

**Merrill Lynch Kingdom of Saudi Arabia Company**

# **Pillar 3 Disclosure**

As at 31 December 2015

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## List of Abbreviations

BAC	Bank of America Corporation
CCR	Counterpart Credit Risk
CFP	Contingency Funding Plan
COR	Corporate Operational Risk
CMA	Capital Market Authority
FICR	Financial Institution Credit Risk
Fitch	Fitch Ratings, Inc.
ICAAP	Internal Capital Adequacy Assessment Process
IPO	Initial Public Offering
MLKSA	Merrill Lynch Kingdom of Saudi Arabia
Moody's	Moody's Investors Service, Inc.
RCSA	Risk and Control Self-Assessment
RRC	Reputational Risk Committee
S&P	Standard & Poor's
SAMA	Saudi Arabian Monetary Agency
SAR	Saudi Riyals

# 1. Introduction

## 1.1. Overview and Purpose of Document

This document contains the Pillar 3 disclosures as at 31 December 2015 in respect of capital and risk management for Merrill Lynch Kingdom of Saudi Arabia Company (“MLKSA”), a Saudi Arabian Closed Joint Stock Company.

The Basel II framework was implemented by the Capital Market Authority (“CMA”) through its Prudential Rules in 2013. The Prudential Rules consist of three Pillars. Pillar 1 is defined as “Minimum Capital Requirements”, Pillar 2 “Assessment of All Risks” and Pillar 3 “Disclosure and Reporting”. The aim of Pillar 3 is to encourage market discipline by allowing market participants to access key information regarding the capital adequacy of institutions through a prescribed set of disclosure requirements.

The document provides detail on the capital resources available to MLKSA (“Capital Resources”) and the regulatory defined Pillar 1 minimum capital requirements for MLKSA (“Minimum Capital Requirements”), and demonstrates that MLKSA has Capital Resources in excess of these requirements and robust risk management and controls.

### 1.1.1. Merrill Lynch Kingdom of Saudi Arabia Company

MLKSA is a Saudi Closed Joint Stock Company registered in the Kingdom of Saudi Arabia under Commercial Registration No. 1010245128 issued in Riyadh on Safar 19, 1429H (corresponding to February 26, 2008), CMA license No. 07066-37 dated 18 Dhul Qa’idah 1429H (corresponding to November 18, 2008) and ministerial resolution number 5/314 dated 1 Dhul Haj 1428H (corresponding to December 11, 2007).

MLKSA is Bank of America’s (“BAC” or “the Company”) Saudi Arabian broker-dealer. MLKSA is a wholly-owned indirect subsidiary of BAC. MLKSA has its office in Riyadh, in Saudi Arabia, and plays a key role within the wider BAC group, providing access to the Saudi Arabian market for Global Banking and Global Markets clients. MLKSA is BAC’s exclusive Global Markets trading entity in Saudi Arabia.

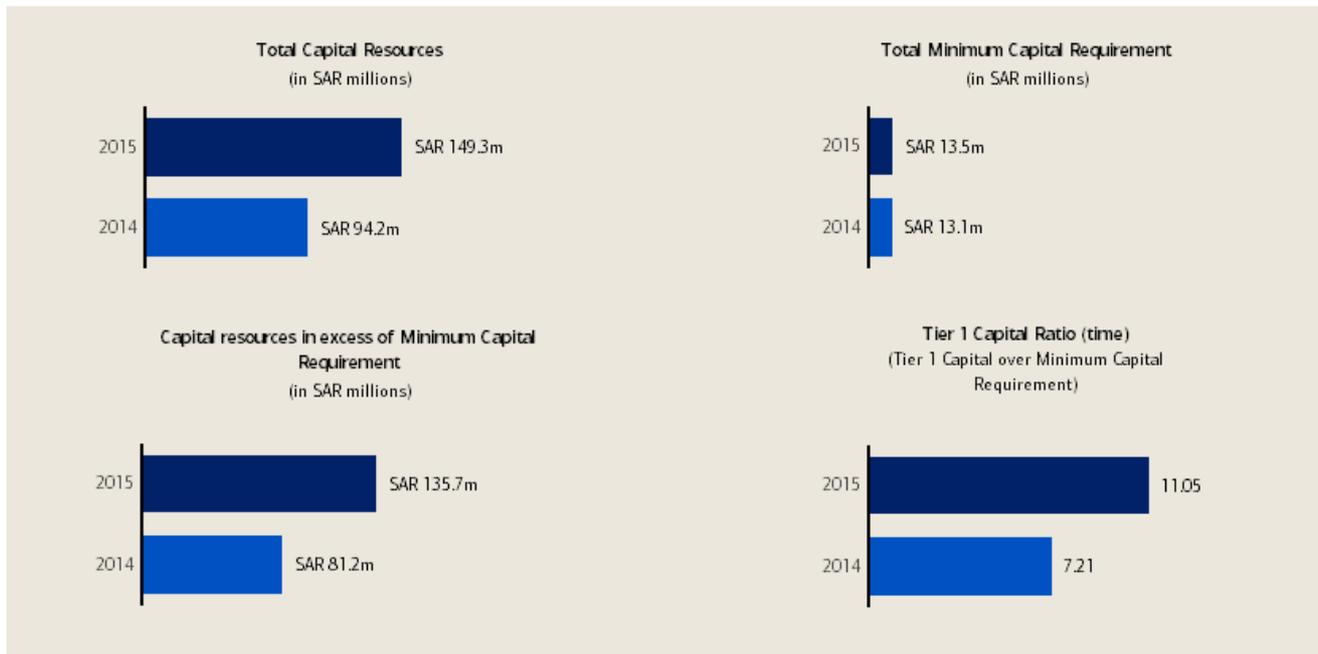
The activities of MLKSA are to engage in dealing activities in its capacity as an agent and principal and to undertake underwriting, management, arranging, advisory and custody services for securities.

# Merrill Lynch Kingdom of Saudi Arabia – Pillar 3 Disclosures 2015

## 1.1.2. MLKSA's Capital Position as at 31 December 2015

MLKSA has Capital Resources of SAR 149.3 million made up exclusively of Tier 1 Capital. MLKSA has a Tier 1 Capital Ratio of 11.05 (defined by the CMA as Tier 1 Capital over Total Minimum Capital Requirement) and a surplus over Minimum Capital Requirements of SAR 135.7 million. Figure 1 illustrates MLKSA's key capital metrics.

Figure 1. Summary of Key Metrics as at 31st December 2015



## 1.2. Basis of Preparation

The information contained in these disclosures has been prepared in accordance with regulatory capital adequacy concepts and rules. The information is not directly comparable with the annual financial statements and the disclosures are not required to be audited by the external auditors.

The document has been prepared purely to comply with Pillar 3 disclosure rules, for the purpose of explaining the basis on which MLKSA has prepared and disclosed certain information about the management of risks and regulatory capital adequacy concepts and rules, and for no other purpose. It therefore does not constitute any form of financial statement on MLKSA or of the wider enterprise, nor does it constitute any form of contemporary or forward looking record or opinion on the BAC group. Although Pillar 3 disclosures are intended to provide transparent information on a common basis, the information contained in this document may not be directly comparable with the information provided by other banks.

These disclosures are published on both MLKSA and BAC corporate websites:

<http://investor.bankofamerica.com>

[www.ml-ksa.com](http://www.ml-ksa.com)

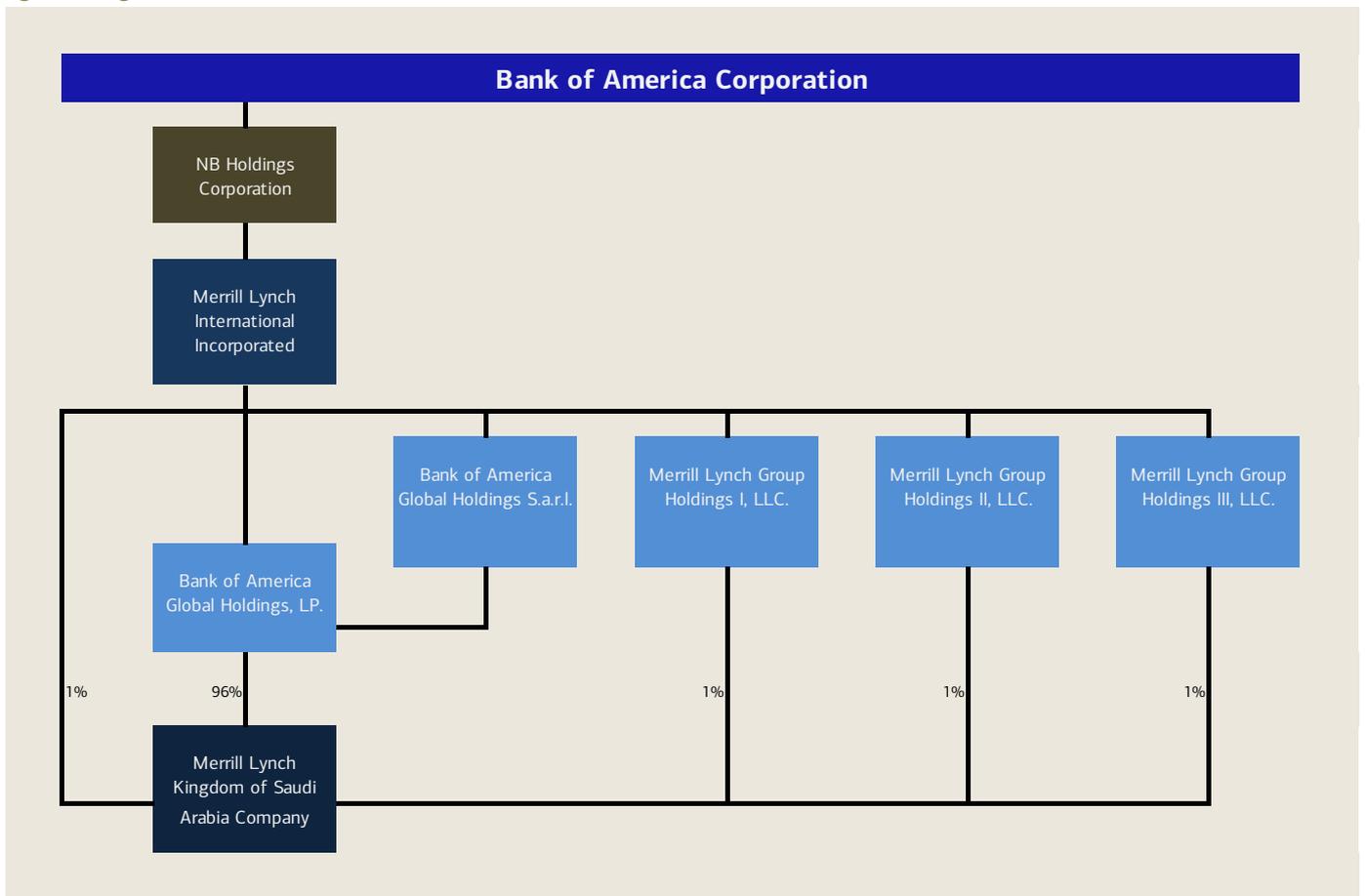
## 1.3. Operation, Structure and Organisation

MLKSA has a key role within the wider BAC group, by providing Saudi market access for Global Banking and Global Markets clients. MLKSA is BAC's exclusive Global Markets trading entity in Saudi Arabia.

The principal activities of MLKSA are to engage in dealing activities in its capacity as an agent and principal and to undertake underwriting, management, arranging, advisory and custody services for securities.

For a full BAC organisation chart, please refer to the investor relations website at <http://investor.bankofamerica.com>

Figure 2. Organisation Chart



## 2. Capital Resources and Minimum Capital Requirements

## 2.1. Capital Resources

### 2.1.1. Summary of Capital Resources in 2015

Capital resources represent the amount of regulatory capital available to an entity in order to cover all risks. Defined under the CMA's Prudential Rules, capital resources are designated into 2 tiers, Tier 1 and Tier 2 Capital. Tier 1 Capital is the highest quality of capital and typically represents equity and audited reserves. Tier 2 Capital typically consists of subordinated debt capital instruments, and capital contributions not meeting the conditions of Tier 1.

MLKSA's Capital Resources are composed entirely of Tier 1 Capital.

Table 1. Capital Resources

(SAR in Thousands)	2015	2014
Fully Paid Up Ordinary Share Capital*	143,000	95,000
Statutory Reserve	3,733	3,239
Profit and Loss Account and Other Reserves	4,618	176
Total Tier 1 Capital Before Deductions	151,351	98,415
Deferred tax assets	-2,101	-4,177
<b>Tier 1 Capital</b>	<b>149,250</b>	<b>94,238</b>
<b>Tier 2 Capital</b>	<b>0</b>	<b>0</b>
<b>Total Capital Resources (net of deductions)</b>	<b>149,250</b>	<b>94,238</b>

### 2.1.2. Key Movements in 2015

MLKSA's Tier 1 Capital base increased from SAR 94.2 million in 2014 to SAR 149.3 million in 2015 as a result of both a capital injection of SAR 48 million, approved by the CMA on 7<sup>th</sup> January 2015, and the addition of 2015 audited post-tax profits.

MLKSA's Tier 1 Capital ratio, as defined by the CMA, increased from 7.21 to 11.05 as a result of the increase in Tier 1 Capital.

### 2.1.3. Transferability of Capital within the Group

MLKSA's Capital Resources are satisfied by sourcing capital either directly from BAC or from other affiliates.

There are no current or foreseen material practical or legal impediments to the prompt transfer of capital resources or repayment of liabilities.

## 2.2. Minimum Capital Requirements

### 2.2.1. Summary

MLKSA must ensure that its capital surplus remains above the CMA’s Pillar 1 minimum capital requirements at all times. MLKSA’s capital resources must be greater than its Total Minimum Capital Requirements, allowing for a capital surplus to cover any additional requirements, for example, Pillar 2.

MLKSA’s Total Minimum Capital Requirement principally comprises of credit risk in non-trading books, operational risk and market risk requirements. MLKSA does not have risks in the trading book nor any commodity risk.

MLKSA has a Total Minimum Capital Requirement of SAR 13.5 million including a credit risk requirement SAR 6.2 million, operational risk requirement SAR 7.1 million, and market risk requirement of SAR 0.3 million.

Table 2 details the Minimum Capital Requirements for MLKSA by type of risk. MLKSA’s Capital Resources are significantly in excess of the Pillar 1 Minimum Capital Requirements.

Table 2. Minimum Capital Requirements  
(SAR in Thousands)

	2015	2014
<b>Total Capital Resources</b>	<b>149,250</b>	<b>94,238</b>
Market Risk	253	1,116
Credit Risk	6,203	5,982
Operational Risk	7,052	5,966
<b>Total Minimum Capital Requirements</b>	<b>13,508</b>	<b>13,063</b>
<b>Surplus over Requirements</b>	<b>135,742</b>	<b>81,175</b>

### 2.2.2. Key Movements in 2015

MLKSA’s Total Minimum Capital Requirements have increased from SAR 13.1 million to SAR 13.5 million. The increase in capital requirement is a function of an increase in credit risk reflecting higher cash balances held at a Saudi bank and operational risk derived from a higher expense base in 2015. The increase in both credit and operational risk was offset by a lower market risk capital requirement derived from lower foreign exchange (“FX”) risk as, over the 2014 year end, MLKSA had placed USD 12.8 million with a Saudi bank associated to the SAR 48 million capital injection. The capital injection was approved by the CMA on 7<sup>th</sup> January 2015 and subsequently exchanged from USD to SAR reducing market FX risk.

### 2.2.3. Minimum Capital Requirements Approach

MLKSA has adopted the approach specified by the CMA in their Prudential Rules for calculating credit risk capital requirements and expenditure based approach for calculating the operational risk capital requirement. MLKSA uses external ratings based on a combination of Moody’s Investors Service, Inc. (“Moody’s”), Standard and Poor’s (“S&P”) and Fitch Ratings, Inc. (“Fitch”), and adheres to the Prudential Rules set out by the CMA.

## 2.3. Capital Resources vs. Minimum Capital Requirements and Tier 1 Capital Ratio (time)

### 2.3.1. Capital Resources vs. Total Minimum Capital Requirements

MLKSA has SAR 135.7 million of Capital Resources in excess of Total Minimum Capital Requirements, which has increased from SAR 81.2 million in 2014. The increase in the excess is driven by an increase in Capital Resources.

Capital Resources and Capital Requirements for MLKSA are monitored on a daily basis. MLKSA continuously maintains a surplus over Total Minimum Capital Requirements.

### 2.3.2. Tier 1 Capital Ratio (time)

An entity's Tier 1 Capital Ratio (time) is defined by the CMA as Total Tier 1 Capital over Total Minimum Capital Requirement.

MLKSA's Tier 1 Capital Ratio (time) has increased from 7.21 to 11.05 over the year due to an increase in Tier 1 Capital Resources while Total Minimum Capital Requirements remained broadly flat year on year. MLKSA's Tier 1 Capital Ratio (time) is in excess of the CMA ratio requirement of 1.00.

Table 3. Capital Surplus over Minimum Capital Requirements and Tier 1 Capital Ratio (time)

(SAR in Thousands)	2015	2014
Total Capital Resources	149,250	94,238
Total Minimum Capital Requirements	13,508	13,063
<b>Surplus over Requirements</b>	<b>135,742</b>	<b>81,175</b>
Tier 1 Capital Resources	149,250	94,238
<b>Tier 1 Capital Ratio (time)</b>	<b>11.05</b>	<b>7.21</b>

### 3. Risk Management, Objectives and Policy

## 3.1. Enterprise Risk Framework

BAC has established a risk governance framework (the “Risk Framework”) which serves as the foundation for consistent and effective management of risks facing BAC and its subsidiaries. BAC adopted a revised Risk Framework in January 2016 with additional enhancements to the original Framework published in 2010.

MLKSA is integrated into and adheres to the global BAC group management structure including risk management and oversight, as adapted to reflect local business, legal and regulatory requirements.

The following section lays out the risk management approach and key risk types for MLKSA.

## 3.2. Enterprise Risk Management Approach

Risk is inherent in all business activities. Managing risk well is the responsibility of every employee. Sound risk management enables BAC to serve customers and deliver for the shareholders. If not managed well, risks can result in financial loss, regulatory sanctions and penalties, and damage to BAC’s reputation, each of which may adversely impact BAC’s ability to execute its business strategies. It is critical that every employee embraces sound risk management practices as a core component of his or her role and responsibilities.

The Risk Framework provides an understanding of BAC’s approach to risk management and each employee’s responsibilities for managing risk. The following are the five components of BAC’s risk management approach:

- Risk Culture
- Risk Appetite
- Risk Management Processes
- Risk Data Management Aggregation and Reporting
- Risk Governance

Focusing on these five components allows effective management of risks across the seven key risk types faced by MLKSA businesses, namely: Strategic, Credit, Market, Liquidity, Operational, Compliance and Reputational risks.

## 3.3. Risk Culture

A strong risk culture is fundamental to BAC’s core values and operating principles. It requires BAC to focus on risk in all activities and encourages the necessary mindset and behaviour to enable effective risk management and promote sound risk-taking within BAC’s risk appetite. Sustaining a strong risk culture throughout the organization is critical to the success of BAC and is a clear expectation of BAC’s executive management team and its Boards of Directors.

The following principles form the foundation of BAC’s risk culture:

1. Managing risk well protects BAC and its reputation and enables BAC to deliver on its purpose and strategy
2. BAC treats customers fairly and acts with integrity to support the long-term interests of its employees, customers and shareholders
3. Individual accountability and an ownership mindset are the cornerstones of BAC’s Code of Conduct and are at the heart of its risk culture
4. All employees are responsible for proactively managing risk as part of their day-to-day activities through prompt identification, escalation and debate of risks

5. While BAC employs models and methods to assess risk and better inform BAC's decisions, proactive debate and a thorough challenge process lead to the best outcomes
6. Lines of business and other front line units are first and foremost responsible for managing all aspects of their businesses, including all types of risk
7. Independent risk management provides independent oversight and effective challenge, while Corporate Audit provides independent assessment and validation
8. BAC strive to be best-in-class by continually working to improve risk management practices and capabilities

## 3.4. Risk Appetite

BAC's and line of business risk appetite statements clearly define the amount of capital, earnings or liquidity that it is willing to put at risk (over a certain time period with a given likelihood of occurring) to achieve its strategic objectives and business plans, consistent with applicable regulatory requirements. The risk appetite statements ensures that BAC maintains an acceptable risk profile that is in alignment with its strategic and capital plans. The risk appetite statements include both quantitative limits and qualitative components that are reviewed and approved by the BAC Board of Directors at least annually.

The Risk Appetite Statement is rooted in following principles:

- **Overall risk capacity:** BAC's overall capacity to take risk is limited; therefore, it prioritizes the risks it takes.
- **Financial strength to absorb adverse outcomes:** BAC sets objectives and targets for capital and liquidity that permit it to continue to operate in a safe and sound manner at all times, including during periods of stress.
- **Risk-reward evaluation:** Risks taken must fit BAC's risk appetite and offer acceptable risk-adjusted returns for shareholders.
- **Acceptable risks:** BAC considers all types of risk including those that are difficult to quantify. Qualitative guidance within the risk appetite statement describes BAC's approach to managing such risks in a manner consistent with its risk culture.
- **Skills and capabilities:** BAC seeks to assume only those risks it has the skills and capabilities to identify, measure, monitor and control.

## 3.5. Risk Management Processes

The Risk Framework requires that strong risk management practices are integrated in key strategic, capital and financial planning processes and day-to-day business processes across BAC, thereby ensuring risks are appropriately considered, evaluated and responded to in a timely manner.

BAC approach to Risk Management Processes:

- All employees are responsible for proactively managing risk
- Risk considerations are part of all daily activities and decision-making
- BAC encourages a thorough challenge process and maintains processes to identify, escalate and debate risks
- BAC utilises timely and effective escalation mechanisms for risk limit breaches

The front line units have primary responsibility for managing risks inherent in their businesses. BAC employs an effective risk management process, referred to as IMMC: Identify, Measure, Monitor and Control as part of its daily activities.

## 3.6. Risk Data Management, Aggregation and Reporting

Effective risk data management, aggregation and reporting is critical to provide a clear understanding of current and emerging risks and enable BAC to proactively and effectively manage risk.

Risk Data Management, Aggregation and Reporting Principles:

- Comprehensive, accurate, reliable and timely data.
- Clear and uniform language to articulate risks consistently across BAC.
- Robust risk quantification methods.
- Timely, accurate and comprehensive view of all material risks, including appropriate levels of disaggregation.

## 3.7. Risk Governance

BAC adheres to a risk governance framework that is designed by independent risk management and approved by the BAC Board of Directors. The risk governance framework includes delegation of authority from BAC Board of Directors or board committees to management committees and executive officers as well as risk limits established for material activities to ensure BAC operates within risk appetite.

BAC's Risk Governance Principles serve as the cornerstone of its risk governance framework. The BAC Code of Conduct, Risk Framework and risk appetite statements are overarching documents that firmly embed BAC's risk culture in everything it does.

## 3.8. Key Risk Types

The Risk Framework outlined above allows BAC to manage risks across the seven key risk types; strategic, credit, market, liquidity, operational, compliance and reputational. MLKSA's risk management is overseen by the Board of Directors of MLKSA in collaboration with other Risk groups. The seven risk types are defined below, and key risk assessments for MLKSA's activities are provided below:

### Strategic Risk

#### Definition

Strategic risk is the risk that results from adverse business decisions, inappropriate business plans, ineffective business strategy execution, or failure to respond in a timely manner to changes in the macroeconomic environment, such as business cycles, competitor actions, changing customer preferences, product obsolescence, technology developments and regulatory environment.

#### Management of risk

The strategic risk appetite is translated into operational, earnings, capital and liquidity targets which are embedded into BAC's strategic and financial operating plans. Senior management is responsible for measuring and assessing strategic risk against these targets. Strategic and financial operating plans are updated, as needed, to balance and optimize between achieving shareholder returns and maintaining the targeted risk appetite and financial profile.

### Credit Risk

#### Definition

BAC defines credit risk as the loss arising from the inability or failure of a borrower or counterparty to meet its obligations. BAC defines the credit exposure to a borrower or counterparty as the loss potential arising from loans, leases, derivatives and other extensions of credit.

#### MLKSA credit risk

MLKSA credit risk primarily arises from cash placed at a Saudi Bank, and intercompany receivables. Credit risk may also, but does not ordinarily, arise from its Global Markets Equities business, which provides local clients prefunding facilities on an uncommitted basis to access the local stock market.

#### Management of risk

Credit risk is managed based on the risk profile of the borrower or counterparty, which includes repayment sources, underlying collateral (if any), and the expected impacts of the current and forward-looking economic environment on these borrowers. Underwriting, credit management and credit risk limits are proactively reassessed as a borrower's or counterparty's risk profile changes.

Credit management includes the following processes:

- Credit origination
- Portfolio management
- Loss mitigation activities

Managing through these processes creates a comprehensive consolidated view of our enterprise wide credit risk activities, thus providing executive management the information required to guide or redirect strategic plans.

## Credit Risk (cont'd)

### **Application of the credit risk management process to MLKSA credit facilities**

Credit analysis of clients of MLKSA is aligned to BAC's credit policies and standards, credit risk appetite and applicable local laws and regulations. Credit risk profiles are assessed through risk modeling, underwriting and asset analysis, whilst also considering current economic and industry outlooks. Limits and ratings are subsequently approved based on the appropriate Credit Authority Grid. Limits applied for equities settled free of payment reference MLKSA's capital base and can be subject to a Streamlined Tolerance Limit (subject to eligibility criteria).

Risk management is overseen by the Board of Directors of MLKSA in collaboration with other Risk groups. MLKSA's equity trading employees in conjunction with CFO and Operations are responsible for ensuring that all of transactions are conducted with approved clients, limits and policies. At the front line unit level, independent risk oversees credit risk management processes and governance in accordance with BAC requirements and authority levels. MLKSA Operations produce daily reporting on positions. At an Enterprise level, BAC's credit risk reporting enables appropriate risk escalation, which includes defined protocols to be followed for policy violations, limit breaches, exceptions, emerging risks and issues.

## Market Risk

### **Definition**

BAC defines Market risk as the risk that changes in market conditions may adversely impact the value of assets or liabilities or otherwise negatively impact earnings.

### **MLKSA Market Risk**

Market Risk in MLKSA arises from FX and from equity participation in Initial Public Offerings ("IPO's"). FX risk is minimal as the Saudi Riyal is pegged to the US Dollar. MLKSA does participate in equity IPO's, and this participation can generate market risk. MLKSA is not faced with market risks that relate to concentrated, one-way, or illiquid positions.

### **Management of risk**

The Global Markets division of BAC seeks to run its business on a globally consistent basis. This means that the market risks assumed by Global Markets are identified, measured and controlled on a consistent basis irrespective of the location in which they are taken and booked. IPO positions are all subject to pre-approval by MLKSA's Investment Committee, and Market Risk also provides input to the approval process.

## Liquidity Risk

### **Definition**

BAC defines Liquidity Risk as the potential inability to meet contractual and contingent financial obligations, both on or off-balance sheet, as they come due.

### **MLKSA Liquidity Risk**

MLKSA has minimal inherent liquidity risk within its business activities.

### **Management of risk**

In line with CMA Prudential Rules requirements, the MLKSA Liquidity Risk Policy articulates the principles for managing liquidity risk within MLKSA. The MLKSA Contingency Funding Plan documented within the Liquidity Risk Policy also details senior management's strategy to address potential liquidity shortfalls during periods of stress.

## Operational Risk

### Definition

BAC defines Operational Risk as the risk of loss resulting from inadequate or failed internal processes, people and systems, or from external events.

### MLKSA Operational Risk

Operational risks are associated with the following seven operational loss event categories: internal fraud; external fraud; employment practices; clients, products and business practices; damage to physical assets; business disruption and systems failures; and execution, delivery and process management. MLKSA faces operational risk from its Global Banking and Markets activities.

### Management of risk

Operational risk is managed by all employees as part of their day-to-day activities. Front line units and control functions own operational risk and are responsible for monitoring, assessing and testing the effectiveness of controls, while continuing to identify, escalate, debate and report operational risks. Front line units / control functions may have business oversight or control teams that support business leaders in the implementation of the program.

The Operational Risk management function at BAC is independent of front line unit / control function management, and consists of:

- The Corporate Operational Risk (“COR”) team, which is responsible for designing the program and overseeing its implementation and execution in accordance with the Policy and its supporting Standards;
- Operational Risk Teams which are responsible for objectively assessing, challenging and advising the front line units / control functions on operational risk;

The Operational risk management framework incorporates and documents the overarching processes for identifying, measuring, mitigating, controlling, monitoring, testing, reviewing and reporting operational risk information to senior management and governance bodies.

Transparency of operational risks is critical to effective risk management. To achieve transparency, MLKSA reports regularly on operational risk exposures, including operational loss events.

## Compliance Risk

### Definition

BAC defines Compliance Risk as the risk of legal or regulatory sanctions, material financial loss or damage to the reputation of BAC and its enterprise subsidiaries, which includes MLKSA, arising from a failure to comply with requirements of applicable laws, rules and regulations.

### Management of risk

Front line units are responsible for the proactive identification, management and escalation of compliance risks across BAC. Global Compliance is responsible for setting companywide policies and standards and provides independent challenge and oversight to the front line units. BAC’s approach to the management of compliance risk is further described in the Global Compliance Policy, which outlines the requirements of the Company’s Global Compliance Program and defines roles and responsibilities related to the implementation, execution and management of the compliance program by Global Compliance.

## Compliance Risk (cont'd)

Global Compliance is a separate function with governance routines and executive reporting distinct from those of the front line units and other control functions. Global Compliance also collaborates with other control functions to provide additional support for specific remediation efforts and shares responsibility with the front line units, Global Risk Management and other control functions for mitigating reputational risk.

The Global Compliance Executive leads the Global Compliance organization, which together with the front line units, also has primary responsibility for the aggregated identification, management and escalation of compliance risks and compliance-related matters across BAC, including financial crimes compliance risks.

Compliance Risk issues are reported to the MLKSA Board / Audit and Compliance Committee, the EMEA Executive Committee and the EMEA Regional Controls Committee.

## Reputational Risk

### Definition

BAC defines Reputational Risk as the potential that negative perceptions of BAC and its enterprise subsidiaries, which includes MLKSA, conduct or business practices will adversely affect its profitability, operations or customers and clients.

Reputational risk encompasses many factors, including the Company's scale of operations and resulting visibility in the financial markets and management's ability to develop and sustain appropriately controlled business practices that can withstand adverse situations. Reputational risk events may arise from negative perception on the part of key stakeholders (e.g., customers, counterparties, investors or regulators), scrutiny from external parties (e.g., politicians, consumer groups and media organizations) and the ongoing threat of litigation. These reputational risk events could adversely affect BAC's financial standing through an inability to maintain or establish business relationships, access to funding, etc.

### Management of risk

Reputational risk is managed through established policies and controls in our business and risk management processes, programs and approaches to mitigating reputational risks in a timely manner and through proactive monitoring and identification of potential reputational risk events. This includes client selection controls, the Country Leadership governance routines and a regional New Business Review committee.

## 3.9. Other Risk Considerations

### Wrong-Way Risk

Wrong-way risk is a concentration risk which exists when there is adverse correlation between the counterparty's probability of default and the market value of the underlying transaction and /or the collateral. Examples of wrong-way risk include, but are not limited to situations that involve a counterparty that is a resident and/or incorporated in an emerging market entering into a transaction to sell non-domestic currency in exchange for its local currency; a trade involving the purchase of an equity put option from a counterparty whose shares are the subject of the option; or the purchase of credit protection from a counterparty who is closely associated with the credit default swap reference entity.

BAC uses a range of policies and reporting to detect and monitor wrong-way risk from trade inception until maturity of the transaction. Forums have been established to review potential situations of wrong-way risk and, depending on the type of wrong way risk the risk management ranges from ex-ante approval prior to trade inception to ex-post portfolio limit management.

The nature of MLKSA's business activities are such that MLKSA is not exposed to wrong way risk.

### Internal Capital Adequacy Assessment Process ("ICAAP")

MLKSA prepares an ICAAP document which includes the following key elements:

- Description of senior management oversight process including risk management monitoring of risk profile.
- A three year capital plan.
- Analysis of the impact of stress testing. The impact of the stress on regulatory Capital Resources and Requirements are analysed.

An output of the ICAAP is to identify those risks which are not included in the Pillar 1 capital adequacy calculation and to assess appropriate additional capital requirement to be included as Pillar 2.

These additional requirements may include increased allocations of capital for Operational, Market and Credit Risk. MLKSA remains sufficiently capitalized throughout the three year planning horizon to support current and future activities.

## 4. Credit and Counterparty Risk

## 4. Credit and Counterparty Risk

Counterparty and Credit Risk is the risk of loss arising from a borrower or counterparty failing to meet its financial obligations. Counterparty and Credit Risk Capital Requirements are derived from risk-weighted exposures, determined using the method prescribed by the CMA in its Prudential Rules.

MLKSA uses external ratings based on a combination of Moody’s Investors Service, Inc. (“Moody’s”), Standard and Poor’s (“S&P”) and Fitch Ratings, Inc. (“Fitch”). The external credit rating against an exposure is then used to assign a Credit Quality Step according to the classification of the counterparty, and as prescribed by the CMA in the Prudential Rules. The same approach for assigning a credit rating is used for all exposures. MLKSA itself is not externally credit rated.

### 4.1. Credit Risk Exposures

MLKSA had no ‘past due’ claims, impaired liabilities or specific provisions as at December 31, 2015. There were no events that would give rise to any charges for impairments or specific provisions during the last financial year. Exposures are not covered by collateral, guarantees or credit derivatives. As such, the exposure amounts upon which the Credit Risk Capital Requirement is calculated has not been adjusted for credit risk protection.

MLKSA has counterparty and credit risk exposure as a result of non-trading book receivables in the form of deposits with local, Saudi Arabian Monetary Agency (“SAMA”) regulated settlement banks, inter-affiliate receivables, tangible fixed assets and prepaid expenses. The table below details the risk weighted exposures and credit risk capital requirements for MLKSA by counterparty type.

Table 4. Credit Exposures by counterparty type, non-trading activities

(SAR in Thousands)

	CQS	2015		2014	
		RWA	Capital	RWA	Capital
Exposures to local banks	1	30,092	4,213	28,752	4,025
Exposures to authorised persons and banks	2	301	42	232	32
Exposures to authorised persons and banks	Unrated	2,869	402	2,203	308
Tangible assets	n.a.	4,485	628	6,804	953
Prepaid Expenses	n.a.	5,609	785	4,736	663
Contingent Liability	Unrated	953	133	-	-
		<b>44,308</b>	<b>6,203</b>	42,727	5,982

*n.a. : Not applicable*

Credit Risk in MLKSA may, but does not ordinarily, arise from its Global Markets Equities business, which provides local clients prefunding facilities on an uncommitted basis to access the local stock market.

## 5. Liquidity Risk

## 5.1. Liquidity Position

### 5.1.1. Regulatory Requirements

MLKSA is subject to Minimum Liquidity Requirements set out by the CMA and is required to manage its liquidity risks in accordance with the CMA's Prudential Rules.

MLKSA has a Liquidity Risk Policy that is appropriate and tailored to its business objectives, in which it defines roles and responsibilities in relation to liquidity risk management and monitoring.

### 5.1.2. Liquidity Position

MLKSA maintains sufficient access to liquidity resources to meet its financial obligations. As of 31 December 2015, MLKSA held SAR 150.5 million in the form of cash and cash equivalents, up from SAR 143.8 million in 2014.

The Current Ratio for the entity as of 31 December 2015 was 2,583%, up from 2,254% as of 31 December 2014, the increase being attributable to the increase in cash and cash equivalents during the year.

### 5.1.3. Funding Profile

MLKSA has minimal inherent liquidity risk within its business activities, as such, internal liquidity stress testing is not deemed necessary at present.

MLKSA maintains a Contingency Funding Plan ("CFP"), which represents management's strategy to address potential liquidity shortfalls during periods of stress. The MLKSA contingency funding plan includes two contingency funding levels.

- Level 1: Elevated Liquidity Monitoring
- Level 2: Contingency Actions / Recovery Plan

For each level of heightened management action, the MLKSA CFP describes:

- Potential indicators that may lead to activation
- The governance structure to activate and revoke
- A menu of available funding sources
- Escalation procedures