order to monitor such risks the Bank has established an independent Sharia Board and a Sharia Compliance Audit Unit under Sharia'h Group.

13.1. Sharia Governance

The Sharia'h Compliance Framework was formulated to enable Alinma Bank to communicate its strategies towards the effective and efficient Sharia compliance risk management throughout the organization in line with the Sharia principles. The Sharia Compliance Framework is the enterprise-wide Sharia management plan consisting of Sharia'h Governance Structure, systems processes and control to be undertaken by relevant business entities across the group. The Sharia governance is affected through the following functions:

- Sharia Review;
- Sharia Advisory & Research;
- Sharia Audit.

13.2. Sharia Board

The operation of the Islamic Bank is governed by Sharia'h law of Islamic Banking which stipulates that any licensed Islamic bank is required to provide for the establishment of Sharia'h advisory body to advise the bank on the operations of its business in order to ensure that it does not involve any element which is Sharia'h non-compliant.

The Sharia'h Board is responsible to:

- Advise the Board on Sharia matters in its business operations;
- Endorse Sharia Compliance Manual and Framework;
- Endorse and validate relevant documentations;
- Advise the Bank on the computation and distribution of Zakat;
- Assist related parties on Sharia matters;
- Provide written Sharia opinion.

13.3. Rectification Process of Sharia Non-Compliance Income

The control structure for handling and reporting Sharia'h non-compliance and Potential Sharia'h Non-compliance has already been put in place.

Key measures undertaken by the bank for managing Sharia'h Compliance risk include having in place the following processes:

- Awareness and Communication;
- Identification and assessment;
- Mitigation and control; and
- Monitoring and reporting.

14. Liquidity Risk

Liquidity risk is the risk that the Bank will encounter difficulty in meeting obligations associated with its financial liabilities that are settled by delivering cash or other financial assets. Liquidity risk can be caused by market disruptions or credit downgrades, which may cause certain sources of funding to dry up. To mitigate this risk, management actively pursues the diversification of funding sources; assets are priced taking liquidity into consideration; the Bank maintains an adequate balance of cash and cash equivalents.

The recent global financial crisis has resulted in a significant change in the regulation and supervision of liquidity risk in financial institutions. Arising from the Basel III liquidity risk management requirements, two ratios are used to manage liquidity risks: Liquidity Coverage Ratio (LCR) and Net Stable Funding Ratio (NSFR).

14.1. Liquidity Risk Management Approach

In terms of day-to-day liquidity management, the Treasury Business Support unit ensures sufficient funding to meet its intraday payment and settlement obligations on a timely basis.

The process of managing liquidity risk also includes:

- Maintaining a sufficient amount of unencumbered high quality liquidity buffer as a protection against any unforeseen interruption to cash flow;
- Managing short- and long-term cash flow via maturity mismatch report and various indicators;
- Monitoring depositor concentration at Bank level to avoid undue reliance on large fund providers;
- Diversifying funding sources to ensure proper funding mix;
- Ensuring that regulatory ratios such as SAMA Liquidity Ratio, LCR and NSFR are maintained at the required minimum;
- Conducting biannually liquidity stress testing under various scenarios as part of prudent liquidity control to examine the effectiveness and robustness of the plans.

All liquidity policies and procedures are covered by the Treasury Risk Policy which is subject to review and approval by the Executive Committee of the Board (EXCOM).

In accordance with Banking Control Law and the regulations issued by SAMA, the Bank maintains a statutory deposit with SAMA equal to 7% of total demand deposits and 4% of customers' time investments. In addition to the statutory deposit, the Bank also maintains liquid reserves of no less than 20% of its deposit liabilities, in the form of cash and assets, which can be converted into cash within a period not exceeding 30 days.

The Bank has the ability to raise overnight funds through special investment arrangement facilities with SAMA (i.e. Murabaha with SAMA).

15. Profit Rate Risk in Banking Book

Profit rate risk arises from changes in profit rates which affect either the fair values or the future cash flows of profit-rate sensitive financial instruments in the Banking Book.

15.1. Yield sensitivity of assets, liabilities and off balance sheet items

The Bank manages exposure to the effects of various risks associated with fluctuations in the prevailing levels of market profit rates on its financial position and cash flows. The Bank uses the SAIBOR for lending as a benchmark rate for different maturities. At times when these benchmark rates are not representative of the actual transactions in the market, marginal cost-of-fund is provided by Treasury. The Bank charges profit rates based on the maturity of loans (longer term financing requires a higher profit rate).

16. Macroeconomic and business cycle risk

The Macroeconomic and business cycle risk is a risk factor that will in turn give rise to other risk types like credit, market or liquidity. The Bank has assessed this risk using hypothetical but plausible scenario based analysis. The major activity of the Bank is financing, so it is assumed that the impact of such risks would be primarily on the credit risk.

17. Strategic Risk

Strategic Risk of the Bank refers to the risk to its earnings and profitability arising from its strategic decisions, changes in the business conditions and improper implementation of decisions. Thus, Strategic Risk arises due to external causes, arising out of adopting wrong strategies and choices that can cause loss to the Bank in the form of reduction in shareholder value, loss of earnings, etc.

The Bank has assessed its Strategic Risk based on a very conservative scorecard approach considering various risk drivers / factors related to strategic planning process and Implementation capabilities.

18. Reputational Risk

Reputational Risk refers to the potential adverse effects, which can arise from the Bank's reputation being sullied due to factors such as unethical practices, regulatory actions, customer dissatisfaction and complaints, negative/adverse publicity and etc.

The Bank has assessed the Reputational Risk based on a scorecard approach. The scorecard benchmarks various risk drivers to best practices and generates an overall score.

19. Risk Based Compensation

The Bank has established a Risk-based compensation framework to align the salary and bonuses of employees vis-à-vis their risk taking activities. The core of the implementation is in the performance objective setting and appraisal process at the entity and individual staff's level. The purpose of this effort is to balance the risk vs. reward in pursuing the strategic and business objective and embed risk management into the day-to-day operations of the Bank. The following are the employee categorization arranged by criticality of risk activities:

- Senior Executives requiring SAMA no objection -these employees are Group Heads having authority and responsibility for planning, directing and controlling the activities of the Group;
- Employees engaged in risk taking activities - these employees sit within business areas / divisions / subsidiaries engaged in risk taking activities (Retail Banking, Corporate, Treasury, selected subsidiary departments). They are officers who have direct responsibility and are the key drivers in undertaking business transactions and managing business risks. Such officers may be undertaking these risks on an individual basis or overseeing a group of employees undertaking such risks;
- Employees engaged in control functions - such employees are defined as undertaking a role through which they support the profit generating functions by providing financial and risk control and compliance oversight. Such functions include Finance (financial control), Risk Management, Legal, Compliance, Sharia Compliance, and Internal Audit;
- Other employees - these are all other full time staff not deemed to be 'senior executives requiring SAMA no objection' or 'employees engaged in risk taking activities';
- Outsourced Employees / Service providers engaged in risk taking activities - these employees are outsourced by business areas / divisions / subsidiaries engaged in risk taking activities (Retail Banking, Corporate, Treasury, selected subsidiary departments). Such employees may either be deemed individual risk takers or sitting within a collective group of risk takers.