

Merrill Lynch Kingdom of Saudi Arabia Company

Pillar 3 Disclosure

As at 31 December 2018

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List of Abbreviations

BAC	Bank of America Corporation
CEEMEA	Central and Eastern Europe, Middle East and Africa
CFP	Contingency Funding Plan
CMA	Capital Market Authority
Fitch	Fitch Ratings, Inc.
FLU	Front Line Unit
FX	Foreign Exchange
GRM	Global Risk Management
ICAAP	Internal Capital Adequacy Assessment Process
MLKSA	Merrill Lynch Kingdom of Saudi Arabia
Moody's	Moody's Investors Service, Inc.
Risk Framework	Risk Governance Framework
S&P	Standard & Poor's
SAMA	Saudi Arabian Monetary Agency
SAR	Saudi Riyals
USD	United States Dollars
WWR	Wrong Way Risk

1. Introduction

Merrill Lynch Kingdom of Saudi Arabia – Pillar 3 Disclosures 2018

1.1. Overview and Purpose of Document

This document contains the Pillar 3 disclosures as at 31 December 2018 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 details 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 29, 1429H (corresponding to March 7, 2008), CMA license No. 07066-37 dated 26 Jumadah Al-Awwal 1428H (corresponding to June 12, 2007). The Company received its full CMA operating license in January 2011.

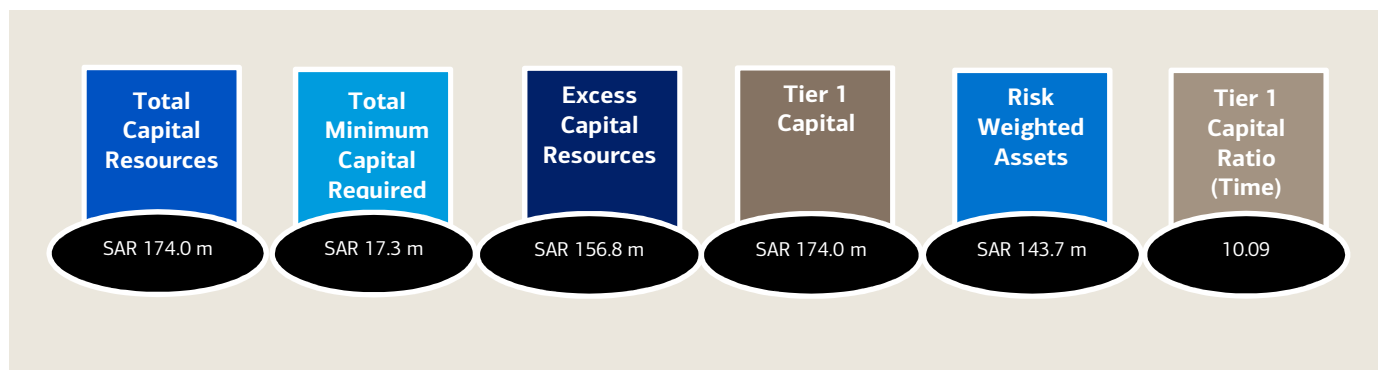
MLKSA is Bank of America Corporation’s (“BAC” or “the Company”) Saudi Arabian broker-dealer. MLKSA is a wholly-owned indirect subsidiary of BAC. MLKSA has its office in Riyadh, in Saudi Arabia, and plays a key role within the wider BAC group, providing access to the Saudi Arabian market for Global Banking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

1.1.2. MLKSA’s Capital Position as at 31 December 2018

MLKSA has Capital Resources of SAR 174.0 million made up exclusively of Tier 1 Capital. MLKSA has a Tier 1 Capital Ratio (time) of 10.09 (defined by the CMA as Tier 1 Capital over Total Minimum Capital Requirement) and a surplus over Total Minimum Capital Requirements of SAR 156.8 million. Figure 1 illustrates MLKSA’s key capital metrics.

Figure 1. Summary of Key Metrics as at 31st December 2018



1.2. Basis of Preparation

The information contained in these disclosures has been prepared in accordance with regulatory capital adequacy concepts and CMA Prudential 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

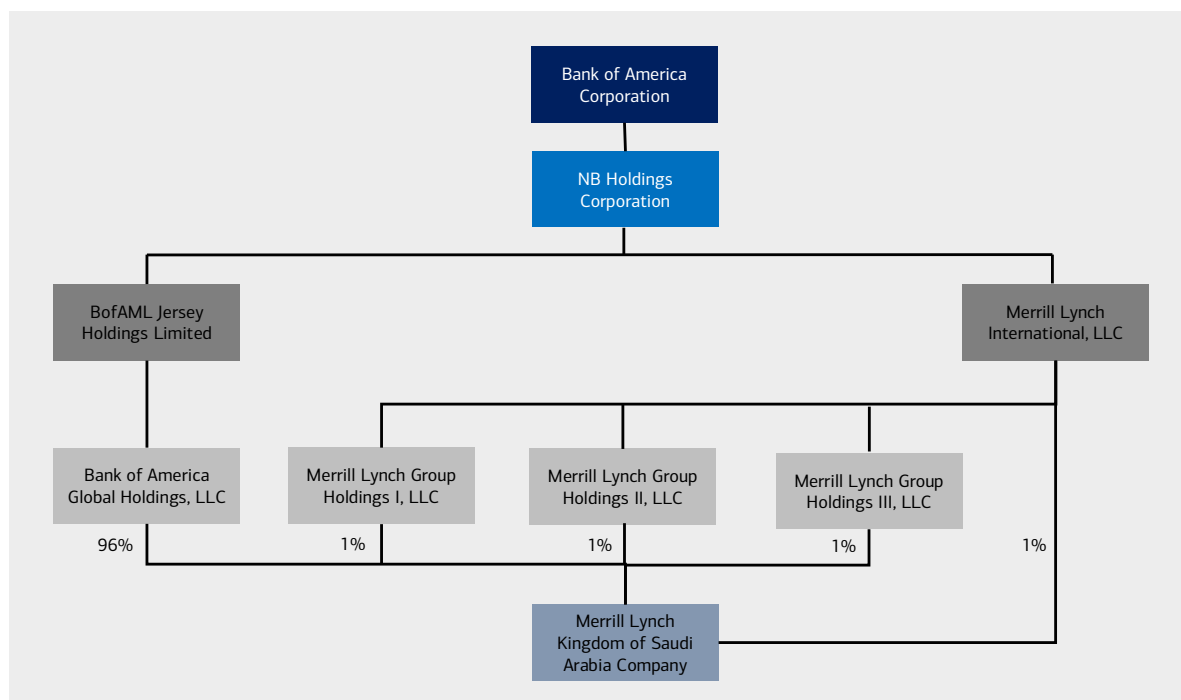
1.3. Operation, Structure and Organisation

MLKSA has a key role within the wider BAC group, by providing Saudi Arabian 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, 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



A decorative header section with a blue geometric background consisting of various shades of blue and dark blue shapes. The text is centered in white.

2. Capital Resources and Minimum Capital Requirements

2.1. Capital Resources

2.1.1. Summary of Capital Resources in 2018

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)	2018	2017
Fully Paid Up Ordinary Share Capital	143,000	143,000
Statutory Reserve	6,229	5,047
Profit and Loss Account and Other Reserves	26,999	16,445
Total Tier 1 Capital Before Deductions	176,228	164,492
Deferred tax assets	(2,202)	(2,209)
Tier 1 Capital	174,025	162,283
Tier 2 Capital	0	0
Total Capital Resources (net of deductions)	174,025	162,283

2.1.2. Key Movements in 2018

MLKSA's Tier 1 Capital base increased from SAR 162.3 million in 2017 to SAR 174.0 million in 2018 as a result of the addition of 2018 audited post-tax profits.

MLKSA's Tier 1 Capital ratio (time), as defined by the CMA, decreased to 10.09 from 10.82 as a result of increased Capital Requirements in 2018.

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 resources remain 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 17.3 million, this included a credit risk requirement of SAR 8.4 million, an operational risk requirement of SAR 7.8 million, and market risk requirement of SAR 1.1 million.

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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)

	2018	2017
Total Capital Resources	174,025	162,283
Market Risk	1,056	463
Credit Risk	8,373	7,572
Operational Risk	7,825	6,970
Total Minimum Capital Requirements	17,254	15,004
Surplus over Requirements	156,771	147,279

2.2.2. Key Movements in 2018

MLKSA's Total Minimum Capital Requirements increased to SAR 17.3 million in 2018 from SAR 15.0 million in 2017. The increase in market risk capital requirement was derived from an increase in USD foreign exchange ("FX") risk. The increase in credit risk capital requirement was predominantly driven by inter-affiliate exposures as well as exposures to unrated corporates relating to the Saudi Arabian Stock Exchange's (Tadawul) T+2 settlement cycle as at 31st December 2018. The increase in operational risk was driven by a larger operating expense base in 2018.

2.2.3. Minimum Capital Requirements Approach

MLKSA has adopted the approach specified by the CMA in their Prudential Rules for calculating credit and market 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 had SAR 156.8 million of Capital Resources in excess of Total Minimum Capital Requirements as at 31 December 2018. The Capital Surplus over Total Minimum Requirements increased from SAR 147.3 million in 2017 due to the addition of 2018 audited post-tax profits to Capital Resources. 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 decreased from 10.82 to 10.09 over the year due to an increase in Total Minimum Capital Requirements. MLKSA's Tier 1 Capital Ratio (time) is in excess of the CMA ratio requirement of 1.00.

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

(SAR in Thousands)

	2018	2017
Total Capital Resources	174,025	162,283
Total Minimum Capital Requirements	17,254	15,004
Surplus over Requirements	156,771	147,279
Tier 1 Capital Resources	174,025	162,283
Tier 1 Capital Ratio (time)	10.09	10.82

3. Liquidity Position

3.1. Liquidity Position

3.1.1. 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.

3.1.2. Liquidity Position

MLKSA maintains sufficient access to liquidity resources to meet its financial obligations. As of 31 December 2018, MLKSA held SAR 184.0 million in the form of cash and cash equivalents, up from SAR 166.4 million in 2017.

The Current Ratio for the entity as of 31 December 2018 was 1,335%, compared to 1,317% as of 31 December 2017.

3.1.3. Funding Profile

MLKSA has minimal inherent liquidity risk within its business activities. 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

4. Risk Management, Objectives and Policy

4.1. BAC 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 the 2019 Risk Framework in December 2018. The key enhancements from the 2018 Risk Framework include restructuring the operational risk and compliance risk sections to reflect the combination of compliance and operational risk into the Global Compliance and Operational Risk function and an update to Compliance Risk Appetite.

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

The following sections lay out the risk management approach and key risk types for MLKSA.

4.2. Risk Management Approach

Risk is inherent in all business activities. Managing risk well is the responsibility of every employee. Sound risk management enables MLKSA 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 MLKSA’s reputation, each of which may adversely impact MLKSA’s ability to execute its business strategy. Managing risk well is fundamental to delivering on MLKSA’s strategy for responsible growth. 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 MLKSA’s approach to risk management and each employee’s responsibilities for managing risk. The following are the five components of MLKSA’s risk management approach:

- Culture of Managing Risk Well
- 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: Credit, Market, Liquidity, Strategic, Reputational, Compliance and Operational Risks.

4.3. Culture of Managing Risk Well

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

The following principles form the foundation of BAC’s culture of managing risk well, and apply to MLKSA as follows:

- Managing risk well protects MLKSA and its reputation and enables MLKSA to deliver on its purpose and strategy
- MLKSA treats customers fairly and acts with integrity to support the long-term interests of its employees, customers and shareholders. Improper conduct, behaviour or practices by the entity, its employees or representatives could harm MLKSA, shareholders or customers, or damage the integrity of the financial markets

- Individual accountability and an ownership mind-set are the cornerstones of BAC's Code of Conduct. All MLKSA employees are subject to the principles defined in the BAC Risk Framework and BAC Code of Conduct
- All MLKSA employees are responsible for proactively managing risk as part of their day-to-day activities through prompt identification, escalation and debate of risks
- While MLKSA employs models and methods to assess risk and better inform MLKSA's decisions, proactive debate and a thorough challenge process lead to the best outcomes
- MLKSA's 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
- The MLKSA Country Risk Manager, part of Independent Risk Management, provides independent oversight and effective challenge, while Corporate Audit provides independent assessment and validation
- MLKSA strives to be best-in-class by continually working to improve risk management practices and capabilities

4.4. Risk Appetite

The BAC Risk Appetite Statement, together with the BAC Risk Framework, provides MLKSA with the basis to establish and execute risk taking activities in a manner consistent with the aggregate risk appetite. The Risk Appetite Statement refers to, and should be read in conjunction with, the Risk Framework. BAC's Risk Appetite Statement clearly defines 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 BAC Risk Appetite Statement is rooted in several principles:

- Overall risk capacity: BAC's overall capacity to take risk is limited; therefore, it prioritizes the risks it takes. BAC's risk capacity informs BAC's risk appetite, which is the level and types of risk BAC is willing to take to achieve its business objectives
- Financial strength to absorb adverse outcomes: BAC must maintain a strong and flexible financial position so it can weather challenging economic times and take advantage of organic growth opportunities. Therefore, BAC set objectives and targets for capital and liquidity that permit BAC 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 consider 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 culture. For example, actions considered in a line of business that unduly threaten BAC's reputation should be escalated and restricted appropriately
- Skills and capabilities: BAC seek to assume only those risks it has the skills and capabilities to identify, measure, monitor and control

The BAC Risk Appetite Statement covers the following seven key risk types: Credit, Market, Liquidity, Strategic, Reputational, Compliance and Operational Risks.

4.5. Risk Management Processes

BAC's Risk Framework requires that strong risk management practices are integrated in key strategic, capital and financial planning processes and day-to-day business processes. MLKSA follows the same approach and ensures risks are appropriately considered, evaluated and responded to in a timely manner.

MLKSA approach to Risk Management Processes:

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

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

4.6. Risk Data Management, Aggregation and Reporting

Effective risk data management, aggregation and reporting are critical to provide a clear understanding of current and emerging risks and enable MLKSA 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 MLKSA
- Robust risk quantification methods
- Timely, accurate and comprehensive view of all material risks, including appropriate levels of disaggregation

4.7. 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 MLKSA Board of Directors is responsible for oversight of adequate risk management and controls for the entity and ensures this through its committees, executive officers and risk limits established for material activities.

BAC's risk governance principles serve as the cornerstone of MLKSA's risk governance framework. The BAC Code of Conduct, Risk Framework, Risk Appetite Statement and Strategic Plan are overarching documents that firmly embed MLKSA's culture of managing risk well in everything it does.

4.8. Key Risk Types

The risk management processes outlined above allow MLKSA to manage risks across the seven key risk types: Credit, Market, Liquidity, Strategic, Reputational, Compliance and Operational. Details of how risk is managed within MLKSA is given below.

4.8.1. Credit Risk

Definition

Credit risk is the risk of loss arising from the inability or failure of a borrower or counterparty to meet its obligations.

Credit Risk Management

MLKSA's Credit risk is managed in line with BAC's global credit policies and standards, credit risk appetite and applicable Saudi Arabian laws and regulations.

Credit Risk in MLKSA arises from its established Equities business, cash placed at bank and its inter-affiliate activities.

With regard to its Equities business, MLKSA is exposed to credit risk on execution activity where it is the cash custodian for certain clients. Execution activity results in receivables recorded on MLKSA's balance sheet on T+0, which remain in place until clients deliver cash on T+2. Credit risk is also derived from placing cash with local and foreign banks.

Credit risk management includes the following processes:

- Credit origination
- Portfolio management
- Loss mitigation activities

Front line units ("FLUs") manage credit risk through increased frequency and intensity of portfolio monitoring for moderate to weak risk profiles, hedging and transferring management of deteriorated commercial exposures to specialized asset officers. Limits and ratings are applied based on the appropriate authorities. MLKSA's Equity Trading in conjunction with Finance and Operations are responsible for ensuring that all transactions are conducted with approved clients, limits and policies.

Risk management is overseen by the Board of Directors of MLKSA in collaboration with other Risk groups. Independent risk management oversees credit risk management processes and governance in accordance with Company requirements and authority levels. At the legal entity level, credit risk teams oversee credit risk management processes in accordance with the Company's subsidiary governance requirements. This includes reporting to various risk committees, executive management and boards of directors.

Further details on MLKSA's credit and counterparty risk are supplied in section 5.

4.8.2. Compliance and Operational Risk

Definition

Compliance risk is the risk of legal or regulatory sanctions, material financial loss or damage to the reputation of MLKSA or the Company arising from MLKSA's failure to comply with the requirements of applicable laws, rules and regulations and internal policies and procedures. MLKSA is committed to the highest level of compliance and has no appetite for violations of legislative or regulatory requirements. MLKSA seeks to anticipate and assess compliance risks to the core businesses and respond to these risks effectively should they materialize. While the Company and MLKSA strive to prevent compliance violations in everything it does, it cannot fully eliminate compliance risk, but manages it by establishing permissible thresholds to reduce exposure to financial loss, reputational harm or regulatory sanctions.

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Operational risk is the risk of loss resulting from inadequate or failed processes, people and systems or from external events. The Company has designed an operational risk management program, in compliance with Basel II Advanced Measurement Approach requirements, that incorporates and documents the process for identifying, measuring, monitoring, controlling and reporting operational risk information to executive management and the board of directors, or appropriate board-level committees. The Company manages operational risk by establishing permissible thresholds to reduce exposure to financial loss, reputational harm or regulatory sanctions. Independent risk management actively oversees FLUs and control functions to monitor MLKSA's adherence to the program and identify, advise and challenge operational risks.

Compliance and Operational Risk Management

FLUs and control functions are first and foremost responsible for managing all aspects of their businesses, including their compliance and operational risk. FLUs and control functions are required to understand their business processes and related risks and controls, including the related regulatory requirements, and monitor and report on the effectiveness of the control environment. In order to actively monitor and assess the performance of their processes and controls, they must conduct comprehensive quality assurance activities and identify issues and risks to remediate control gaps and weaknesses. Front line units and control functions must also adhere to compliance and operational risk appetite limits to meet strategic, capital and financial planning objectives. Finally, front line units and control functions are responsible for the proactive identification, management and escalation of compliance and operational risks across the Company.

4.8.3. Market Risk

Definition

Market risk is the risk that changes in market conditions may negatively impact earnings, including adversely impacting the value of assets or liabilities.

MLKSA offers access to Tadawul on a predominantly agency basis to local clients domiciled within the Gulf Co-operation Council as well as stock execution for Merrill Lynch International.

Market risk in MLKSA arises primarily from FX although the risk is minimal as the Saudi Riyal is pegged to the US Dollar.

Market Risk Management

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.

Market Risk Management in MLKSA is a decentralized process with centralized oversight. To be effective, all personnel involved in risk related activities are an active part of the risk management process and regular reporting provides transparency across FLUs, management and Board.

4.8.4. Liquidity Risk

Definition

Liquidity risk is the inability to meet expected or unexpected cash flow and collateral needs while continuing to support the businesses and customers, under a range of economic conditions.

Liquidity Risk Management

Each of the FLU's are accountable for managing liquidity risk by establishing appropriate processes to identify, measure, monitor and control the risks associated with their activities. Global Risk Management ("GRM") provides independent

oversight and supervision of FLU activities, an independent view of the liquidity risk of FLU activities and assesses the effectiveness of MLKSA's liquidity risk management processes.

The MLKSA Liquidity Risk Policy is owned by the MLKSA Board and establishes the overarching governance, controls and risk management practices to monitor and manage liquidity risk across MLKSA. In certain jurisdictions, such as Saudi Arabia, liquidity management responsibilities are undertaken by local finance and management teams, who consult with Corporate Treasury and GRM.

MLKSA has a funding line with Merrill Lynch International that it may draw down at any time to prevent liquidity risk and a Guarantee Letter from Saudi British Bank to further support MLKSA's trading activity.

Regular liquidity risk reports are sent to the MLKSA Board and Senior Management.

4.8.5. Strategic Risk

Definition

Strategic risk is the risk that results from incorrect assumptions about external and/or internal factors, inappropriate business plans (e.g. too aggressive, wrong focus, ambiguous), ineffective business strategy execution, or failure to respond in a timely manner to changes in the regulatory, macroeconomic and competitive environments in the geographic locations in which BAC operates (such as competitor actions, changing customer preferences, product obsolescence, and technology developments).

Strategic Risk Management

Strategic risk is managed through the assessment of effective delivery of strategy and business performance is monitored by the executive management team to assess strategic risk and find early warning signals so that risks can be proactively managed.

MLKSA strategic execution and risk management processes are aligned to the overall BAC strategic plans through a formal planning and approval process and are set within the context of overall risk appetite. The BAC Board is responsible for overseeing the strategic planning process and management's implementation of the resulting strategic plan. BAC's strategic plan is reviewed and approved annually by the BAC Board. Strategic planning at BAC level is representative of more detailed planning undertaken at the business unit, regional and MLKSA level. MLKSA's strategy is reviewed by MLKSA Board on an annual basis.

Strategic decisions relating to MLKSA are presented and discussed at MLKSA Board. FLUs provide updates to MLKSA Board on their business performance and management of strategic risk. Updates take into account analyses of performance relative to the strategic plan, financial operating plan, risk appetite and performance relative to peers.

4.8.6. Reputational Risk

Definition

Reputational risk is the potential risk that negative perceptions of BAC's conduct or business practices will adversely affect its profitability or operations through an inability to establish new or maintain existing customer / client relationships or otherwise impact relationships with key stakeholders, such as investors, regulators, employees and the community.

Reputational Risk Management

BAC manages reputational risk through established policies and controls in the business and risk management processes to mitigate reputational risks in a timely manner and through proactive monitoring and identification of potential reputational risk events.

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For the UK and Central and Eastern Europe, Middle East and Africa (“CEEMEA”) region there is a dedicated committee, the Regional Reputational Risk Committee, whose mandate includes consideration of reputational risk issues and to provide guidance and approvals for activities that represent specific Reputational risks which have been referred for discussion by other current control frameworks or lines of business. Reputational risk items relating to MLKSA are considered as part of the Regional Reputational Risk Committee.

Ultimately, to ensure that reputational risk is mitigated through regular business activity, awareness of reputational risk is integrated into the overall governance process, as well as incorporated into the roles and responsibilities for employees. Given the nature of reputational risk, BAC does not set quantitative limits for the level of acceptable risk. Through proactive risk management, BAC seeks to minimise both the frequency and impact of reputational events.

Through the EU, UK & CEEMEA Regional Risk Committee and the Regional Reputational Risk Committee, BAC has an appropriate organisational and governance structure in place to ensure strong oversight at the entity business level.

The Regional Reputational Risk Committee is a sub-committee of both the EU, UK & CEEMEA Regional Risk Committee and the Global Reputational Risk Committee and is applicable to all key legal operating entities in the region.

Items requiring increased attention may be escalated from the Regional Reputational Risk Committee to the Global Reputational Risk Committee as appropriate.

Reporting of reputational risk issues is captured as part of management routines for the Regional Reputational Risk Committee. Items presented to the Regional Reputational Risk Committee are maintained through reporting which includes description of the reputational risk issue, geographical jurisdiction, reason for escalation and decision reached. A summary report of issues discussed at the Regional Reputational Risk Committee is provided to the EU, UK & CEEMEA Regional Risk Committee on a quarterly basis

4.9. Other Risk Considerations

4.9.1. Wrong Way Risk

Wrong-way risk (“WWR”) arises when a counterparty’s credit quality is correlated to the underlying risk exposure in a transaction such that as the credit quality of the counterparty deteriorates, the mark-to-market owed by the counterparty has a tendency to increase. There are two classifications of WWR:

Specific WWR: Self-referencing transactions e.g. counterparties trading own securities, or related group entities, directly or indirectly or via derivative type contracts with their securities, or related group entities, as reference assets.

General WWR: Arises when the likelihood of default by a counterparty is positively correlated with general market risk factors such that corresponding mar-to-market increases as credit quality of the counterparty deteriorates.

BAC uses additional policies and reporting to identify and monitor wrong-way risk across the portfolio. Forums have been established to review potential situations of wrong-way risk, and depending on the nature of the wrong way risk, Risk Management may require pre-trade approval or apply various portfolio limits. In keeping with BAC’s risk management framework, several processes exist to control and monitor wrong-way risk including reviews at the Global Markets Risk Committee.

4.9.2. Internal Capital Adequacy Process (“ICAAP”)

MLKSA prepares an ICAAP document annually in compliance with CMA’s Prudential Rules. The ICAAP assesses the capital adequacy of MLKSA in relation to current and future activities and ensures that MLKSA maintains an appropriate amount of capital relative to the risks to which it is exposed. The ICAAP forms a key part of the governance framework and is approved by the MLKSA Board of Directors.

5. Further Detail on Credit and Counterparty Risk

5.1. Credit and Counterparty Risk

Credit and Counterparty Risk is the risk of loss arising from a borrower or counterparty failing to meet its obligations. Credit and Counterparty 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., Standard and Poor’s and Fitch Ratings, Inc. The external credit rating against an exposure is then used to assign a Credit Quality Step according to the classification of the counterparty, 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.

5.2. Credit Risk Exposures

MLKSA had no ‘past due’ claims, impaired liabilities or specific provisions as at December 31, 2018. In accordance with International Financial Reporting Standards, MLKSA has recorded an impairment allowance against exposures to local banks. The opening balance was SAR 85 thousand and closing balance was SAR 77 thousand. The movement in impairment allowance of SAR 8 thousand was recorded directly in the income statement. 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 credit and counterparty 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, deposits with foreign banks, inter-affiliate receivables, tangible fixed assets, prepaid expenses and other assets. 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	2018		2017	
		RWA	Capital	RWA	Capital
Exposures to local banks	1	27,473	3,846	30,203	4,229
Exposures to foreign banks	1	9,328	1,306	3,071	430
Exposures to authorised persons and banks	2	150	21	389	55
Exposures to authorised persons and banks	Unrated	2,353	329	2,213	310
Corporates	Unrated	4,559	639	8,846	1,238
Tangible assets	N/A**	3,244	454	3,140	440
Prepaid Expenses	N/A**	11,430	1,600	6,222	871
Other assets	N/A**	1,271	178	-	-
		59,808	8,373	54,084	7,572

*NPO: Non-profit organisation

Credit Risk in MLKSA arises from its established Global Markets Equities business. MLKSA is exposed to credit risk on trades where it is the cash custodian for clients.