



MULKIA INVESTMENT COMPANY

PILLAR III DISCLOSURES

For the year ended 31 December 2019

Table of Contents

| | | |
|----------|---|-----------|
| 1 | <i>Background and Purpose of the Report</i> | 4 |
| 1.1 | Company Background | 4 |
| 1.2 | Material or Legal Impediments between AP and its Subsidiaries | 5 |
| 2 | <i>Capital Structure</i> | 5 |
| 2.1 | Tier 1 capital | 5 |
| 2.2 | Tier 2 capital | 5 |
| 2.3 | Total Capital | 5 |
| 3 | <i>Capital Adequacy</i> | 6 |
| 3.1 | Capital adequacy Overview | 6 |
| 3.2 | Capital adequacy ratio and Minimum capital requirements | 7 |
| 4 | <i>Risk Management</i> | 7 |
| 4.1 | Sharia Compliant Company | 9 |
| 4.2 | Committees | 9 |
| 4.3 | Material Risk Identification Process | 10 |
| 4.4 | Internal Audit Function | 10 |
| 4.5 | Compliance Function | 11 |
| 5 | <i>General Qualitative disclosure for risk</i> | 11 |
| 5.1 | Credit Risk | 11 |
| 5.2 | Market Risk | 11 |
| 5.3 | Operational Risk | 11 |
| 5.4 | Concentration risk | 12 |
| 5.5 | Liquidity Risk | 13 |
| 5.6 | Interest Rate Risk | 13 |
| 5.7 | Settlement Risk | 13 |
| 5.8 | Reputational risk | 14 |
| 5.9 | Business and Strategic Risk | 14 |
| 5.10 | Legal risk | 15 |
| 5.11 | Regulatory Risk | 15 |

| | | |
|-----------|--|-----------|
| 6 | <i>Credit Risk Quantitative disclosures</i> | 15 |
| 6.1 | Gross Credit Risk Exposures and Risk Weights | 15 |
| 6.2 | Impaired loans | 15 |
| 6.3 | Credit risk's rated exposure | 15 |
| 6.4 | Credit Risk Mitigation Exposures | 16 |
| 6.5 | Residual contractual maturity of Credit exposures | 16 |
| 6.6 | Geographic exposures of Credit Risk Exposures | 16 |
| 6.7 | Reconciliation report for provisions and impairments | 16 |
| 6.8 | COUNTERPARTY CREDIT RISK (CCR) AND OFF B/S DISCLOSURES | 16 |
| 7 | <i>Market Risk Disclosures</i> | 16 |
| 7.1 | Market Risk - Qualitative disclosures | 16 |
| 7.2 | Quantitative disclosures | 17 |
| 8 | <i>Operational Risk Disclosures</i> | 17 |
| 8.1 | Qualitative disclosures | 17 |
| 8.2 | Quantitative disclosures | 18 |
| 9 | <i>Liquidity Risk Disclosure</i> | 18 |
| 9.1 | Qualitative disclosures | 18 |
| 9.2 | Quantitative disclosures | 19 |
| 10 | <i>Appendix I – Disclosure on Capital Base</i> | 19 |
| 11 | <i>Appendix II – Capital Adequacy</i> | 20 |
| 12 | <i>Appendix III – Credit Risk's Risk Weights</i> | 21 |
| 13 | <i>Appendix IV – Credit Risk's rated exposures</i> | 22 |
| 14 | <i>Appendix V - Disclosure on Credit Risk Mitigation (CRM)</i> | 23 |
| 15 | <i>Appendix VI - Residual Contractual Maturity of Credit Risk Exposures</i> | 24 |
| 16 | <i>Appendix VII – Geographic Distribution</i> | 25 |

1 BACKGROUND AND PURPOSE OF THE REPORT

The Prudential rules issued by the Capital Market Authority of Saudi Arabia covers and consists of three pillars of Capital adequacy viz, Pillar 1 (dealing with rules for capital requirements for Credit, market and operational risk) Pillar II (dealing with assessment of all risks, ICAAP document covering capital assessment, risk management and governance) The purpose of Pillar II is to ensure that authorised persons have sufficient capital to support all material risks to which their business is exposed. It shall therefore reinforce the link between the risks and the capital, so that the Authorized Person's risk management strategy, approaches and systems are integrated with its capital planning.

This disclosure requirement meets the minimum requirements of the annual market disclosure of information referred to as "Pillar III disclosure" to be published by the Authorized Persons (APs) licensed to dealing, managing and/or custodial activities

The purpose of Pillar III disclosures is for the market participants to assess the key pieces of information on the scope of application, capital, risk exposure, risk assessment processes and the capital adequacy of the Authorized Persons.

This document has been prepared in compliance to the guidelines issued by the Capital Market authority of Saudi Arabia. The Pillar III disclosure consists of both quantitative and qualitative disclosures.

This Pillar III disclosure has been approved by the Board of directors of Mulkiya investment before its publication. The information contained in this Pillar III disclosure report has not been subjected to External audit, as the same is not a requirement.

1.1 Company Background

Mulkiya Investment is a Saudi (Closed Joint Stock) Company, headquartered in Riyadh with Authorised share capital of 75 Million Saudi Riyals, and it conducts its business pursuant to the laws and regulations issued by Capital Market Authority (CMA) in the Kingdom of Saudi Arabia. The paid Up Capital at formation is SAR 75 million and the balance to be paid on the dates to be determined by the Board of Directors.

Mulkiya obtained Capital Market Authority license on 5/11/2013 to carry out securities business including: Managing Investment Funds, Managing Clients' Portfolios, Custody, Dealing as Principal, Underwriting, Arranging and Advising Services.

Mulkiya provides diversified and integrated financial and investment services tailored to suit the goals of individuals and institutions of different types and sizes. Mulkiya operates in the field of asset management, arraigning & corporate finance, financial advisory and research. All investments and financial services provided by Mulkiya are compliant to Islamic law (Sharia Principles) as well as being subject to the supervision and compliance review of an independent Sharia Committee. Taking a leading position in managing assets, wealth and investment banking in the Middle East. Mulkiya works hard to live up and to be the leading investment services provider in the Middle East who outperforms the local and regional standards and practices in addition to providing a comprehensive solution for managing assets, wealth and investment banking to meet the evolving needs of its customers.

1.2 Material or Legal Impediments between AP and its Subsidiaries

Mulkia Investment does not have any subsidiaries and has no current or foreseen material or legal impediments for transfer of capital.

2 CAPITAL STRUCTURE

The Company's objective when managing capital is to comply with the capital requirements set by the Capital Market Authority (CMA) to safeguard the Company's ability to continue as a going concern and maintain a strong capital base. The rules state that an authorized person shall continually possess a capital base which corresponds to not less than the total of the capital requirements as prescribed under Part 3 of the Prudential Rules.

It is the company's policy to maintain a strong capital base and to utilize it efficiently throughout its activities to optimize the return to shareholders, while maintaining a prudent relationship between the capital base and the underlying risks of the business. In carrying out this policy, the Company has taken into account the supervisory requirements of the Prudential Rules. The shareholders of Mulkia is well diversified.

For regulatory purposes, capital is categorized into two main classes. These are Tier 1 and Tier 2, which are as described below. The calculation of the Capital Base complies with all the respective chapters under the requirements of Part 2 – Capital Base of the Prudential Rules

2.1 Tier 1 capital

Tier-1 capital of the Firm consists of paid-up capital, reserves (other than revaluation reserves) and audited retained earnings and has deductions in the form of dividend expense from retained earnings & negative equity items.

2.2 Tier 2 capital

The company does not have any Tier II capital, which is a positive feature.

2.3 Total Capital

The total eligible capital (Tiers 1 and 2) calculated in accordance with CMA guidelines as of December 31, 2019 is given in Appendix I.

3 CAPITAL ADEQUACY

The company maintains adequate level of capital to cover risks inherent in its business operations and to support current & future activities

3.1 Capital adequacy Overview

3.1.1 PILLAR 1 - MINIMUM CAPITAL REQUIREMENTS

Pillar I sets minimum capital requirements to meet credit, market and operational risk as contained in the Part 3 chapter 4 to 16 of the Prudential Rules. Mulkiya Investment uses the Standardized Approach in the calculation of the capital required for Credit risk.

The capital charge for market risk is assessed for trading book portfolio and Foreign exchange positions in the books.

Under Pillar 1, the capital needed to cover operational risks is the higher of 15% of the last 3-year average revenues or 25% of last year's operating expenditure.

3.1.2 PILLAR II - ICAAP

The Internal Capital Adequacy Assessment Process is introduced under Pillar II of the Prudential Rules, which is contained in Part 6 (Article 66) and Annex 9 of the Prudential Rules.

Pillar II requires APs to perform a thorough review of all material risks, extensive stress testing, strategic capital planning, the internal control framework and the roles and responsibilities of departments / individuals that are critical to the implementation of framework.

The Firm has taken various initiatives to implement the ICAAP and assess capital requirements in accordance with the Firm's risk profile, size and complexity of business. The ICAAP describes the Firm's business strategy, its forecasts for the next three years for risk weighted assets, its risk appetite and the assessment of specific risk exposures, their mitigation and the capital allocated to these risks.

Stress Testing

The Company has defined a formal approach to stress testing and Scenario Analysis that defines the framework and approach for conducting stress tests to assess the impact on earnings and capital. Stress scenarios have been designed for material risk factors.

Stress testing is used to evaluate potential vulnerability of risk management system of the Company to certain unlikely but plausible events or movements in financial variables. Stress testing can be done by using sensitivity analysis (wherein impact of change in one variable is assessed on the Company's financial position) or using scenario test (which include simultaneous moves in a number of variables based on a single event experienced in the past).

3.1.3 PILLAR III – MARKET DISCIPLINE

Pillar III aims to provide a detailed and transparent reporting framework that enhances market discipline to operate as sharing of information facilitates assessment of the AP by others, including investors,

analysts, customers, and rating agencies, which leads to an improved corporate governance.

The information provided here has been reviewed and validated by the Management and is in accordance with the rules in force at the time of publication, covering both the qualitative and quantitative items. Mulkia Investment shall publish the Pillar III disclosures at its website henceforth.

3.2 Capital adequacy ratio and Minimum capital requirements

The Company's capital requirement is calculated based on CMA Prudential Regulations. The Firm is adequately capitalized with Tier I capital ratio of 2.86x of required capital which is above CMA's minimum regulatory requirement of 1.00x.

The capital adequacy calculation has been calculated as at 31st December 2019 which corresponds to the end of the annual reporting period for the Company and are based on the audited financial statements.

Appendix II provides the Company's capital adequacy ratio.

4 RISK MANAGEMENT

Given the size of the Company and its operations, the Company has adequate risk management framework to identify and manage major risks.

Risk management strategies and processes: The management of risk in Mulkia Investment lies with its Board of directors. There is a clear division of responsibility at the head of the company which ensures a balance of power and authority between the Chairman, who controls and directs the Board meetings and the Chief Executive Officer and Managing Director, who is running the business. The Board consists of a balance of both executive and non-executive directors as well as independent members. The Board of directors manages risk through its committees viz., Audit & Risk Committee, nomination and remuneration committee, investment committee, sharia compliance committee and management committee. The company has detailed the high level organization, authorities and processes relating to risk management. The risk management covers all risks the company is exposed to viz., Credit risk, market risk, operational risk, interest rate risk, concentration risk, liquidity risk, settlement risk, foreign exchange risk, strategic risk, reputation risk etc. The guiding principles are as under:

- All asset management activities that commit the company to deliver risk sensitive products require approval from competent authority as defined in the policy prior to commitment
- There is clear distinction from business functions and risk management functions
- Risk management structures, policies and procedures are transparent and are based on consistent principles, in written form and well-communicated
- Decisions on policy, products etc are taken by the committees
- Authorities are delegated by the Board of directors based on level of expertise and seniority through an approved authority matrix
- Risk and reward are borne by the same business unit

- Risk management is embedded in all the company's processes and not stand-alone.
- The above guiding principles and underlying elements of risk management framework are dictated by policies and procedures and the prudential guidelines of Capital Market Authority of Saudi Arabia

Structure of organization of risk management and compliance function: The Firm follows the “three lines of defense” approach for management of risks with business units forming the first line of defense and the risk and compliance forming the second line of defense. The Company has a Board approved Compliance Manual which documents the company's key obligations with regard to the Capital Market Authority's “CMA” rules and regulations and what derives from these regulations related to a company and its employees, and towards the Company's Customers. This Manual, apart from the above-mentioned objectives, provides a summary, of the applicable Authorized Persons Regulations “APRs” issued by the Board of Capital Market Authority, for the guidance of employees.

Internal Audit Function

The Company's internal audit function focuses on the appropriateness of controls instituted in the Company's processes. The internal audit function provides oversight and third line of defense over internal controls. External auditors are used to support the internal team. Auditor's review outcome and recommendations are addressed on a priority basis to strengthen the Company's control environment.

Scope and nature of risk reporting and measurement systems: Risk management helps ensure that risk exposures do not become excessive relative to the Firm's capital position and its financial position. In all circumstances, all activities giving rise to risk are identified, measured, managed and monitored as per guidelines set out in the policy. The risk management includes that following four cycles:

Risk identification ➡ Risk measurement ➡ Risk mitigation ➡ Risk monitoring and reporting

Reports are distributed to appropriate levels of management and to all areas of concern that may have an impact. The reports will fully reflect any identified problem area and will motivate timely corrective action on outstanding issues. The reports will be analyzed with a view to improving existing risk management performance as well as to develop new risk management policies and procedures.

Policies and guidelines for monitoring and mitigating risks: The company has put in place Risk appetite along with risk limits for monitoring risks. The risk limits are thresholds to monitor that actual risk levels lie below the limits set. All limit breaches are monitored by the Risk Department who seeks clarifications of such breaches from the business and reports to the CEO and Audit and Risk Committee. Limit breaches are followed by corrective actions in order to bring the risk to acceptable levels.

The strategies and processes for each risk category such as risk identification, assessment, mitigation, monitoring and reporting are described under each category in the forthcoming paragraphs.

4.1 Sharia Compliant Company

Mulkia is a professionally managed investment company. It conducts business according to the principles of Islamic Sharia and gives utmost importance to these principles. Mulkia aims at achieving comprehensive distinction in all of its business and achieving suitable returns for its shareholders and customers in light of compliance with the rules and principles of Islamic Sharia in all of its transactions. The corporate governance structure includes independent Sharia Compliance Committee.

4.2 Committees

The Company has setup the following Board level and Management level committees.

4.2.1 AUDIT & RISK COMMITTEE

It is concerned with supervising the effectiveness of the internal controls, compliance to laws and regulations procedures and the effectiveness of risk management function. The committee works with the management to ensure consistency of the accounting system with statutory requirements and recommending the appointment and re-appointment of auditors and as well as evaluating their works, dismissing them and determining their fees, in addition to studying the interim and final financial statements of the company.

4.2.2 NOMINATION & REMUNERATION COMMITTEE

A consultant committee of Company Board of Directors, appointed by the Board according to the regulation approved by Company General Assembly. The purpose of the Committee is to provide recommendations to Company Board of Directors about nomination to the membership of the Board and setting policies and standards for the remunerations of Board members and Company senior executives. The committee will be responsible for reviewing the board member's independence, determining the strong and weak points of the board and advising for rectifying them in consistency with the interest of the company.

4.2.3 INVESTMENT COMMITTEE

Investment Committee is formed from the Board Directors with the purpose to help the board in supervising investment transactions and monitoring the compliance to investment policies, strategies and risk limits, and review the overall performance of Mulkia in this regard. It also provides continuous assessment of investment portfolio performance against planned targets and review the level of compliance to the approved strategies, policies, standards and risk limits.

4.2.4 SHARIA COMPLIANCE COMMITTEE

Mulkia operates in the field of asset management, arraigning & corporate finance, financial advisory and research. Investments and financial services provided by Mulkia are compliant to Islamic law (Sharia Principles) as well as being subject to the supervision and compliance review of an independent Sharia Committee. The Committee looks after reviewing sophisticated contracts, certifying funds and corporate transactions, and monitoring all activities with annual Sharia audits.

4.2.5 MANAGEMENT COMMITTEE

The Management Committee is responsible for the execution of the business strategy and therefore bears responsibility for the identification, assessment and management of all risk categories through its day-to-day management of the Company and the implementation of effective management structures. The members of the Management Committee collectively have direct responsibility for all functions within the Company and receive update reports on the issues and risks arising from the various departments through regular meetings with the department heads.

The Company wishes to manage risks through a comprehensive mechanism that addresses risks at both senior management and operational level. As mentioned earlier, risk and audit committee that reviews the organizational risks at senior level is a critical component. The other important components of the risk management framework, as follows, are being actively considered in the HR, operations & accounting manuals:

4.3 Material Risk Identification Process

The Company will consider only material risks for ICAAP. Non-material risks will be identified and documented, however will be excluded with adequate justification for excluding them.

Risk Identification Process comprises the following key methodologies that provide a basis for prioritizing key risks. Material risk identification is an integrated process involving the following techniques as well as other Business Unit level initiatives. All the identified risks are communicated to Senior Management for appropriate action.

4.3.1 DUE DILIGENCE PROCESS TO MITIGATE INVESTMENT RISK

All investments are made only after proper approval by the Investment Committee. The investment philosophy is based on the objective of attaining the maximum returns to customers with the minimum degree of acceptable risks. To achieve this, the investment portfolios are carefully designed with proper diversification according to customer's investment targets, risk appetite and investment horizon. Before entering into any investment, the fundamental and technical researches, studies and analysis for the planned investment are conducted.

4.3.2 RISK REGISTERS

The Company has developed Risk Register that outlines key operational risk and other risks for the Company. Mitigation plan, action plan and due dates are defined for each major risk. This helps the company manage operational risks in a formal structured manner.

4.4 Internal Audit Function

The Company's internal audit function focuses on the appropriateness of controls instituted in the Company's processes. External auditors will be used to support the internal team. Auditor's review outcome and recommendations will be addressed on a priority basis to strengthen the Company's control environment.

4.5 Compliance Function

The Company has a Board approved Compliance Manual. The purpose of this manual is to document the Mulkiya's key obligations with regard to the Capital Market Authority's "CMA" rules and regulations and what derives from these regulations related to a company and its employees, and towards the Company's Customers. This Manual, apart from the above-mentioned objectives, provides a summary, of the applicable Authorized Persons Regulations "APRs" issued by the Board of Capital Market Authority, for the guidance of employees.

5 GENERAL QUALITATIVE DISCLOSURE FOR RISK

5.1 Credit Risk

Credit risk is one of the most important risks that Mulkiya faces in its operations and it is the failure of one or more of its major counterparties. It could be defined as the risk of a potential loss of cash reserves due to a Company failure or an obligor's non-payment of an outstanding debt.

Credit risk is principally controlled by establishing and enforcing limits and by defining exposure levels to counterparties and checking the creditworthiness of counterparties that are not related parties. To mitigate this risk, Mulkiya has diversified its banking relationships across local Saudi and international banks. It is to be noted that bank deposits in Saudi Arabia is guaranteed by the Saudi Arabian Monetary Agency (the Central Bank).

5.2 Market Risk

Market risk is the risk that the value of an investment will decrease due to movements in the market. The CMA has listed the following as key market risks: equity & fund risks, interest rate risk, commodities risk, foreign exchange risk, underwriting risk and settlement risk. Mulkiya has no exposure on currencies other than Saudi Riyals. Hence no foreign exchange risk is faced by the company. The company is exposed to specific risk and general market risk on its equity positions and investment funds. For measuring market risk various risk limits have been put in place. These limits work as active tools to control market risks emanating from changes in the value of market variables such as, equity prices.

5.3 Operational Risk

Basel II requires banks/Companies to have sufficient capital to cover Operational Risks. Operational Risk is defined as risk of loss resulting from inadequate or failed internal processes, people and systems as also the risk of loss arising from external events. More than the regulation, Basel II provides opportunity to improve internal control and risk measurement processes supplemented by supervisory review process and market discipline through Pillar II as well as Pillar III of the Accord.

Risks in this category are broad in nature and inherent in most businesses and processes and cover the Fraud or the risk of loss from financial crime.

Mulkiya aims to minimize the opportunity for fraud and financial crime through segregation of duties and due process. Employee background checks followed by the company while recruiting employees, employee code of conduct, compulsory leave policy and job rotation policy of the company will help

minimize frauds.

Outsourcing risk is mitigated by proper due diligence process in selecting outsourcing agency and periodical review of the same.

Business continuity and disaster recovery

Physical disasters affecting Mulkiya's premises and continued operations could come in many different forms – fire, flood, failure of IT systems, hacking, etc. Each of these different threats presents a risk to the Company. However, the impact of these different threats materializing will have many common implications which are detailed in the Disaster Recovery and Business Continuity Plans of the company. Appropriate electronic access control systems are being provided for entry into the organization. The Company's business is heavily technology dependent. In order to ensure uninterrupted operations, it is the policy of the organization to provide for back-ups of the following aspects of the business: (i) Data & information technology software (ii) Power supply (including UPS & Generator) (iii) Business continuity in case of extreme events (iv) Stand-by equipment (e.g. servers) that could be used on the failure of the equipment in service

5.4 Concentration risk

The regulators worldwide consider concentration risk as a material Pillar 2 Risk. Credit risk concentrations may involve large exposures to groups of connected clients. These groups refer to companies which are legally or economically connected in such a way that a majority of the individual companies in the group would encounter repayment problems if a single one of them encountered financial difficulties. Credit risk concentrations can generate such large losses that the risk-bearing capacity and continued existence of the Company might be endangered.

5.4.1 TYPES OF CONCENTRATION RISK

Concentration risk can take many forms and can arise whenever a significant number of credits have similar risk characteristics. Large exposures and high correlation between exposures could increase the amount of losses for the Company, and can arise from the following:

- Revenues generated from a particular geographical regions/ jurisdiction
- Revenues from a specific client
- Revenues from a specific product
- Revenues from a particular industry or economic sectors

Concentration Risk is managed through prescription of various prudential / exposure limits. The company's large exposures are within the prescribed prudential limits and does not pose any risk

5.4.2 GEOGRAPHIC CONCENTRATION

Credit risk concentrations may also emerge due to large exposures to a particular region/location. Any calamity or other events may affect a particular region adversely which may result in large credit losses and thus monitoring and ensuring geographical diversification is key to mitigate such concentration risks. The company is marginally exposed to geographic concentration as its entire investments are in Saudi

Arabia. However, the company does not actively monitor geographic concentration as the company is aware that the geographic concentrations are a result of its business model. Further, the exposures are well diversified.

5.4.3 CONCENTRATION RISK – INCOME

The company's major source of income is from Asset Management activity. If, for any reason, if the Asset management business faces difficulty or if some major investors pull out their funds the company may suffer a major setback in revenue, which will affect profitability and capital. The company shall take steps to ensure that it does not depend upon one or two major sources of revenue. This will be monitored through Risk Appetite statement.

The Company has in place the mitigating steps and controls such as comprehensive limit systems, diversification and monitoring.

5.5 Liquidity Risk

Liquidity Risk is the 'potential for loss' to Mulkia arising from either its inability to meet its obligations or to fund assets as they fall due without incurring unacceptable cost or losses. Liquidity Risks can be classified as:

- Funding liquidity risks: Need to replace net outflows.
- Time risk: Need to compensate for non-receipt of expected inflows,
- Call risk: Due to crystallization of contingent liabilities.

The company identifies the liquidity risk on an on-going basis. To mitigate these risk company, maintain enough cash to pay all projected operating costs for a period of 12 months. In respect of investing in long-term projects, Mulkia only invests in its own products. All investments are managed through the investment committee and regular reporting on performance and risks are made by the respective Head of Departments on the use of the Company's capital.

In order to ensure adequate liquidity availability and healthy funding profile, the company uses various metrics and internal controls. The liquidity risk measurement approach is qualitative and EWI (Early Warning Indicator) based. Cost to revenue ratio is one such metric. The company has proposed a cost to revenue ratio of 70% as cap in the risk appetite statement.

Liquidity risk is mitigated by the fact that Mulkia has no debt, maintains cash levels in excess of regulatory capital requirements

5.6 Interest Rate Risk

The exposure of the company's financial condition to adverse movements in interest rates is referred to as Interest Rate Risk. Since all of the Company's sources of funds are equity and there are no interest sensitive liabilities, IRRBB has no impact on company's Net Worth.

5.7 Settlement Risk

Settlement risk is the risk arising from failed transaction i.e. transaction executed is not settled as

expected. It is mainly associated with foreign exchange transaction falling in different time horizon and over the counter trades. It comprises both counterparty risk and liquidity risk. Counterparty risk derives from partial performance, late performance or default of the counterparty. Since the transactions are settled through exchange, which guarantees delivery/payment to the parties involved, there is no settlement risk faced by the company. Formal risk mitigation procedures will be defined when in the future, the Company enters into trading activities that may subject the Company to Settlement Risk.

5.8 Reputational risk

Reputational risk is the risk of indirect loss (current or prospective) and indirect risk to earnings and capital arising from adverse perception of the image of the financial institution on the part of customers, counterparties, shareholders, investors or regulators. It is manifested in the fact that the external opinion on the institution is less favorable than desired. Reputation is the Company's most vital intangible asset. While it takes enormous effort to protect the reputation, it does not take much to lose it. Reputation risk could arise due to compliance failure, failure to provide agreed service to customers or even due to failure to carry out adequate due diligence before admitting a customer into a relationship

This is particularly relevant since Mulkia is a small firm and therefore have to convince customers that they are credible and can offer good products and services expected from high profile investment banks. In order to protect its reputation, Mulkia needs to have the operational systems and control to mitigate this risk. The company manages reputation risk by ensuring business continuity, compliance to all regulatory guidelines etc. Since reputation risk is difficult to quantify, measurement is mostly qualitative in the form of an overall judgment on whether reputation risk is high or low. In the future, as the business increases, reputation risk scorecards may be developed to put a quantitative value to reputation risk.

Reputation risk is mitigated through good corporate governance structure, robust internal controls, timely honoring of commitments to counterparties, high quality human resources, quality products, distinctive media presence and distinctive commercial identity. Any adverse effects of reputation risk can be absorbed by the excess capital maintained over the regulatory capital levels.

5.9 Business and Strategic Risk

Strategic risk or business risk means the current and prospective risk to earnings and viability arising from (i) adverse changes in business environment with respect to the economy, political landscape, regulations, technology and actions of competitors. Business and strategic risks arise due to (i) company's plans to achieve a growth rate or market share that does not harmonize with the market environment (ii) lack of timely and proper adherence to environmental changes, (iii) assignment of inappropriate means to correctly chosen objectives (iv) Adverse business decisions, (v) proper implementation of decisions or poorly timed alignment to changes in the business environment, or specific actions that do not comply with strategic objectives and (vi) Lack of responsiveness to changes in the business environment.

The steps to assess the strategic risk for the Company are mainly relating to identification of the key drivers of the risk, assessment of the level, adequacy and effectiveness of the strategic risk management in the Company and to formulate a Strategic Risk Scorecard to quantify risk.

The strategic risk and business risks are mitigated through the risk management/risk monitoring elements viz. defining Risk appetite for the firm, conducting board meetings periodically, robust internal reporting system, performance monitoring etc.

5.10 Legal risk

Legal risk is the risk of financial or reputational loss arising from: regulatory or legal action; disputes for or against the company; failure to correctly document, enforce or adhere to contractual arrangements; inadequate management of non-contractual rights; or failure to meet non-contractual obligations.

An elaborate compliance manual helps the company to address all the above risks.

5.11 Regulatory Risk

The company operates under dynamic legislative environment whereas the capital market authority is continuously developing the regulations and rules governing the company's business. The changes that may occur on the applicable laws and regulations effective in the Kingdom of Saudi Arabia may effect on the company's business whether negatively or positively. In order to reduce the impact of such changes – if applicable – the company will permanently check the amendments to be made on the regulations and to study the impact of such amendments on its business and then to take the required steps for reducing the impact of such amendments and to employ it in a way to serve its business.

6 CREDIT RISK QUANTITATIVE DISCLOSURES

6.1 Gross Credit Risk Exposures and Risk Weights

Appendix III reveals the exposures attracting different risk weights.

6.2 Impaired loans

The Company regularly monitors the past due loans and the duration of such past due exposures. Depending on how long the loan has been past due and the availability of financial collateral, the Company decides to write off the loan amount as per the internal policy guidelines with the approval of competent authorities. A loan is considered past due if it is not repaid on the payment due date or maturity date.

The Company does not have any past due loans.

6.3 Credit risk's rated exposure

(Long term ratings of counterparties & Short term ratings of counterparties)

Appendix IV shows the exposures with each type of counter parties classified based on the credit rating of the counterparty as of December 31, 2019.

Mulkia follows Annex 11 and Annex 12 of the Prudential rules to determine the exposure's credit quality. All the exposures are short term in nature.

A major part of the credit exposure remained in unrated category and the remaining in Credit quality step 1.

6.4 Credit Risk Mitigation Exposures

6.4.1 QUALITATIVE DISCLOSURE

The Company does not deal in lending activities and as such has no eligible or non-eligible financial collaterals user for credit risk mitigation purposes. Accordingly, credit risk mitigation exposures are Nil.

6.4.2 QUALITATIVE AND QUANTITATIVE DISCLOSURE

Appendix V provides details for gross and net credit risk exposure as there are no risk mitigation exposures.

6.5 Residual contractual maturity of Credit exposures

The maximum amount credit risk exposures on contractual maturity falls beyond one year followed by > one month to three months and 1 day to one month as can be seen from the details in Appendix VI.

6.6 Geographic exposures of Credit Risk Exposures

The company has credit risk exposures only in Saudi Arabia. The details are furnished in Appendix VII.

6.7 Reconciliation report for provisions and impairments

Not applicable

6.8 COUNTERPARTY CREDIT RISK (CCR) AND OFF B/S DISCLOSURES

6.8.1 QUALITATIVE DISCLOSURE

Counterparty risk derives from the exposure to a single party in a financial transaction or business transaction. It is the risk in a transaction that may occur if the counterparty is unable to perform in accordance with the agreements executed with the Company.

6.8.2 QUALITATIVE AND QUANTITATIVE DISCLOSURE

The Company does not deal with transactions in OTC derivatives, repos and reverse repos and securities borrowing/ lending.

7 MARKET RISK DISCLOSURES

7.1 Market Risk - Qualitative disclosures

Market risk is the risk that the value of an investment will decrease due to movements in the market. The CMA has listed the following as key market risks: equity & fund risks, interest rate risk, commodities risk,

foreign exchange risk, underwriting risk and settlement risk.

Mulkia has no exposure on currencies other than Saudi Riyals. Hence no foreign exchange risk is faced by the company. The company is now not exposed to specific risk and general market risk on its equity positions and investment funds. Currently, market risk consists of only underwriting risk. For measuring market risk various risk limits have been put in place. These limits work as active tools to control market risks emanating from changes in the value of market variables such as, equity prices.

7.2 Quantitative disclosures

| <u>Market Risk</u> | Capital Required 31 Dec 2019 | Capital Required 31 Dec 2018 |
|--|---------------------------------|---------------------------------|
| Interest rate risks | | |
| Equity price risks | | |
| Risks related to investment funds | 3,019 | 963 |
| Underwriting Risk | | |
| Securitisation/re-securitisation positions | | |
| Excess exposure risks | | |
| Settlement risks and counterparty risks | | |
| Foreign exchange rate risks | | |
| Commodities risks | | |
| Total Market Risk Capital | 3,019 | 963 |

8 OPERATIONAL RISK DISCLOSURES

8.1 Qualitative disclosures

Basel II requires banks/Companies to have sufficient capital to cover Operational Risks. Operational Risk is defined as risk of loss resulting from inadequate or failed internal processes, people and systems as also the risk of loss arising from external events. More than the regulation, Basel II provides opportunity to improve internal control and risk measurement processes supplemented by supervisory review process and market discipline through Pillar II as well as Pillar III of the Accord

Outsourcing risk is mitigated by proper due diligence process in selecting outsourcing agency and periodical review of the same.

Employee retention is ensured through incentive of professionalized environment that motivates loyalty and creativity and continued development of employees. Imparting internal and external training is another strategy employed by Mulkia.

Legal action The risk of liability related to litigation from clients, staff or third parties is covered under legal action. This risk is mitigated by compliance with existing legislation, which is reinforced by internal policies and monitoring checks.

Business continuity and disaster recovery The company has robust Business Continuity and disaster recovery plans and also well thought out access control mechanism for IT systems.

8.2 Quantitative disclosures

Under Pillar 1, the capital needed to cover operational risks is the average of 15% of the last three reporting years' operating income approach or 25% of current reporting year expenditure approach. For Mulkia, the capital needed is based on 25% of the current year expenditure SAR. 13,161,000 and amounts to SAR 3,290,000 as it amounts to higher capital charge.

| Approach | Year | Gross Income | Average Gross Income | Risk Capital Charge (%) | Capital Required (SAR '000) |
|----------------------------------|------|--------------|----------------------|-------------------------|-----------------------------|
| Basic Indicator Approach | 2017 | 12,819 | 15,553 | 15% | 2,333 |
| | 2018 | 16,307 | | | |
| | 2019 | 17,534 | | | |
| Expenditure Based Approach | 2019 | 13,161 | 25% | | 3,290 |
| Minimum Operational Risk Capital | | | | | 3,290 |

9 LIQUIDITY RISK DISCLOSURE

9.1 Qualitative disclosures

Liquidity Risk is the 'potential for loss' to Mulkia arising from either its inability to meet its obligations or to fund assets as they fall due without incurring unacceptable cost or losses. Liquidity Risks can be classified as:

- Funding liquidity risks: Need to replace net outflows.
- Time risk: Need to compensate for non-receipt of expected inflows,
- Call risk: Due to crystallization of contingent liabilities.

The company identifies the liquidity risk on an on-going basis. To mitigate these risk company, maintain enough cash to pay all projected operating costs for a period of 12 months. In respect of investing in long-term projects, Mulkia only invests in its own products mainly. All investments are managed through the investment committee and regular reporting on performance and risks are made by the respective Head of Departments on the use of the Company's capital.

In order to ensure adequate liquidity availability and healthy funding profile, the company uses various metrics and internal controls. The liquidity risk measurement approach is qualitative and EWI (Early Warning Indicator) based.

9.2 Quantitative disclosures

Cost to revenue ratio is one such metric used to mitigate liquidity risk. The company has proposed a cost to revenue ratio of 70% as cap in the risk appetite statement, the EWI being set at 60%.

Liquidity risk is mitigated by the fact that Mulkia has no debt, maintains cash levels in excess of regulatory capital requirements

10 APPENDIX I – DISCLOSURE ON CAPITAL BASE

(SAR 000)

| Capital Base | 31 Dec. 2019 | 31 Dec. 2018 |
|--|---------------|---------------|
| <u>Tier-1 capital</u> | | |
| Paid-up capital | 75,000 | 75,000 |
| Audited retained earnings | (14,308) | (18,751) |
| Share premium | | |
| Reserves (other than revaluation reserves) | | |
| Tier-1 capital contribution | | |
| Deductions from Tier-1 capital | (522) | (1,891) |
| Total Tier-1 capital | 60,170 | 54,358 |
| <u>Tier-2 capital</u> | | |
| Subordinated loans | - | - |
| Cumulative preference shares | - | - |
| Revaluation reserves | - | - |
| Other deductions from Tier-2 (-) | - | - |
| Deduction to meet Tier-2 capital limit (-) | - | - |
| Total Tier-2 capital | - | - |
| TOTAL CAPITAL BASE | 60,170 | 54,358 |

11 APPENDIX II – CAPITAL ADEQUACY

(SAR '000)

| Exposure Class | Exposures before CRM SAR '000 | Net Exposures after CRM SAR '000 | Risk Weighted Assets SR '000 | Capital Requirement SAR '000 |
|---|----------------------------------|--|------------------------------------|------------------------------------|
| <u>Credit Risk</u> | | | | |
| <i>On-balance Sheet Exposures</i> | | | | |
| Governments and Central Banks | - | - | - | - |
| Authorised Persons and Banks | 6,283 | 6,283 | 1,257 | 176 |
| Corporates | 121 | 121 | 864 | 121 |
| High risk investments | 3,034 | 3,034 | 12,136 | 1,699 |
| Investment funds | 30,848 | 30,848 | 73,592 | 10,303 |
| Investment funds (underlying) | 6,804 | 6,804 | 10,190 | 1,427 |
| Others exposures | 2,173 | 2,173 | 7,293 | 1,021 |
| Total On-Balance sheet Exposures | 49,263 | 49,263 | 105,332 | 14,746 |
| <i>Off-balance Sheet Exposures</i> | | | | |
| OTC/Credit Derivatives | | | | |
| Repurchase agreements | | | | |
| Securities borrowing/lending | | | | |
| Commitments | - | - | - | - |
| Other off-balance sheet exposures | | | | |
| Total Off-Balance sheet Exposures | - | - | - | - |
| Total On and Off-Balance sheet Exposures | 49,263 | 49,263 | 105,332 | 14,746 |
| Prohibited Exposure Risk Requirement | - | - | - | - |
| Total Credit Risk Exposures | 49,263 | 49,263 | 105,332 | 14,746 |
| <u>Market Risk</u> | Long Position | Short Position | | |
| Interest rate risks | | | | - |
| Equity price risks | | | | - |
| Risks related to investment funds | 18,866 | | | 3,019 |
| Securitisation/resecuritisation positions | | | | - |
| Underwriting Risk | | | | - |
| Settlement risks and counterparty risks | | | | - |
| Foreign exchange rate risks | | | | - |
| Commodities risks. | | | | - |
| Total Market Risk Exposures | 18,866 | - | | 3,019 |
| <u>Operational Risk</u> | | | | 3,290 |
| Minimum Capital Requirements | | | | 21,055 |
| Surplus/(Deficit) in capital | | | | 39,115 |
| Total Capital ratio (time) | | | | 2.86 |

12 APPENDIX III – CREDIT RISK'S RISK WEIGHTS

(SAR 000)

| Risk Weights | | | | | | | | |
|------------------------------------|------------------------------|------------|-----------------------|------------------|-------------------------------|------------------|---|----------------------------|
| | Authorised persons and banks | Corporates | High Risk Investments | Investment funds | Investment funds (underlying) | Others exposures | Total Exposure after netting and Credit Risk Mitigation | Total Risk Weighted Assets |
| 0% | | | | | | | - | - |
| 20% | 6,283 | | | | 12 | | 6,295 | 1,259 |
| 50% | | | | | | | - | - |
| 100% | | | | | | | - | - |
| 150% | - | | | 593 | 6,792 | | 7,385 | 11,078 |
| 200% | | | | | | | - | - |
| 300% | | | | 24,234 | | 1,986 | 26,220 | 78,660 |
| 400% | | | 3,034 | | | | 3,034 | 12,136 |
| 500% | | | | | | | - | - |
| 714% (include prohibited exposure) | | 121 | | | | 187 | 308 | 2,199 |
| Average Risk Weight | 20% | 714% | 400% | 296% | 150% | 336% | 244% | |
| Deduction from Capital Base | 176 | 121 | 1,699 | 10,303 | 1,427 | 1,021 | 14,746 | |

13 APPENDIX IV – CREDIT RISK'S RATED EXPOSURES

(SAR 000)

| Exposure Class | Long term Ratings of counterparties | | | | | | |
|---|-------------------------------------|------------|----------|--------------|------------|----------|----------------|
| | Credit quality step | 1 | 2 | 3 | 4 | 5 | 6 |
| | S&P | AAA TO AA- | A+ TO A- | BBB+ TO BBB- | BB+ TO BB- | B+ TO B- | CCC+ and below |
| | Fitch | AAA TO AA- | A+ TO A- | BBB+ TO BBB- | BB+ TO BB- | B+ TO B- | CCC+ and below |
| | Moody's | Aaa TO Aa3 | A1 TO A3 | Baa1 TO Baa3 | Ba1 TO Ba3 | B1 TO B3 | Caa1 and below |
| | Capital Intelligence | AAA | AA TO A | BBB | BB | B | C and below |
| On and Off-balance-sheet Exposures | | | | | | | |
| Governments and Central Banks | | - | | | | | |
| Authorised Persons and Banks | | 6,283 | | | | | - |
| Corporates | | | | | | | 121 |
| Retail | | | | | | | - |
| Investments | | | | | | | 40,686 |
| Securitisation | | | | | | | - |
| Margin Financing | | | | | | | - |
| Other Assets | | | | | | | 2,173 |
| Total | - | 6,283 | - | - | - | - | - |

| Exposure Class | Short term Ratings of counterparties | | | | |
|---|--------------------------------------|-----------|-----|-----|-----------|
| | Credit quality step | 1 | 2 | 3 | 4 |
| | S & P | A-1+, A-1 | A-2 | A-3 | Below A-3 |
| | Fitch | F1+, F1 | F2 | F3 | Below F3 |
| | Moody's | P-1 | P-2 | P-3 | Not Prime |
| | Capital Intelligence | A1 | A2 | A3 | Below A3 |
| On and Off-balance-sheet Exposures | | | | | |
| Governments and Central Banks | | | | | |
| Authorised Persons and Banks | | 6,283 | - | | - |
| Corporates | | | | | 121 |
| Retail | | | | | - |
| Investments | | | | | 40,686 |
| Securitisation | | | | | - |
| Margin Financing | | | | | - |
| Other Assets | | | | | 2,173 |
| Total | - | 6,283 | - | - | - |

14 APPENDIX V - DISCLOSURE ON CREDIT RISK MITIGATION (CRM)

(SAR 000)

| Exposure Class | Exposures before CRM | Exposures covered by Guarantees/ Credit derivatives | Exposures covered by Financial Collateral | Exposures covered by Netting Agreement | Exposures covered by other eligible collaterals | Exposures after CRM |
|---|----------------------|---|---|--|---|---------------------|
| <u>Credit Risk</u> | | | | | | |
| <i>On-balance Sheet Exposures</i> | | | | | | |
| Governments and Central Banks | - | - | - | - | - | - |
| Authorised Persons and Banks | 6,283 | - | - | - | - | 6,283 |
| Corporates | 121 | - | - | - | - | 121 |
| Retail | - | - | - | - | - | - |
| Investments | 40,686 | - | - | - | - | 40,686 |
| Margin Financing | - | - | - | - | - | - |
| Others exposures | 2,173 | - | - | - | - | 2,173 |
| Total On-Balance sheet Exposures | 49,263 | - | - | - | - | 49,263 |
| <i>Off-balance Sheet Exposures</i> | | | | | | |
| OTC/Credit Derivatives | - | - | - | - | - | - |
| Exposure in the form of repurchase agreements | - | - | - | - | - | - |
| Exposure in the form of securities lending | - | - | - | - | - | - |
| Exposure in the form of commitments | - | - | - | - | - | - |
| *Other Off-Balance sheet Exposures | - | - | - | - | - | - |
| Total Off-Balance sheet Exposures | - | - | - | - | - | - |
| Total On and Off-Balance sheet Exposures | 49,263 | - | - | - | - | 49,263 |

* Refer to Chapter 2 of Annex 3.

15 APPENDIX VI - RESIDUAL CONTRACTUAL MATURITY OF CREDIT RISK EXPOSURES

(SAR 000)

| Exposure Class | Total | 1 Day to 1 month | >1 month to 3 months | >3 months to 6months | >6 months to 1 year | >1 year |
|---|---------------|------------------|----------------------|----------------------|---------------------|---------------|
| <i>Credit Risk</i> | | | | | | |
| <i>On-balance Sheet Exposures</i> | - | | | | | |
| Governments and Central Banks | - | - | | | | |
| Authorised Persons and Banks | 6,283 | 6,283 | - | | | |
| Corporates | 121 | | | | 121 | |
| Retail | - | | | | - | |
| Investments | 40,686 | | | | | 40,686 |
| Securitisation | - | | | | | |
| Margin Financing | - | | | | | |
| Other Assets | 2,173 | | | | | 2,173 |
| Total On-Balance sheet Exposures | 49,263 | 6,283 | - | - | 121 | 42,859 |
| <i>Off-balance Sheet Exposures</i> | - | | | | | |
| OTC/Credit Derivatives | - | | | | | |
| Repurchase agreements | - | | | | | |
| Securities borrowing/lending | - | | | | | |
| Commitments | - | | | | | - |
| Other off-balance sheet exposures | - | | | | | |
| Total Off-Balance sheet Exposures | - | - | - | - | - | - |
| Total On and Off-Balance sheet Exposures | 49,263 | 6,283 | - | - | 121 | 42,859 |

16 APPENDIX VII – GEOGRAPHIC DISTRIBUTION

(SAR 000)

| Exposure Class | Total | Saudi Arabia | GCC (Except Saudi Arabia) | Europe | Rest of the World |
|---|---------------|---------------|---------------------------|--------|-------------------|
| <i>Credit Risk</i> | | | | | |
| <i>On-balance Sheet Exposures</i> | - | | | | |
| Governments and Central Banks | - | - | | | |
| Authorised Persons and Banks | 6,283 | 6,283 | | - | |
| Corporates | 121 | 121 | | | - |
| Retail | - | - | | | |
| Investments | 40,686 | 40,686 | | - | - |
| Securitisation | - | | | | |
| Margin Financing | - | | | | |
| Other Assets | 2,173 | 2,173 | | | |
| Total On-Balance sheet Exposures | 49,263 | 49,263 | - | - | - |
| <i>Off-balance Sheet Exposures</i> | - | | | | |
| OTC/Credit Derivatives | - | | | | |
| Repurchase agreements | - | | | | |
| Securities borrowing/lending | - | | | | |
| Commitments | - | - | | | |
| Other off-balance sheet exposures | - | | | | |
| Total Off-Balance sheet Exposures | - | - | - | | - |
| Total On and Off-Balance sheet Exposures | 49,263 | 49,263 | - | - | - |



