Basel III

Liquidity Coverage Ratio (LCR) Qualitative Disclosure

31 March 2017

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Governance of Liquidity Risk Management:

Liquidity risk arises when the Bank is unable to meet its payment obligations when they fall due and to replace funds when they are withdrawn, in particular, its failure to meet obligations to repay depositors and fulfil commitments to lend.

The appropriate and efficient management of liquidity is essential to BAJ in ensuring the confidence of the financial markets in order to pursue its identified business strategy.

Additionally, the Bank manages risk in relation to:

- The mismatched funding of medium term assets by short term or retail liabilities, which can increase the potential for liquidity problems at a future date and
- Meeting regulatory requirements at all times.

The Bank at all times maintains financial resources, including capital and liquidity resources, which are adequate, both as to amount and quality, to ensure that there is no significant risk that its liabilities cannot be met as they fall due.

Treasury has overall responsibility for liquidity management on a day-to-day basis and in the event of a liquidity crisis. In normal conditions liquidity is managed as per policy and guidelines already established.

Effective and professional relationships are established with Saudi Arabia Monitory Agency (SAMA) and any other relevant regulator. To avoid the risk of liquidity related penalty or regulation on BAJ, Market Risk Management advises immediately of any event that could adversely impact relationships with regulators. Bank complies with all regulatory reporting requirements, terms and conditions for the operation of accounts with central banks or codes of conduct imposed by or agreed with SAMA or other regulators in respect of liquidity risk.

Liquidity Management Strategy:

The Bank applies a prudent mix of liquidity controls which provide security of access to funds without undue exposure to increased costs of funds from the liquidation of assets, or aggressive bidding for deposits. The Bank uses cash flow match approach and liquid assets approach. Under the cash flow approach the Bank attempts to match the cash outflows against the contractual cash inflow leaving around one month cash requirement at all times to absorb unexpected cash movement. The excess liquidity for over one month is managed on the basis of liquid assets approach and as per SAMA guidelines.

The Bank has to maintain liquid assets of at least 20% of deposit liabilities in the form of cash or assets that can be converted into cash within a period not exceeding 30 days. Liquidity risk is monitored and evaluated daily by Treasury to ensure that, over the short term and by major currency, the profile of projected future cash inflows is adequately matched to the maturity of the liabilities.

The Basel liquidity principles are implemented more specifically in the Bank's overall liquidity risk framework through the following:

I. Board Risk Committee and Asset & Liability Committee being focused on the liquidity strategy and management;
II. Liquidity and Contingency Liquidity policies;
III. Liquidity Gap / Market Access Requirement analysis for daily management against liquidity limits;
IV. Monitoring of Liquidity ratios to re-align short term and medium term structural imbalances;
V. Management of liquidity concentration risk for Significant Funding Sources (large depositors);
VI. Liquidity Stress tests and the Contingency funding plan.

Liquidity Monitoring and Control

Market Risk Management has established a monitoring and reporting framework for liquidity risk that provides pertinent information to ALCO.

The following lists the salient aspects of monitoring that is done on a regular basis:

- Monitoring of the implementation of the limits according to Market Risk Policy guidelines
- Timely detection and correction of deficiencies in the policies, processes and procedures of liquidity gap risk
- Managing liquidity risk through on-going, periodic and annual reviews
- Verifying the authenticity and availability of the sources of funds available to the Bank

Liquidity Stress Testing:

As part of our enterprise wide Stress Testing exercise, Enterprise Risk Management Group (ERMG) addresses unusual and unexpected events to occur and accordingly prepares to face and survive such situations. This requires foreseeing situations under hypothetical scenarios considering the question 'what-if' and development of stress tests in such scenarios. This enables the organization to be well equipped to cope with the crisis situations when they arise.

Contingency Funding Plan:

Contingency planning is a combination of early warning procedures and advance preparation for potential high-severity / low-probability liquidity events. In the unlikely event of a funding crisis, good contingency planning makes the difference between being in control and simply reacting to events.

The need for a robust contingency funding plan is driven by the following factors:

I. Bank can never avoid liquidity risk
II. As liquidity risk increases, it becomes even more un-hedgable.
III. It is too expensive to hold enough liquidity to survive a severe or prolonged funding crisis.

Therefore, contingency planning may be defined as the bridge between the liquidity the bank chooses to hold and the maximum it might need.

Main Contributor:

The main contributors to BAJ LCR on assets side are Sovereign entity, SAMA (Securities and Reverse Repo) and one of the largest PSE of Kingdom, while on the liability side the major portion is deposits mainly contributed by our large corporate & retail customers.

Composition of High Quality Liquid Assets (HQLA):

The HQLA of BAJ LCR consists of Cash, SAMA placements/Reverse repo and the investments issued or guaranteed by Sovereign/central bank. The Level 2A Assets in BAJ LCR are the Sukuks issued by one of the largest PSE of Kingdom, which are included due to its repo-ability characteristic.

Currency Mismatch:

As outlined in guideline, while the LCR is expected to be met on a consolidated basis and reported in a common currency, bank manages the liquidity needs in each significant currency. As indicated in the LCR, the currencies of the stock of HQLA are similar in composition to the operational needs of the bank. Bank does not assume that currencies are transferable and convertible in a stress period.