



Bait Al Mal Al Khaleeji (BMK)
PILLAR 3 REGULATORY CAPITAL DISCLOSURES

For the period ended December 31, 2016

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Bait Al Mal Al Khaleeji

Investment Services Company

Licensed by CMA - No. 08123-37

CR: 2050065112 - Saudi Closed Joint Stock Company - Paid Up Capital : SR 80,000,000

Pillar III Disclosure:

This disclosure is presented by Bait Al Mal Al Khaleeji ("BMK") licensed by Capital Market Authority ("CMA") license number 08123-37.

Overview:

This disclosure sets the minimum requirements for the annual market disclosure of information as referred to by the article 68 of the Prudential Rules (PRs).

Purpose:

The purpose from this disclosure is for the market participants to assess the key pieces of information on the scope of application, capital, risk exposure, risk assessment processes, and hence the capital adequacy of the APs.

Capital Structure:

Amount of Tier I capital:

Description	Amount 2016	Amount 2015
Paid-up capital	80,000,000	80,000,000
Audited retained earnings	(33,376,837)	(34,089,871)
Total amount of Tier 1 capital	46,623,163	45,910,129

Amount of Tier II capital:

Description	Amount 2016	Amount 2015
Credit risk	29,770,020	29,437,240
Market risk	-	5,135
Operational risk	2,243,099	1,902,387
Total Tier 1	32,013,119	31,344,762
Concentration risk	7,264,922	7,343,284
Liquidity risk	260	825
Legal risk	-	-
Strategic risk	338,184	454,442
Reputational risk	2,382,484	1,960,799
Total Tier 2	9,985,850	9,759,350
ICAAP capital requirement	41,998,969	41,104,112
Additional capital required	(1,649,889)	(1,664,354)
Capital Base	46,623,163	45,910,129
Surplus (Deficit) in Capital Base	2,974,305	3,141,663
Capital Ratio	1.46	1.46

Capital Adequacy:

Risk appetite is defined as the magnitude of all risks that the Company is willing to undertake in order to achieve its desired business objectives. Risk appetite is reflected by risk indicators, and is managed by well-defined risk limits based on the risk area.

Currently, the ICAAP represents the capital requirements that are minimally required to meet the business needs and cover future losses that may arise to the Company.

The business strategy of the Company will be defined in alignment with the risk strategy and appetite of the Company keeping in view the same action plan that the Company is following the foregoing approach.

Timing

- The effective date of ICAAP calculations for the purpose of its submission to authorities is 29 May 2017. The events during the intervening period have been considered for their potential impact on the ICAAP. The major events noted during the period were swap of equity investment with the unit of mutual funds (equity based) under management. The plan to dispose real estate investments. These events do not expect to have any change in the model or basis on which ICAAP has been prepared because swap of investment is just another form of investment responsive to same risk profile. However, investment in real estate is still considered as a high risk exposure because it is being the quantum of investment involved in it.
- The capital has been assessed over a horizon of one year either using a historical data or budgeted growth factors. Since, the Company is being engaged in asset management business and most of its assets either in the short term category or planned to be utilized in the same horizon as such: equity investments, later swapped with mutual fund investments, are being held primarily for trading purposes and real estate investments have been planned to be diluted in upcoming period.

Risk Management:

The Company's assessment of risk profile led to the identification of following risk under:

1) Pillar I

- a) Credit risk;**
- b) Market risk; and**
- c) Operational risk.**

2) Pillar II

- a) Concentration risk;
- b) Liquidity risk;
- c) Legal risk
- d) Strategy risk; and
- e) Reputational risk

The characteristics, assessment and methodology followed in assessment of each of the above risks are detailed hereunder:

a) Credit risk

The Company does not regularly make investments in any of the categories other than HFT. Hence, credit risk is identified pertaining to its only investment in real estate sector, which mainly comprises of land.

The Company calculates the capital charge for credit risk by applying the Standardized Approach as used in regulatory return for Pillar I. In using this approach, all balances (Company and others assets) and investments, excluding the trading portfolio, are categorized into the relevant buckets as prescribed in guidelines. Appropriate risk weights, based on credit ratings of counterparties are applied to determine the Company's overall credit risk weighted assets. The Investment portfolio of the Company includes investments in shares of land i.e. real estate, which have been classified as investment properties being held to be used in the business. The investment property is carried at cost and is subject to credit risk under the standardized approach as promulgated by CMA through its regulation.

The Company considers it sufficient for internal purposes as well. The difference between the return filed and ICAAP is downgrading of risk category of real estate investment risk from high risk weight of 714% to its regular weight of 400%. It was held in the high risk category because of being part of prohibited exposure. For ICAAP purposes it is taken at regular level and has been taken into account in the concentration risk. Additionally, the management has commenced the available option to utilize the land into business opportunity and the fair value as per the valuation from two independent evaluators is higher than its book value. Accordingly, in the presence of viable utilization plan it is not considered a direct high credit risk item. This has resulted in reduction of capital charge from SR 41,998,969 (2015: SR 41,104,112) to SR 32,013,119 (2015: SR 31,344,762). Following is the GAP Analysis schedule:

Sr.	Description	Balance sheet as at 31 Dec 2016	0-30 days	1-3 months	3-6 months	6 months-1 year	1 year-2 years	2 years-5 years	More than 5 years
ASSETS									
	Cash & cash equivalents	16,845,226	16,845,226						
	Held-for-trading investments	-							
	Prepayments and other receivable	2,068,735	1,034,368	206,874	802,669	24,325		500	
	Investment properties	28,182,027				28,182,027			
	Property and equipment	597,703					298,852	298,852	
	Total assets	47,693,691	17,879,594	206,874	802,669	28,206,352	298,852	299,352	-
	Total assets after 5% stress of run offs	45,309,006	16,985,614	196,530	762,536	26,796,034	283,909	284,384	-
Liabilities									
	Accrued and other liabilities	389,306	59,875	219,919	35,038	74,474			
	Zakat payable	463,300			463,300				
	Employee termination benefits	217,922					217,922		
	Total liabilities	1,070,528	59,875	219,919	498,338	74,474	217,922	-	-
	Net gap		16,925,739	(23,389)	264,198	26,721,560	65,987	284,384	-
	Cumulative net gap		16,925,739	16,902,349	17,166,548	43,888,108	43,954,095	44,238,478	44,238,478
	Operational cashflows available stressed at 10%		877,043	(11,741)	690,868	(45,134)	268,966	450	-
	Net GAP after cashflows		17,802,782	(35,130)	955,067	26,676,426	334,953	284,834	-
	Average funding requirement upto 1 year		-	(8,662)	-	-			
	Total annual funding requirement					(8,662)			

b) Market risk

The market risk of the Company lies in Held for Trading "HFT" equity investments. This risk is being assessed as per its risk management policy manual using a Value at Risk "VaR" model. The Company's HFT exposure's VaR is computed based on 1 year historical data using a 99% confidence level with the assumption of 1 day holding period.

For the purposes of ICAAP a conservative approach is following this VaR which is compared with regulatory capital requirement and higher amount is considered. Currently, the VaR is lower than regulatory allocated capital. Hence, the regulatory charge is also considered as internal capital requirement as well.

VaR is a widely used measure for the assessment of portfolio risk. However, it has a drawback of excusing risk correlation co-efficient, but it is still widely used so far has proven to be an appropriate measure of portfolio analysis and management.

c) Operational risk

Operational Risk within the Company mainly originates from the following events:

- a) Fraud (internal and external);
- b) Error resulting from the direct or indirect actions of staff;
- c) Risk of information systems failure;
- d) Absence of standard operating procedures; and
- e) Non-adherence to policies and procedures;

The Company has a well-defined policies and procedures manual duly approved by the Board of Directors. Policies and procedural manual is designed in such a way to prevent, detect and correct inherent risks in the business.

Operational risk, being moderately significant, is effectively managed through control processes established in standard operating procedures for each business line, obtaining insurance where appropriate, as well as a comprehensive internal audit and review process.

Assessment of the operational risk is performed through event/instance analysis on the basis of criteria included in its risk management policy framework. The management of operational risks in the three infrastructural elements namely: People, Systems and Processes of the Company.

The approach for operational risk followed is same as used in regulatory return. Since, the budgeted position of the Company is growing, the capital charge allocated for regulatory purposes is considered to be the best representative of its appetite.

d) Concentration risk

The financing and investment portfolio of the Company consists of exposures in two economic sectors namely equity portfolio/investment funds and real estate. Since all the equity investments are classified as HFT and individually none of those hold a significant value or excessive exposure only investment in land is considered for the purposes.

Any exposure over and above the 25% of the total available capital of the Company is considered as highly concentrated and is considered for risk measurement. Any amount that is higher than the sated limit is subjected to maximum credit risk weight of 714% minus its regular credit risk weight already applied in credit risk measurement. The resultant amount is factored by 14% to arrive at capital charge.

The capital limit is taken from regulatory guidelines as the Company is allowed to have an exposure over and above this amount.

e) Liquidity risk

The Company's liquidity risk is assessed through mismatch of assets and liabilities maturities over at least next one year's horizon.

The liquidity risk is assessed using the maturity ladder approach which involves analyzing liquidity gaps in different time periods. This approach enables the Company in assessing the gaps between the inflows and the outflows so that remedial measures could be taken in time.

The negative gaps due to mismatches between the maturities of the assets and liabilities are taken and adjusted with operational cash flows that are already stressed at 10%. An annual average funding requirement is computed using the net negative gaps and a cost of fund is arrived at. This cost is taken as capital charge because it is presumed to have direct effect on the earning.

Currently, the maturity mismatch of the Company is in positive condition, hence, the measured amount of risk is also Nil.

Currently the liquidity is monitored by the management and BOD through projected cash in certain future period.

f) Legal risk

Legal risk is arising from uncertainty due to legal actions or uncertainty in the applicability or interpretation of contracts, laws or regulations. Legal risk also includes risk arising from the lack of proper documentation of contracts.

The Company assesses the extent of legal risk by monitoring certain indicators which are indicative of risk concerns. The indicators are:

- a- Internally identified erroneous non-compliances;
- b- History of non-compliance events identified by CMA;
- c- No. of cases filed against the company;
- d- Duration of time for each case;
- e- Strength of documentation of each case. e.g. the strength of collateral documentation;
- f- Value of the claim; and
- g- Complexity involved in the case i.e. regulatory concerns, cross-border cases.

The risk is measured by taking the un-avoidable and covered legal cases against the Company. These are factored at business growth factor to arrive at capital charge amount.

g) Strategic risk

Strategic risk arises from inaccurate business decisions, changes in the economic environment, deficient or insufficient implementation of decisions, or a failure to adapt to changes in the economic environment.

The sources of strategic risk are categorized into 3 components:

- a- Strategic governance and oversight;
- b- Strategic formation; and
- c- Strategic implementation

Strategic risk is assessed using the negative variance between actual return on assets and budgeted return on assets which using a 99% confidence level are used to compute the worst case loss. This loss after dividing with budgeted net asset employed provides the worst loss case capital charge. This capital charge is decayed over a score where the average score from a survey within the organization is used to choose the relevant charge.

Those factors used for scoring are also used to analyse the qualitative aspect of strategy alignment.

h) Reputational risk

The reputation risk can arise from following sources:

- a- No. of complaints lodged by customers;
- b- Failure to comply with regulatory or legal obligations;
- c- Failure to deliver minimum standards of service and product quality to customers;
- d- Unethical practices in the conduct of business;
- e- Failure to achieve financial performance targets;
- f- Association with suppliers, partners and alliances with poor reputations; and
- g- Employee dissatisfaction and negative publicity by media.

Due to limitation of data and any other measure in the absence of the Company's market capitalization the following steps are used to qualitatively keep the risk under controlled.

- Effective communication with stakeholders; and
- Enforcement of controls on governance, business and legal compliance.