RISK MANAGEMENT

The Bank regularly reviews the policies and systems of risk management, and keeps up with market and product changes, in order to adopt and implement best international banking practices.

A Primary part of the nature of a bank's businesses to be exposed to risks. To avoid them, these risks are monitored and managed by the Risk Management Group in the bank which is responsible for managing credit risks, market risks, operational risks, anti-fraud risks and information security risks. And abiding by the requirements of Saudi Central Bank and Basel Committee. A full description of these risks is found in the representations attached to the consolidated financial statements notes from 29 to 34 considering them complements to the report of the Board of Directors. Below is a short summary of these risks:

Such risks are monitored and managed through the Bank's Risk Management Group, whose tasks include managing a range of risks, as well as ensuring compliance with the requirements of the Saudi Central Bank (SAMA) and the Basel Committee. A full description of the mentioned risks is found in the representations attached to the Consolidated Financial Statements notes 29 to 34, which forms part of the Board of Directors' report. Below is a short summary of these risks:

Throughout 2020, the Risk Management Group continued to focus on improving the effectiveness of its risk management system, while implementing best practices to ensure that the Bank's activities maintain the right balance between achieved returns and expected risks.

The Group's framework is based on three key pillars, namely the sound principles of risk management the organizational structure, and risk measurement and monitoring. These practices should align with the banking activities to ensure that risks are maintained at an acceptable level. The Risk Management Group operates separately and independently from the Bank's other business groups and divisions, in line with SAMA's guidelines and Basel Committee's requirements.

The Bank implements frameworks to identify, measure, monitor and manage risks, covering credit risk, market risk, liquidity risk, operational risk and fraud risk. The Bank regularly reviews the policies and systems of risk management, and keeps up with market and product changes, in order to adopt and implement best international banking practices.

1. CREDIT RISK

Credit risk is one of the key risks to which the Bank is exposed, mainly through financing and investment activities. Managing credit risks involves multiple units that operate under a unified system in accordance with approved credit policies and procedures.

a. Measurement of Credit Risk Degree

The Bank measures the degree of credit risk to identify the qualitative and quantitative amounts of risk to which it might be exposed, and to determine the degree of credit risks to which the Bank is actually exposed. The Bank employs an advanced system for the internal assessment of the degree of credit risk to which corporate banking, retail banking, financial institution clients, corporations and small and medium enterprise clients may present. This assessment helps measure the probability of default, the volume of projected default and the likely or possible amount of losses resulting from such default. To ensure a more accurate and fair assessment of risk degree, the Bank continues to improve its assessment methods and applies a different assessment methodology Additionally, the Bank has put in place a system to measure the level of risk for retail banking clients.

b. Credit Risk Mitigation and Control

The Bank employs several methods of assessment aimed at mitigating the degree of credit risk within reasonable levels. Such methods include analyzing future data in order to measure the client's ability to meet financing obligations. Credit approvals in such cases are issued by several levels and several credit committees composed of Bank executives, or by Board-level committees. The approval depends on the degree of credit risk, potential credit loss and the total volume of credit facilities provided to each client depending on the credit authority matrix. In addition to these measures, the Bank requires clients to provide such reasonable collateral as is deemed necessary against the facilities to be provided. There are many types of collateral against facilities, such as cash coverage, mortgage against investments and assets for the Bank, mortgage of commercial and residential real estate assets, waiving project returns in certain instances of project financing, as well as requiring financial, personal or thirdparty guarantees against the facilities. Guarantees under a sponsor guarantee program for the financing of small and medium enterprises (SMEs) should be collected as long as the program's terms are met However, financing for individuals is on the basis of conditions that involve specific credit standards to be met and require the transfer of the client's salary to the Bank. This type of financing also requires that the credit portfolio involves no concentration of credit risk, as well as the conformity of credit exposure levels with relevant established controls, be it exposure to a certain entity or a specific sector or activity.

c. Monitoring and Reporting

The Bank, at minimum, conducts a comprehensive annual credit review of the financial and credit positions of all clients who are financed through corporate and retail banking services. This review ensures that the client's status, and their financing needs, is sustainable and that the smooth functioning of credit relations with them remain viable. The Bank also conducts reviews that involve regular visits to financed clients throughout the year. The bank also measures and monitors early warning signs for its clients on a periodical basis to ensure the safety of their credit Position.

High credit risk corporate clients are categorized as clients who require special supervision. Their credit exposure is closely and carefully monitored and reviewed bi-annually in order to properly mitigate the risk exposure. On the other hand, the Bank conducts comprehensive monitoring of the portfolio of retail banking clients who have obtained credit facilities for consumer purposes and credit cards. This involves the evaluation of established standards for each segment in the portfolio independently.

The Bank calculates the appropriate level of credit provisions in its records and financial statements in accordance with recognized international financial standards for accounts that may incur losses. This measure is adopted when there are indications that circumstances exist which may affect the expected cash flow of these assets or investments and that such provisions are required. The bank also reviews the inputs and assumptions employed to specify expected credit losses such as adjusting the factors/inputs of the macroeconomy that the bank uses in the form of expected credit losses including missing payment rates taking into consideration the economic changes that are the result of Corona virus (COVID-19) impact

The Bank also prepares a comprehensive monthly status report for its portfolio, analyzing the concentration of credit exposure, and comparing it with approved percentages. This report is submitted for the Bank's Senior Management's review and supervision.

2. MARKET RISK

Market risks are among the key risks to which bank activities are exposed, where fluctuations in price, profit margin rates and foreign exchange rates lead to negative outcomes and may consequently result in lossesfor the Bank. Additionally, the sudden and significant change in these rates may affect the Bank's liquidity position as well as its financing ability. Market risk involves several main risks to which the Bank is exposed, including:

Profit rate risk: Known as the potential impact on the Bank's profitability due to fluctuations in market return rates. These changes often occur as a result of overall market activity, or due to specific reasons affecting the borrower.

Foreign exchange risk: The risk resulting from Exchange rate fluctuations, which impacts both the Bank's profitability and shareholder rights and exposes the Bank to increased risk. Managing the Bank's market risk is generally based on monitoring market conditions and seeking to increase return within the limits of approved market risk policies, as well as within the Bank's acceptable risk levels.

Price Risk

The risk that the value of a security or investment will decrease.

The Bank is exposed to market risks from the following sources: **Trading portfolios:** Risk exposure in the case of foreign exchange trading portfolios arising from meeting the Bank's and clients' requirements for foreign exchange. **Non-trading portfolios:** Risk exposure in the case of non-trading portfolios mainly occurs due to non-conformity of assets and their maturity dates with the maturity dates of liabilities. It also occurs due to the impact of rate fluctuations upon re-investment.

3. LIQUIDITY RISK

Considered one of the most critical risks to which the banking sector in general as well as individual banks could be exposed, liquidity risk takes into consideration the Bank's potential inability to meet financing requirements at reasonable cost (liquidity financing risk) or its inability to liquidate its position reasonably quickly while maintaining an appropriate price level (market liquidity risk).

Market and Liquidity Risk Governance: Managing market risks helps to place limits as well as monitor compliance by implementing policies and controls that are approved and adopted by the Board of Directors. The Assets and Liabilities Committee is responsible for managing market risks on a strategic level in accordance with its delegated duties and responsibilities. Additionally, portfolio and product limitations, as well as risk types, are identified based on the levels of market liquidity and associated credit risks, and on an analysis of the extent to which the limitations are used.

The Market Risk Management sector is categorized as an independent supervisory function, responsible for a range of activities. These include:

The effective implementation of market risk policies; the development of the Bank's market risk management techniques and methods; the development of measurement mechanisms and behavioral assumptions of liquidity and investment; the immediate reporting to Senior Management of any violation of established limits and controls in accordance with the strict procedure approved and adopted by the Board; regular reporting to the Assets and Liabilities Committee and the Board, of any exposure to market risks and limit violations.

In order to limit exposure to liquidity risk, the Bank seeks to diversify financing sources to help reduce the degree of concentration and maintain an acceptable level of liquid assets. The Bank also puts in place policies and standards aimed at managing liquidity risks, and develops a contingency plan in accordance with the Basel Committee's best practices regarding liquidity risk management. A regular review of liquidity risk management policies and measures is subject to the approval of the Assets and Liabilities Committee and the Board of Directors.

Moreover, additional control measures often help market risk exposure within an acceptable level of readiness in the case of adverse events. These measures include stress tests and procedures to obtain approval for new products. Stress testing on a regular basis helps identify the impact of fluctuating profit rates and foreign exchange rates, as well as other risk factors that affect the Bank's profitability, capital adequacy and liquidity. These results are periodically sent to the Executive Management and the Board of Directors for their assessment of the potential financial impact on the Bank's profitability of exceptional circumstances. Over the course of 2020, the Risk Management Group successfully improved the performance of IT systems that help measure liquidity and Market risks and manage assets and liabilities, as well carried out relevant studies, reports and stress tests as part of a comprehensive system developed to measure market and liquidity risks.

4. OPERATIONAL RISK

Operational risk is the risk of losses arising from the inadequacy or failure of internal operations, individuals, technical systems or external incidents. This definition of Operational risks includes legal risk – but excludes strategic risk and reputation risk. To this end, Operational risk is an inherent risk in all the Bank's products, activities, operations and technical systems, resulting from internal factors, unlike credit and market risks, which arise from external factors. Taking these aspects into consideration, the Bank adopts a strategy based on the active and effective involvement of its Executive Management in managing this type of risk, which can potentially affect the Bank's various activities. As part of its continuous efforts to limit the effects of operating risk, and consequently help achieve its strategic objectives, the Bank adopts the following practices:

i. Analysis and evaluation of secondary objectives and activities, in order to better limit exposure to operating risk
ii. Identification of potential Operational risk in existing and new products, services as well as in IT activities, operations and systems. This is achieved primarily through calculating operating losses in order to identify the monitory gaps that led to such losses, and developing corrective measures to prevent future occurrences. It also involves evaluating risks inherent in the Bank's various activities, as well as monitoring elements in place to manage these risks. Collecting indicator data about key risks to monitor exposure levels to Operational risks is also part of this process. These indicators act as an initial warning before the risk occurs.
iii. A proactive approach to operating risk management.
iv. Continuous and independent assessment of policies, procedures and Bank performance.
v. Compliance with the guidelines and regulations issued by regulatory bodies as well as international standards of risk management.
vi. Regular reporting to the Bank's Executive Management and Board of Directors about risk assessment and operating losses, as well as corrective measures put in place to manage the risks.

5. FRAUD RISK

Fraud risks are among the operating risks to which organizations, including banking organizations, are often exposed. To this end, the Bank focuses on implementing best practices and meeting the requirements of relevant regulatory and supervisory bodies in order to limit exposure to such risks. The Bank has developed relevant policies and procedures focused on raising awareness among its employees and clients about ways to detect fraud, and has implemented techniques to measure and limit fraud risk by evaluating

such risks and implementing controls covering any vulnerabilities to avoid isolated or repeated exposure to risk. Fraud risk evaluation is applied to existing and new products. The Bank has developed further monitoring mechanisms applied to its operations, as well as indicators that examine such operations based on approved standards. It continues to improve on existing systems to increase the efficiency of monitoring and fraud detection efforts, offering improved channels through which employees and clients can report fraud or suspected fraud, in accordance with the rules and standards of regulatory and supervisory bodies, and in line with the Bank's strategy aiming towards keeping fraud risk within acceptable levels.

6. INFORMATION SECURITY RISK

In view of the increased reliance on information and telecommunication technologies, there is an increased risk, both emerging and potential, that could critically threaten companies' networks and information security. The Bank's Information Security Department is responsible for supporting the growth of the Bank's IT capability by mitigating information technology risks. This is achieved by applying information security standards within the organization, which include Availability, Integration and Confidentiality. These efforts go hand in hand with a continuous evaluation of risks to ensure that they cover all tech-related weaknesses within services and technologies adopted by the Bank in order to service its client base. Evaluating information security risks includes the following steps:

i. Taking part in the process of evaluating any new services, technological projects or changes adopted by the Bank in its efforts to improve e-services.
ii. Evaluating the level of response to cyber security incidents periodically to ensure the effectiveness of the procedure.
iii. Evaluating and detecting security Vulnerabilities within the Bank's offering, by looking for any gaps and testing for breaches existing in highly sensitive data systems, which may occur due to the digital transformation within the organization.
iv. Periodically evaluating risks targeted at business and IT divisions to detect any vulnerabilities or risks related to security in the procedures or regulations of security systems.
v. Overseeing the implementation of compliance with relevant regulations, making sure cyber security controls are properly and adequately implemented.

Business Continuity

The Bank recognizes the criticality of business continuity and has a robust Business Continuity Plan (BCP) to enable it to respond to any serious and/or disruptive incident in a timely and appropriate manner. Business Continuity create working remotely with successful result during COVID-19 pandemic. During 2020, two comprehensive tests were carried out to ensure the effectiveness of the Plan. In addition, a continuous ten-day recovery test was conducted on all mission-critical IT operations by switching them over to the Bank's Disaster Recovery Centre (DRC). The Bank will continue to upgrade its disaster recovery capabilities, as well as provide ongoing training specific to business continuity, to ensure its optimum response capability in the event of a major incident. The Bank has already begun establishing a new DRC which will be completed in 2021.

Compliance and anti financial crime

Bank Albilad considers that compliance with regulations, standards and instructions issued by the regulatory and supervisory authorities is one of the most important success factors of the bank, and maintains its reputation and credibility and the interests of shareholders and depositors, as well as providing protection against regulatory and legal penalties. And it is on the top priority of the bank.

Compliance and anti financial crime division role

Compliance is an independent function that identifies, assesses and monitors non-compliance risks, provides advice and consultation, and reports on compliance issues, with the objective of protecting the bank and its ambassadors from being exposed to regulatory or administrative penalties, financial losses, or loss of reputation that occur as a result of failure to comply with regulations, instructions, controls and the code of principles and rules of professional and ethical conduct.

The Compliance and **Anti Financial Crime Division** ensures that all the bank's policies, manuals and procedures comply with regulations and instructions issued by the regulatory and supervisory authorities as well as ensures the proper implementation of these policies, manuals and procedures in the bank.

Compliance and Anti Financial Crimes Division has several general roles and responsibilities. Following are Some of the specific functions fall under the Division:

- Anti-Money Laundering, Combat of terrorist financing and Preventing Proliferation.
- Combat Financial Fraud, Corruption and Financial Crimes
- Providing advisory and support to all administrative units
- Identify, analyze and assess the risks of non-compliance related to the bank's customers, services, products, geographical areas, delivery channels, and setting appropriate controls and standards.
- Strengthen relations with regulatory and supervisory authority
- Training and awareness
- Report on non-compliance issues and provide recommendations related to the processes of resolving those issues

Monitor and evaluate the effectiveness of implementing regulations and instructions

The Compliance and Anti Financial Crimes Division is responsible for ensuring that the bank's policies, directives, procedures, products and services are in line with the regulations and instructions issued by the regulatory and legislative bodies and monitoring the effectiveness of the proper implementation of these policies, directives and procedures.

Compliance initiatives

Bank Albilad aims to enhance the culture of its employees and the community related to compliance and anti-financial crimes.

One of the Compliance and Anti Financial Crime Division functions is to organize the education and awareness of staff on compliance and anti-financial crimes subjects. The Bank continuously conducts training on compliance, including compliance, AML&CTF and anti-financial fraud and corruption training to all the Bank's Ambassadors to enhance their knowledge of all relevant compliance regulations, and to develop their skills and capabilities in the compliance area, in addition to the specialized training to Compliance and Anti Financial Crime Division employees, online courses to the Bank's employees, and training for new hires which emphasizes compliance and anti-financial crimes. Further, our compliance and anti-financial crimes training extends to the Board of Directors where we concentrate on enhancing the board members knowledge related to relevant rules and regulations.

In addition, the Compliance and Anti Financial Crime Division organize community awareness initiatives in cooperation with universities to provide awareness lectures to students.

Bank Albilad is committed to follow the rules and regulations to protect the Bank and its customers from risks. Documents have been prepared for the Bank's employees on the appropriate implementation of compliance regulations, rules, and standards through policies and procedures and other documents such as compliance manual and internal rules.

Human resources policy

The Bank's compliance with rules, laws and regulations, is one of the most important bases and factors of its success, excellence and maintenance of its reputation and credibility. It is obligatory, therefore, that all the Bank's staff are committed to recognize the importance of compliance with regulations, instructions and policies related to the bank's business and the tasks assigned thereto, and apply them without any violation, breach or negligence.