Table 1
Scope of Application

a) Scope

These qualitative disclosures sets out Bank AlBilad approach to Capital assessment.

b) Basis of Consolidation

For accounting purposes all entities where control exists, are consolidated in the Group financial statements.

Entities (within the Group) fully consolidated:

1) AlBilad Investment Company:

AlBilad Investment Company is incorporated in Kingdom of Saudi Arabia as Saudi Limited Liability Company since 2007 and is involved in dealing, managing, arranging, advising and custody of securities. Currently, the Bank owns 99% of the ordinary share capital of the company while 1% is owned by representative shareholders.

2) AlBilad Real Estate Company:

AlBilad Real Estate Company is incorporated in Kingdom of Saudi Arabia since 2006 and is involved in registering the real estate collaterals that the Bank obtains from its customers. Currently, the Bank owns 99% of the ordinary share capital of the company while 1% is owned by representative shareholders.

c) There are no restrictions, or other major impediments, on transfer of funds or regulatory capital within the Group.

Table 2
Capital Structure

Capital of the bank consists of the following instruments:

1. Eligible Paid-up Share Capital

Ordinary share capital of the Bank consists of 300,000,000 shares of SAR 10 each. All these shares carry equal voting rights and are not redeemable. These shares rank junior to all other capital instruments as other claims on the Bank.

2. Eligible Reserves

Eligible reserves are created by accumulated appropriations of profit and are maintained for future growth.

Table 3
Capital Adequacy

Since 1988, the rules on capital adequacy for banks have built on the recommendations of Basel I, a comprehensive set of rules issued by the Bank of International Settlement (BIS). Basel I was intended to make the capital requirement more risk-sensitive and incorporate the effects of off-balance-sheet activities. Another aim was to create more homogeneous regulation for banks on a global basis.

As from the introduction of Basel I, the regulatory capital of banks has been based on central concepts such as Tier 1 capital, supplementary capital and risk-weighted items. Basel I has been adjusted in an ongoing process, for example the introduction of market risk measurement in 1999.

On June 6, 2006, however, new and different minimum capital rules were introduced by SAMA. The new rules build on the recommendations of Basel II, also issued by the BIS. Key areas of the regulatory requirements are broader risk management, flexibility and greater risk sensitivity.

Basel II uses a three-pillar structure: calculation of minimum capital requirement (Pillar I), supervisory review process (Pillar II) and market discipline/disclosure (Pillar III):

As a general rule, the Basel Committee intends to maintain the current capital level in the banking sector, but some banks will undoubtedly enjoy a capital relief under these requirements. There are a number of different factors that may be beneficial for Bank AlBilad under the new capital adequacy rules:

- Good diversification of credit risk between countries, customer segments and industries
- High and stable internal capital generation
- Sound risk, capital and performance management

The risk-weighted assets in Pillar I (according to Basel II guidelines) are calculated using the prescribed Standardized Approach for credit & market risks and the Basic Indicators Approach for operational risk. The Bank conducts a number of stress tests during ICAAP to ensure that its capital is adequate also in unfavorable economic climate. During the tests, the Bank's risk portfolio is exposed to severe stress conditions. The increase in the capital charge resulting from these stress tests is part of the Pillar II capital requirement.

Bank AlBilad's ICAAP policy, which aims to ensure that the Group's capital supports business growth, stipulates that the Bank should maintain an excess cover relative to the statutory requirement. This policy remains unchanged, and Bank AlBilad will also maintain an excess cover relative to the statutory requirement in the future.

Bank AlBilad's capital management aims to ensure efficient use of capital to meet the Bank's overall capital targets.

During 2007, the Bank started working under the Basel II capital adequacy rules. Bank AlBilad has chosen to adopt the standardized approach (for credit & market risks) and the basic indicator approach (for operational risk) to calculate the regulatory requirements of capital adequacy.

The Bank's risk profile complies with the capital targets and implies, among other things, that the Bank must have sufficient capital to cover both organic growth and current fluctuations in the Bank's exposure. The Board of Directors defines risk and capital targets, while the Asset & Liability Management Committee (ALCO) is responsible for ensuring that these targets are met.

The Risk Management Group set up in the Bank receives regular reports on developments in the Bank's balance sheet structure and balance sheet movements, including its capital deployment and risk appetite.

ICAAP

Bank AlBilad's Internal Capital Adequacy Assessment Process (ICAAP) integrates the Group's risk profile, risk management framework with available and required capital. ICAAP has been formally established in Year 2008 with relevant roles and responsibilities to be assigned under ALCO. The Board of Directors approved the Group's first ICAAP report for Year 2009.

One of the aims of the ICAAP is to ensure that management adequately identifies and measures the Bank's risks. The process also checks that management takes steps to ensure that the Bank maintains sufficient internal capital relative to its risk profile and that it applies and develops proper risk management systems. Pursuant to regulatory requirements, SAMA will review and assess the Group's application of ICAAP and the quality of the in-house management procedures of which ICAAP forms part.

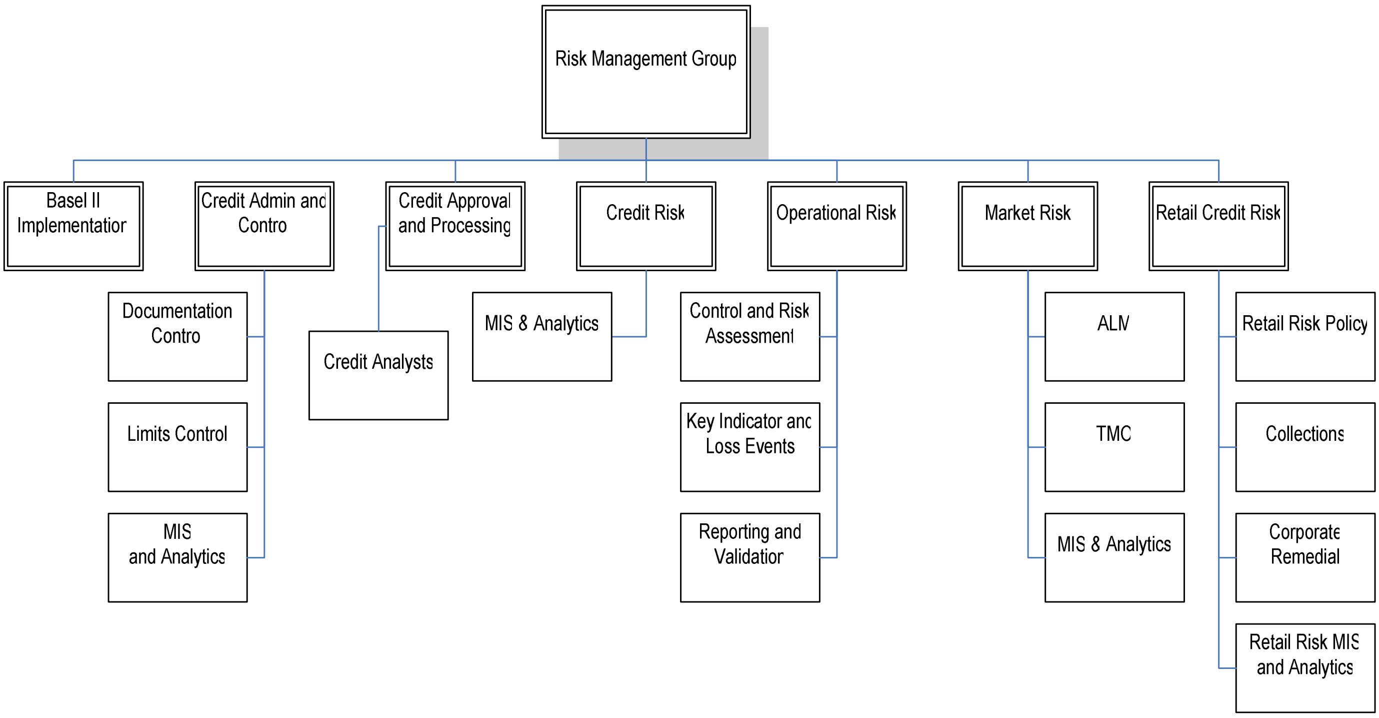
Risk Exposure & Assessment - General Disclosures

A key component of Bank AlBilad's business strategy is for risk management to support the objective of being a strong financial partner with insight and transparency in risk-taking.

The Bank's vision is to adopt best international standards and practices in risk management. Bank AlBilad uses substantial resources to develop procedures and tools that support this vision. Accordingly, the Bank has built up substantial expertise in risk and capital management.

Managing risk is a process operated independently of the business units of Bank AlBilad. It aims to promote a strong risk management culture through a comprehensive set of processes that are designed to effectively identify, measure, monitor and control risk exposures. The Board of Directors and senior management are involved in the establishment of all risk processes and the periodic oversight and guidance of the risk management function. The processes are subject to additional scrutiny by independent Shariah Board as well as internal and external auditors, and the Bank's regulators, which help further strengthen the risk management practices.

The Risk Management Group is organized in the structure as shown below.



Bank AlBilad is exposed to various types of risk that are managed at different levels of the organization. The most important types of risk are as follows:

- Credit risk: The risk of losses because counterparties fail to meet all or part of their obligations.
- Market risk: The risk of losses because the market value of Bank AlBilad 's assets and liabilities will vary with changes in market conditions.
- Liquidity risk: The risk of losses which arises when a bank's normal liquidity reserves remain insufficient to meet its obligations.
- Operational risk: The risk of losses owing to deficient or erroneous internal procedures, human or system errors, or external events.

Each individual risk type is defined in accordance with legislative and regulatory requirements and is described in further detail on the web site.

The Group allocates considerable resources to ensuring the ongoing compliance with credit limits and to monitoring its credit portfolio. The Group has a fixed reporting cycle to ensure that the relevant management bodies, including the Board of Directors and the Executive Committee, are kept informed of developments in the credit portfolio, non-performing loans and the like.

Table 4
Credit Risk – General Disclosures

Credit risk makes up the largest part of Bank's risk exposures. The Bank measure and manage its credit risk by adhering to the following principles:

- Consistent standards are applied across the bank in the respective credit decision processes through the use of Moody's rating model for all corporate lending customers. In addition, the Bank is in the process of deploying Fair Isaac's scoring model for evaluating the retail lending customers.

- The approval of credit limits for counterparties and the management of its individual credit exposures must fit within the Bank's portfolio guidelines and its credit strategies, and each decision also involves a risk-versus-return analysis.

- Every extension of credit or material change to a credit facility (such as its tenor, collateral structure or major covenants) to any counterparty requires credit approval at the appropriate authority level.

- Bank currently assigns credit approval authorities based on dual sign-off system by business and risk up to a certain level, beyond which the proposals are referred to Senior Credit Committee and Executive Committee for approval.

Credit risk reflects the risk of losses because one or more counterparties fail to meet all or part of their obligations towards the Group. Credit risk includes concentration, settlement & underwriting risk.

- Settlement risk is the risk arising in connection with the settlement of payments for trade in securities and other instruments. The risk arises if payments are remitted before the Bank can ascertain that the corresponding payments have been transferred to one of the Bank's accounts.

- Underwriting risk is the risk arising in connection with the procedures adopted by the Bank in the credit appraisal process. It also includes the Bank's exposure on account of security issues underwritten by the Bank.

- Credit concentration risk arises from any single exposure or Group of exposures with the potential to produce losses large enough (relative to a bank's capital, total assets, or overall risk level) to threaten a bank's health or ability to maintain its core operations.

The Credit Policy shall be the primary means of communication through which the Board and Senior Management provide direction to guide and monitor the financing activities so that business goals are achieved without exposing the Bank beyond risk tolerance level approved by Board.

The Credit Policy outlines the basic principles, strategies and objectives which the relevant department in the Bank will pursue for achieving the goals by extending credit facilities. These principles will serve both as "Useful guidelines" and "Precautionary measures" for prudent financing decisions.

The corner stone of the Credit Policy is as under:

❖ The Bank shall mainly provide the Short Term Financing to meet working capital needs. However, Medium and Long Term Financing needs will be reviewed on selective basis for corporate clients having good name in the market, established rating and good track record of credit worthiness.

❖ The financing shall mostly relate to business meeting the risk acceptance criteria.

❖ The professional conduct and prudent administration of Credit Portfolio, within defined risk limitations, shall have a major contribution to Bank AlBilad's overall objectives of achieving profitable and sustained growth.

❖ Bank will not extend any credit facility which violates the rules and regulations prescribed, from time to time by SAMA or any other Regulatory Authority.

❖ The Credit Policy is providing continuity in approach and is taking into account the cyclical aspect of the country's economy.

- All the present and future credit policies of the Bank shall be within the overall framework of Basel II Accord to be adopted as per road map provided / to be provided by SAMA.

- Bank will ensure that the facilities allowed are well aligned to customer's business structure, specific needs and debt servicing capacity.

- It is against the Bank's policy to provide financing for speculative purpose and undesirable activities.

- Bank AlBilad attaches importance to establishing and extending long-term customer relationships

- Bank AlBilad regularly follows up on developments in the customer's financial situation in order to assess whether the basis for the granting of credit has changed

- Bank will consider the Term Finance facilities on very selective basis, only to financially sound business entities.

- Guarantees from private individuals are avoided and accepted as incremental comfort.

- The Bank is particularly cautious in its granting of credits to businesses in troubled or cyclical industries

Credit Concentration Risk

Historical experience has shown that concentration of credit risk in asset portfolios has been one of the key drivers of distress in banking sector. This is true for both individual institutions as well as banking system at large. The importance of concentration risk in bank's portfolio requires separate assessment to assess the potential gap between Pillar 1 capital requirement and the true underlying risk.

Concentration risk denotes the risk arising from an uneven distribution of counterparties in credit or any other business relationship or from concentration in business sectors or geographical regions. Accordingly, concentration risk in credit portfolios comes into being through an uneven distribution of bank loans to individual borrowers (name concentration) or in industry / service sector and geographical regions (sectoral concentration).

Bank AlBilad's identification of risk concentrations in the credit portfolio is included as a credit risk management parameter. The following risk concentrations form a natural part of Bank AlBilad's business strategy:

- Large exposures to a single party
- Large exposures to a particular industry / sector
- Concentration in exposures to a particular rating of customers

Credit Risk – General Disclosures

Default

The definition of default used by the Bank is consistent with the requirements of the Basel II guidelines. A receivable is registered as being in default when it is considered unlikely that the customer will fully repay all his obligations to the Bank or its subsidiaries.

Remedial Management

For lending operations, proper care and caution is exercised and all parameter, as laid down under SAMA rules and Bank's own policy are followed. Despite all prudent ways and means adopted by the banks and financial institutions, the finance / advances may turn bad, leaving the bank with no option but to restructure / write-off the same. In such cases where there is a ray of hope for its recovery, the finances are also rescheduled and nursed for safe work – out. Whenever such a situation arises the Bank cannot sit idle and watch deterioration in the quality of its assets.

Types of Provisions

1. General Provisions

   While for Accounting Financial Statement purposes the guidelines provided in IAS will be followed. However for SAMA / regulatory reporting purpose only, general provision as per rate given by SAMA from time to time of the outstanding balances (other than non – performing risk assets) should be created to cover the impaired assets which will only be identified as such in future.

2. Specific Provisions

   A specific provision must be made of for incurred and expected losses for individually assessed Corporate, Government, Private Banking and other large risk assets to recognize the net realizable value of the risk assets.

   Retail risk assets that fall under non performing categories should also be covered by specific provisions.

Write-off procedures

Loans and advances are written off once the usual collection procedure has been completed and the loss on the individual loan or advance can be calculated. Amounts written off are deducted from the allowance account.

The write off proposal is processed after all possible efforts are exhausted to either recover or improve the risk rating including revival/rehabilitation of the borrower's business without exposing the Bank to unnecessary additional risk. The approving authority will give due consideration to the innovation and ingenuity of proposing officers in improving the risk rating or classification of risk assets, including restructuring of credit facilities. Such proposals should, however, clearly demonstrate improvement in bank's position preferably in both short and long terms.

Credit Risk Mitigation

Bank AlBilad uses a variety of financial and non-financial collateral and guarantees to mitigate the underlying credit risk in its regular lending and treasury operations. There is no collateralisation of treasury operations, i.e. *Murabaha* deals. Usage of purchased protection in the form of credit derivatives is negligible at this point of time .The bank adheres to the list of acceptable collateral and credit protection provided by SAMA to all banks in the Kingdom (except gold and silver).

Broad collateral types currently used by Bank AlBilad include:

- **Financial Collateral**
  - Cash margins typically used only for Letter of Credit and Letter of Guarantee transactions
  - 'Customer Share'. in LC Musharaka transactions, which are cash collateral against the full amount of the LC
  - Cash collateral for extending credit or to protect counterparty default in the treasury transactions.
  - Equities of local listed shares approved by the Shariah Board of the bank for corporate lending and share trading. The list of acceptable equities are periodically reviewed by Credit Committee.
  - Both local and foreign, Mutual Fund units, comprising of listed companies acceptable under Shariah law
- **Real Estate collateral**
  - Commercial Real Estate, used for securing the bank's exposure to corporate and commercial borrowers.
  - Residential Real Estate, used for securing a mortgage provided to a retail customer

- **Guarantees**

    - Formal and legally enforceable guarantees received from Banks.
    - Legally enforceable Personal guarantees

- **Others**

    - Assignment of proceeds for revenue generated by projects financed by Bank AlBilad. Each project financed has a separately defined limit which is part of the credit limit provided to the counterparty.
    - Assignment of salary account in case of individual borrowers, and each instalment to be deducted from this account at each due date

The Credit Committee conducts an independent valuation of the assets being pledged before acceptance and at defined frequencies depending on the nature of collateral. The valuation is conducted by a team of independent valuation experts or by a team of qualified staff from the Bank depending upon the nature of collateral.

Valuation of collaterals is based on the current market value of the same. Independence of the valuation expert and / or the designated staff shall be ensured so that the valuation is not biased to:

- Grant a higher credit limit to the borrower or
- Improve its internal credit rating or
- Make a smaller quantum of provisions or
- Continue interest accrual for a problem credit.

The Risk Management Group ensures that the valuation method used, whether internal or external, is based on assumptions that are both reasonable and prudent and all assumptions have been clearly documented.

Collateral is valued, wherever possible, at net realizable value, defined as the current market value less any potential realization costs including but not limited to carrying costs of the repossessed collateral, legal fees or other charges associated with disposing of the collateral.

Bank AlBilad aims to maintain a level of information about pledges and guarantees that is sufficient for it to regularly estimate the value thereof. The value is calculated as the amount received from a forced sale less the costs of realization, including costs for days on the market.

To some extent, the Bank receives guarantees for credit exposures. A large part of these guarantees are provided by enterprises or persons where a Group relationship between the borrower and the guarantor exists.

Standardized Approach and Supervisory Risk Weights

For portfolios under the standardized approach, External Credit Assessment Institutions risk assessments are used by Bank AlBilad as part of the determination of risk weightings:

Currently the Bank's corporate portfolio is **externally** unrated. However, for Financial Institutions, three SAMA recognized External Credit Assessment Agencies were nominated for this purpose, i.e. Moody's Investors Service, Standard and Poor's Ratings Group and the Fitch Group.

Credit ratings of all exposures are individually determined from the above credit rating agencies and mapped to the exposures assigning a risk weight according to the supervisory tables.

The alignment of alphanumeric scales of each agency to risk buckets is similar to BIS and SAMA guidelines:

Alphanumeric scales:

Moody's	Standard and Poor's	Fitch
Aaa	AAA	AAA
Aa1	AA+	AA+
Aa2	AA	AA
Aa3	AA-	AA-
A1	A+	A+
A2	A	A
A3	A-	A-
Baa1	BBB+	BBB+
Baa2	BBB	BBB
Baa3	BBB-	BBB-
Ba1	BB+	BB+
Ba2	BB	BB
Ba3	BB-	BB-
B1	B+	B+
B2	B	B
B3	B-	B-
Caa1	CCC+	CCC+
Caa2	CCC	CCC
	Caa3	CCC-
	Ca	CC
	C	C
	WR	D
		NR

Claims on sovereigns and their central banks

Credit Assessment	AAA to AA-	A+ to A-	BBB+ to BBB-	BB+ to B-	Below B-	Unrated
Risk Weight	0%	20%	50%	100%	150%	100%

Claims on Banks and Securities Firms (Under Option 2 as required by SAMA)

Credit Assessment	AAA to AA-	A+ to A-	BBB+ to BBB-	BB+ to B-	Below B-	Unrated
Risk Weight under option 2	20%	50%	50%	100%	150%	50%
Risk Weight for Short – Term claims under option 2	20%	20%	20%	50%	150%	20%

Multilateral Development Banks

0% risk weight for qualifying MDB's as per SAMA and in general risk weights to be determined on the basis of individual MDB rating as for option 2 for banks.

Claims on corporate

Credit Assessment	AAA to AA-	A+ to A-	BBB+ to BB-	Below BB-	Unrated
Risk Weight	20%	50%	100%	150%	100%

Claims included in the regulatory non-mortgage retail portfolios

A 75% risk weight to be assigned to such exposures.

Claims secured by residential mortgages

A 100% retail risk weight to be applied to such claims.

Claims secured by commercial real estate

A 100% retail weight to be applied to such claims.

Past Due Loans

Risk Weight %	Level of Provisioning
150	Up to 20%
100	20% to 50%
100	50% and above

Other Assets

The standard risk weight for all other assets will be 100% except gold to be treated equivalent to cash and risk weighted at 0%.

When calculating the risk weighted value of any exposure under the standardized approach, look up function is applied to the central data base maintained in Excel and assigns to each individual exposures.

Table 10
MARKET RISK: DISCLOSURE FOR BANKS USING STANDARDIZED APPROACHES

Market Risk

Market risk concerns profit margin rate and currency and is influenced by general as well as specific changes in the market prices. Bank AlBilad does not have any equity positions risk in Trading Book.

When calculating market risk, Bank AlBilad uses Standardized Approach for Pillar I capital charge and advanced risk models for Pillar II capital charge, such as Value-at-Risk, Stress Testing.

As on December 31, 2008, Bank AlBilad's market risk capital charge amounted to SAR 496,671

Profit Margin Risk

Profit Margin Risk in the banking book is defined as the exposure of the Islamic banking asset products of the Bank to profit margins. It arises principally from mismatches between the future yield on assets and their funding costs, as a result of changes in profit rates.

For the purpose of management of profit margin risk, the market risk at Bank AlBilad also measures its yield curve risk, which expresses the risk of losses if profit margin rates for various terms change independently of one another.

Foreign Exchange Risk

Foreign Exchange Risk is the risk of losses on the trading and banking book positions in foreign currency because of adverse changes in exchange rates against banks exposures.

The overall potential loss is generally calculated using bank net open position as the maximum sum of long and short position currencies. In addition, the risk is measured and reported on a currency-by-currency basis.

Policies & Responsibilities

The Board of Directors has determined the general limits for the market risk, the Risk Management Group sets limits and guidelines for the general business units reflecting the strategic risk exposure and risk appetite targets as per bank's "Trading & Banking Book Policy".

In addition, ALCO (Asset/Liability Committee) regularly monitors and discuss issues within scope of market and liquidity risk.

Bank AlBilad uses both conventional risk measures and advance risk models for measuring risk, such as Market Risk Limits, Liquidity Mis-matches, Concentration Limits, Economic V@R to measure its market risk exposures, including

- Reporting Bank AlBilad's market risk to senior management;
- Reporting to SAMA; and
- Day-to-day management of market risk in the business units.

In addition, internally in the Market Risk Department, models are developed for pricing and risk management of financial products that cannot be valued on the basis of official market prices.

Bank AlBilad's Value-at-Risk (VaR) model currently used for the Pillar II calculation and is in process of acquiring & implementing system for day-to-day risk management.

Value-at-Risk is a statistical measure of the maximum loss that the Bank may incur on its portfolios over a certain period of time at a certain confidence level. Value-at-Risk is a risk measure that quantifies potential losses under normal market conditions.

A 99 per cent one-day VaR of SAR 1,000 for Bank AlBilad expresses, for instance, that there is a 99 per cent probability that the Bank will lose SAR 1,000 at the most the next day. It also means that there is a one per cent probability that the Bank will incur a loss in excess of SAR 1,000.

A major advantage of VaR is that it provides a combined figure for all risk types, which takes into account the correlation structure on the financial markets.

The Bank uses historical simulation to calculate Value-at-risk. This model assumes normally distributed asset returns.

As on December 31, 2008, Bank AlBilad's value at risk amounted to SAR 23,637,048. The amount is the maximum amount the Bank AlBilad would statistically lose at a confidence level of 99%, assuming that the exposure was maintained for 2 weeks or 10 working days.

Bank AlBilad conducts stress tests and scenario analyses to measure its risk of loss under unusual market conditions.

Standard stress tests estimate Bank AlBilad's losses if positions are subjected simultaneously to profit margin rate shocks of +/- 200bp

In addition to standard stress tests, calculations are also made for a number of scenarios which are typically defined based on historic events that caused crises in the financial markets. However, current or future events expected to have an effect on the financial markets may also be used as input when defining the stress test scenarios. These scenarios are revised and changed regularly to reflect changes in Bank AlBilad's risk profile and economic events.
The analyses is made on the basis of the stress testing recommended by the Basel Committee, that is, an profit margin rate shock of +/- 200 bps.

Bank AlBilad also conducts comprehensive stress tests of the model at regular intervals and the results are presented to the senior management. In addition, there are a number of other qualitative requirements to ensure that the model is completely up to date with respect to documentation, calculation methods and control measures.

Certain Bank AlBilad's financial instruments cannot be valued by means of prices in the market; instead they are valued on the basis of pricing models developed internally by the Bank. The Risk Management Group conducts validation such internal models independently in order to assess the ability of the model to price and manage the risk of a given product.

Model validation is made not only of the Bank's new models, but previously approved models are also validated on a regular basis. This is done to ensure that no changes have been made to the product or have taken place in the market that are of significance to the correctness of the model.

In addition, continuous procedures have been established to control and validate the market prices used to value and calculate risk.

The measuring, monitoring and management reporting of market risk are reported on daily basis to the senior management and stakeholders. Current market risks are calculated using a database that is integrated into the bank core systems.

In connection with day-to-day market risk management, limits are established for the trading and banking book of the business unit. These are monitored systematically, and procedures have been established for the subsequent organizational follow-up.

The Board of Directors, the ALCO and the Business and risk management stakeholders are informed regularly about the "Group's Market Risks" and material events in this area. This reporting includes follow-up on both risks within the individual categories of market risks and the overall risk measures in the form of Value-at-Risk. Similarly, risk reporting has been established for the business units authorized to take market risks.

Liquidity Risk

The risk that the Bank may not be able to meet its obligations when due, at an acceptable market cost, is termed liquidity risk. Liquidity risk is measured by matching assets and liabilities based predefined maturity buckets.

Liquidity risk is defined as the risk of losses because

- Bank's funding costs increase disproportionately;
- Lack of funding prevents the Bank from establishing new business; or
- Lack of funding will ultimately prevent the Bank from meeting its obligations.

Liquidity management at Bank AlBilad is based on monitoring and managing operational and structural liquidity risks in various scenarios.

The management of operational liquidity risk aims primarily at ensuring that the Bank always has a liquidity buffer that is sufficient in the short term liquidity shortfall to absorb such net effects of transactions made and expected.

The policies for Bank AlBilad's liquidity risk are defined as part of the policies for market risk in "Trading and Banking Book Policy". Contingency plans have been implemented aiming to ensure that Bank AlBilad is sufficiently prepared to take remedial action if an unfavorable liquidity situation should arise.

It is a natural element of the Bank's business strategy to assume risks in the liquidity field. Bank AlBilad's policies have been defined with respect to how much negative funding the Bank wishes to accept. In liquidity management, the Bank distinguishes between liquidity in Saudi Arabian Riyals, major and other currencies.

The Risk Management Group has set limits for liquidity risks, which are calculated separately for Saudi Arabian Riyals, major and other foreign currencies. The Market Risk Department is responsible for ensuring that the Bank observes the operational liquidity risk limits and expedite to senior management.

The Key Business & Risk Units stakeholders receive reports on the Group's liquidity risks regularly. The ALCO continuously assesses developments in the Group's liquidity and plans long-term funding under the rules set by the Risk Management Group.

Managing Short-Term Liquidity Risk

The management of Bank AlBilad's short-term, or operational, liquidity risk aims primarily at ensuring that the Bank always has a liquidity buffer that is able, in the short term, to absorb the net effects of transactions already made and expected changes.

Liquidity is determined on the basis of known future receipts and payments under transactions already entered into. The calculation is made taking into account the Bank's holdings of liquid assets.

Moreover, the Risk Management Committee has set limits for liquidity in foreign exchange.

Managing Long-Term Liquidity Risk

Structural liquidity risk is managed based on considerations of the Bank's long-term liquidity mismatch. The management of this risk aims to ensure that Bank AlBilad does not build up an inexpediently large future funding requirement. Determining the structural liquidity is important when the Bank plans its funding activities and when pricing intra-Group transactions.

The Bank manages the structural liquidity risk on the basis of a gap report. The gap report is based on a breakdown of the Bank's assets, liabilities and off-balance sheet items by maturity. For that purpose, the Group uses the contractually fixed maturity dates for each product.

As part of the management of the Bank's structural liquidity risk, the liquidity position in the gap report is divided into a number of variables such as foreign exchange, product, business area and organisational unit. These reports reflect, among other things, that the Bank has a structural liquidity surplus in Saudi Arabian Riyals by ways of surplus deposits as well as a structural funding requirement in foreign currencies.

Scenario Analysis

Bank AlBilad conducts stress tests to measure the Bank's immediate liquidity risk and to ensure that the Bank has a certain response time if a crisis occurs. The stress tests estimate the structural liquidity risk in various scenarios.

The scenario analyses involve both Bank AlBilad -specific crises and general market crises.

The Bank monitors the diversification of products, currencies, maturities and counterparties of the funding sources to ensure that the Group has a funding base that will protect the Bank to the greatest possible extent if markets come under pressure.

Together with the centralized funding management at head office, the composition of Bank AlBilad's balance sheet ensures that the Bank can fund its activities as inexpensively as possible at present and in the future. Other contributing factors are the substantial deposits from retail customers and the Bank's ability to undertake Murabaha transactions with other banks.

Table 12
OPERATIONAL RISK

Overview

Bank AlBilad recognizes that integrating business process management with Operational Risk Management (ORM) can dramatically increase Bank AlBilad's optimal business performance and reduce Operational Risk Losses.

We have established a framework that will have positive impact on

Income

Bottom line, shareholder value, reputation, and long term stability

Risks and Controls
Mitigation of risk by having an inventory of key business processes with documented risks and controls and designated senior managers responsible to manage these risks
Efficiency
System will be the focus to implement effective controls, have efficient processes supported by adequate technology

Corporate Governance
Effective tools of controls through out the management will lead to better corporate governance which is also the focus of the regulators

The ORM team in Bank AlBilad has introduced the concepts, the framework, and the tools -none requiring substantial investment- to mitigate operational risk to acceptable residual levels, in accordance with its risk appetite policy, i.e. by maintaining a strong control environment, which is managed through Group's Operational Risk Management Framework. The Group seeks how best to embed these tools and techniques as a long-term solution.

At one end we have operational risk identifying and mitigating risks while working with the business and on the other hand it is also improving key processes under the umbrella of Business Process Re-Engineering

Vision

Our vision is to develop and implement a strong operational risk process and attain a reputation of the most efficient and effective Operational Risk Management in Islamic Banking that brings consistency and risk standardization within Bank AlBilad through a common framework of policies to facilitate optimization of shareholder value and efficient usage of capital.

Objectives

Implement best practice measurement process to facilitate day- to- day management of operational risk; and the following frameworks that meet the local regulatory (SAMA) and International Basel II requirements.

- Governance Structure (ORM Committee)
- Risk and Controls Identification
- Implementation of CRSA, KRI, Loss Event Collection
- Manage fully implemented ORM tools in Bank AlBilad
- Rollout of ORM framework to Retail Branches & Business Lines
- Position Bank AlBilad to move towards Advance Measurement Approach for calculation of Operational Risk Capital

Strategy

Operational Risk Management Strategy is to implement an operational risk framework that is in line with industry best practices and meets regulatory requirements.

Components of the framework include:

- Loss Data – Internal / External / Scenario based
- Key Risk Indicators – By lines of business and risk type with thresholds attached for monitoring and escalation
- Control and Risk Self – Assessment process – Standardized approach

Set common categorization language for Operational Risk Types that will be used for all components of the operational risk framework.

Set of Operational risk policies and guidelines with company wide applicability to support the implementation of the framework as well as for ongoing risk reporting requirements.

Timely reporting of operational risk exposures to the business management and the Risk Management Committee.

Integration of operational risk management in business decision making process.

Ensure that operational risk measurement (Expected Loss/Unexpected Loss/Stress Loss) is tied to the underlying risks faced by business line.

Ensure that operational risk is incorporated in risk-return calculations and continuous monitoring of the business risk profile.

Bank AlBilad Operational Risk Approach

Bank AlBilad has adopted Basic Indicator Approach (BIA) for Regulatory Capital Assessment under Pillar 1, i.e. average of annual gross income over previous 3 years. Additional capital charge could be imposed under Pillar 2 if operational risk arises from control failures.

Over year 2009, Bank AlBilad is planning to have parallel run for implementing Standardized Approach. The decision to adopt other approaches like Advanced Measurement Approach (AMA) will be assessed by year 2011.

Risk Mitigation Processes

The Bank shall adopt a blend of centralized and decentralized approaches for operational risk management. This will enable the bank to effectively manage operational risk in view of varying levels of risk tolerance and operational independence of individual entities.

Bank AlBilad will enhance the risk control by the 3 main components of the Operational Risk Management Functions:

Control Risk Self Assessment: analyzing the processes to identify inherent risks and control gaps and residual risks, treatments and develop mitigation measures with action plans to improve the controls.

Key Risk Indicators: Metrics that serve as predictors of risk providing an early warning signals to business.

Loss Data Collection: risk is manifested in the losses. Collection of operational risk loss data is essential for measuring the operational risk capital charge and better focuses efforts to reduce risk.