



Muscat Capital public disclosure document pertaining to Capital Adequacy and Risk Management - 2016

OVERVIEW

The Capital Markets Authority of Saudi Arabia have specified requirements for licensed firm's financial prudence by way of Prudential Guidelines regulations. These regulations can be found by clicking the following link.

[https://cma.org.sa/en/RulesRegulations/Regulations/Documents/Final%20Draft%20Prudential%20Rules%20\(English\).pdf](https://cma.org.sa/en/RulesRegulations/Regulations/Documents/Final%20Draft%20Prudential%20Rules%20(English).pdf)

Part 7 & Pillar III of the aforesaid rules require all licensed firms to adhere to annual market disclosure of information. The purpose of Pillar III Disclosure is for the market participants to assess the key pieces of information on the scope of application, capital, risk exposures, risk assessment processes, and hence the capital adequacy of the licensed firms. Muscat Capital endeavours to promote good governance and fair & transparent disclosure to enable all its stakeholders be able to better judge the financial risk exposures faced when dealing with the firm and has prepared this disclosure consistent with its scale, complexity and sophistication of the firms approach to risk management and capital adequacy assessment. '

Muscat Capital is a subsidiary of Bank Muscat (SAOG) Oman which prides itself on best practice corporate governance and disclosures. Visit Bank Muscat website relating to corporate governance by clicking on the link <http://www.bankmuscat.com/en-us/InvestorRelation/AboutUs/Pages/CorporateGovernance.aspx>

SCOPE

Muscat Capital LLC Company is regulated by the Saudi Arabian Capital Market Authority with license number 08096-37 and has been authorised to perform all securities investment business activities of Dealing as Agent & Principal, Arranging, Managing, Advising & Custody.



CAPITAL STRUCTURE

Name of authorised person: Muscat Capital
Reporting date: Dec 2016

CAPITAL BASE SAR '000

Tier-1 Capital

Paid-up capital	60,000
Share premium	0
Reserves	744
Audited retained earnings	4,369
Verified previous year profit/(loss)	0
Verified interim profit/(loss)	0
Loss offsetting against capital reduction	0
Tier-1 adjustment *	
<i>Unverified interim loss (-)</i>	0
<i>Unverified previous year loss (-)</i>	0
<i>Goodwill and intangible assets (-)</i>	(172)
<i>Unrealised losses from HFT investments (-)</i>	0
<i>Unrealised losses from AFS investments (-)</i>	(867)
<i>Deferred zakah assets (-)</i>	0
<i>Dividend expense from retained earnings (-)</i>	0
<i>Zakah expense from retained earning (-)</i>	(450)
<i>Other negative equity items (-)</i>	0
<i>Other deductions from Tier-1 (-)</i>	
Deductions (-)	(1,489)
Tier-1 capital	63,624

**Figures mentioned herein and hereunder are based on amounts for the year ended 31st December 2016 as per the auditors of the Company*

CAPITAL ADEQUACY

Muscat Capital confirms that it satisfies all the requirements for the minimum level of capital standards established by the Capital Market Authority promulgated by their Prudential Guidelines. The Company remains well capitalised and comfortably covers the regulatory capital requirement.

Muscat Capital now in its 8th of operation adopts a prudent conservative approach to taking risks, especially in relation to investing its proprietary money, capital funds and funds derived from inflows. The company prudently invests its capital in a mix of low deposit yielding instruments, short term money market instruments and more recently co-invested as seed investors into Muscat Capital IPO Fund &



Riyadh Real Estate Fund. All proprietary investments are made following detailed proposals approved by the Board, senior management and relevant product and risk committees.

The firm deploys an Internal Capital Adequacy Assessment Process which is a structured process to ascertain the capital requirements of the firm based on its budget and expected business activities. This rigorous exercise is approved as a policy by the Muscat Capital Board and thereafter initiated and managed by the company's CEO and CFO. Stress tests are adopted to ascertain the capital requirements of the firm for the next 12 months based on multiple complex scenarios. The objective is to maintain capital coverage well above the regulatory minimum of 1.2 times under all scenarios. All capital planning exercises are undertaken by the CEO and reported to the Board to ensure proper governance.

App II: Disclosure on Capital Adequacy				
Exposure Class	Exposures before CRM SAR '000	Net Exposures after CRM SAR '000	Risk Weighted Assets SR '000	Capital Requirement SAR '000
<i>Credit Risk</i>				
<i>On-balance Sheet Exposures</i>				
Governments and Central Banks				-
Authorised Persons and Banks	55,693	55,693	11,352	1,589
Corporates	2,585	2,585	15,071	2,110
Retail				-
Investments	8,940	8,940	26,433	3,701
Securitisation				-
Margin Financing				-
Other Assets	1,693	1,693	6,747	945
Total On-Balance sheet Exposures	68,911	68,911	59,602	8,344
<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	68,911		68,911	59,602
Prohibited Exposure Risk Requirement				
Total Credit Risk Exposures	68,911		68,911	59,602
<u>Market Risk</u>	Long Position	Short Position		
Interest rate risks				
Equity price risks				
Risks related to investment funds	2,200			352
Securitisation/resecuritisation positions				
Excess exposure risks				
Settlement risks and counterparty risks				
Foreign exchange rate risks	7			0
Commodities risks.				
Total Market Risk Exposures	2,207			352
<u>Operational Risk</u>				4,110
Minimum Capital Requirements				12,806
Surplus/(Deficit) in capital				12,806
Total Capital ratio (time)				4.97



RISK MANAGEMENT

Risk Management is a process by which Muscat Capital identifies key risks, applies consistent, understandable risk measures, and chooses which risks to reduce and which to hold and by what means and establishes procedures to monitor and report the resulting risk position for necessary action. The objective of risk management is to ensure that the firm operates within the risk appetite levels set by its Board of Directors.

Liquidity risk

Liquidity risk is the risk to Muscat Capital's financial condition arising from its inability to meet its obligations. The primary role of managing 'liquidity-risk' is to (1) proactively assess the need for funds to meet obligations and (2) ensure the availability of funds to fulfil those needs. Liquidity risk arises when the firm is unable to generate sufficient cash resources to meet obligations as they fall due or can do so only at materially disadvantageous terms. Such liquidity risk may arise even when the institution is solvent. Liquidity stress may be caused by counterparties withdrawing credit lines or of not rolling over existing funding or as a result of general disruption in the markets or run on group deposits etc.

MC needs to ensure availability of funds during normal and perceived "stressed" situations.

- The monthly budget will be used as a guide to plan for cash flows (in and out) considered in this policy.
- A rolling forecast will be adopted given an analysis of actual expenses vs budgetary expenses.
- MC will distinguish contracted fixed cash flows (inflows and outflows) from those cash in/outflows subject to variable factors and will take into consideration the following inflow revenues:
- Extraordinary items and other non-routine items in the budgeted profit and loss statement will especially be highlighted well in advance and funds provided for
- Income from customers will be identified on a 12 month calendar basis with the assumption that all contracted customers continue and renew their mandates. Budgeted cash flows will immediately need to be modified should any customer indicate a change in their portfolio maturities.
- Budgeted revenue forecasts for the brokerage department will be considered when identifying cash inflows from the department. When calculating cash flow forecasts, consideration must be given to seasonal variations in customer trading.
- Investment banking deal flow are subject to less periodic fluctuations than the other two departments given more predictable cash flow patterns. Expected deal closure and revenue inflow dates must be updated with the head of Investment Banking and CEO on a monthly basis.
- MC will have a forward looking perspective on liquidity risk management and will continually assess the balance sheet structure, cash flows, liquidity positions and off balance sheet risks that may arise. Cash flow budgets for the rest of the year must be updated on a rolling basis having reconciled actual vs budget considerations for previous months actual.



- Suitable analysis and ratios identified above will be used using information in the balance sheet and profit and loss statements to ensure that working capital and revenue earned are properly estimated and managed and finally correctly reflected in the projected cash flow needs.

4.4.2 Credit risk

This represents risk of loss resulting from fluctuations in the credit standing of issuers of securities, counterparties and any debtors to which Muscat Capital is exposed. As far as MC's exposure to credit risk is concerned we analyse the risk of default and counterparty credit event exposure that may arise given MC's Capital funds invested. Currently around funds are placed in with Bank Muscat Riyadh branch. In essence the credit risk exposure of Bank Muscat needs to be considered to understand the risk exposure of these funds. Each year, MC undertakes a detailed risk assessment exercise based on wide ranging criteria to quantitatively ascertain the risk of bank muscat as a banking entity. MC does not envisage additional capital provisioning to mitigate risks and considers the capital set aside and calculated under Pillar I to be adequate and sufficient.

Muscat Capital does not provide any margin directly to customers currently but plans to comply in full to the new regulations where all margin activities currently undertaken by banks on behalf of brokerage customers' needs to be undertaken by a licensed person.

4.4.3 Market risk

This represents risk of loss resulting from fluctuations in the level and in the volatility of market prices of assets, liabilities and financial instruments that Muscat Capital invested into. As per investment guidelines and the conservative attitude to investing its capital in securities instruments, MC has not made any investment into capital market products except in Muscat Capital Trade Finance Fund and Muscat Capital Riyadh Real Estate Fund and capital has been set aside for the associated risks in compliance with Prudential requirements. In addition capital has been set aside for exposure to the deposits placed with bank muscat. In addition, the firm sets limits for each product / activity and risk type in order to ensure that the firms market risk is managed well within the. The firm does not enter into trading positions in commodities & derivatives. Limits and all internal/external guidelines are strictly adhered to, deviations, if any, are immediately escalated and action taken wherever necessary. As stated above, the firm's has investment into Riyadh Real Estate Fund (a privately placed mutual fund) which has invested in stable high rental yielding properties in Riyadh. The market risk represents the loss of value of this investment (i.e a fall in property prices). The properties were acquired at favourable valuations and the firm continues to constantly monitor its investment value in line with market price fluctuations.

4.4.4 Operational risk

Operational risk: At a high level this risk can be defined as the risk of loss resulting from inadequate or failed internal processes, people and systems, or from external events. Each criteria has been examined separately.

- Internal processes. Muscat Capital has a robust and well tested system for all internal systems and processes. It has adopted automation in the area of brokerage settlement and clearing as well as the order management



and back office systems related to brokerage. In addition, the firm has taken out Professional indemnity insurance on a voluntary which covers errors and omissions as well.

- People. All staff are subject to rigorous recruitment and HR procedures in accordance with best practices established by Bank Muscat and Muscat Capital.
- External events. Muscat Capital IT department have disaster recovery and business continuity planning for all IT related hardware, software and information stores.

4.4.5 Concentration risk:

Currently MC has invested its reserve capital in Long term deposit and other low risk money market instruments. This represents a placement of fund with a single institution as well a placement of funds in a single instrument. The risks arising out of this deposit have been extensively discussed above in this document and have been addressed accordingly. Given the above, no additional capital provisioning is envisaged.

4.4.6 Reputation risk.

Given the predominance of the advisory role played by MC we consider it important to identify and analyse the reputation risk specifically brought about products and services offered in the various profit centres of MC and how we have / we will address these risks.

- Investment Banking advisory. Muscat Capital deploys registered staff to execute mandates under well structured mandate agreements. All valuations, due diligence is performed by external consultants.
- Asset Management. MC manages mutual funds (both private and public), discretionary portfolio mandates, private placements and real estate mutual. The Fund manager is mandated to invest in a range of products and counterparties as per guidelines provided and losses or decrease in assets in any of these underlying asset classes could expose MC to clients seeking to take legal action against MC seeking to recover their losses. However, we believe that these risks are inherent capital market securities products which can either rise or fall in value. MC does not engage in speculative or high risk securities products currently on an advisory basis and does not seek to do so in the future. All mandate proposals are approved by the clients and discussed prior to investing.
- Brokerage. Risks are low from a reputation risk point of view given that all transactions are executed by the system or by brokers accepting orders via the internet or telephone calls. MC research nor advisory provides investment advice to brokerage customers hence is not exposed to 'bad advice'. Errors and omissions occurring in the placing of telephone orders by clients have been separately addressed in operational risk above.

4.4.7 Interest rate risk.

Muscat Capital has obtained favourable interest rate terms on its Fixed Deposit placed with its depositor banks. These terms are not subject to risk of fluctuation in the short term but would be indirectly affected in the medium to long term when rates are renegotiated and / or renewed for additional periods. Interest rates in the GCC region are subject to limited fluctuations and variations and while our capital invested in deposit is exposed to these fluctuations the implications are indirect as the revenue forecasted by way of interest



income is ancillary and does not constitute core revenue stream forecasted out of the securities business activities for the firm. Overall the firm has only an indirect and no material exposure to interest rate risk

4.4.8 Settlement risk.

All settlements are currently performed using established clearing & settlement systems with securities are settled via the Tadawul automated settlement system. Risk emanating from the settlor banks as a corporate banking entity has been considered elsewhere in this document extensively and hence risks of settlement negligible. Other forms of risk indirectly affecting settlement risk have been considered in a detailed Risk profiling and risk assessment exercise that is carried out by the CEO and Compliance department annually. We do not foresee material risk of settlement of client securities in the Tadawul system. The soundness and reputation of the capital markets in a country is dependent on a reliable and robust securities settlement system and Saudi Arabia is not affected in any way by the risk of non-settlement using the Tadawul exchange system hence there exists zero or very little risk in this area of risk.



Kindly find below certain additional information pertaining to Muscat Capital's Credit Risk weight, credit risk rated exposure and credit risk mitigation.

App III: Illustrative Disclosure on Credit Risk's Risk Weight													
Risk Weights	Exposures after netting and credit risk mitigation												
	Governments and central banks	Administrative bodies and NPO	Authorised persons and banks	Margin Financing	Corporates	Retail	Past due items	Investments	Securitisation	Other assets	Off-balance sheet commitments	Total Exposure after netting and Credit Risk Mitigation	Total Risk Weighted Assets
<i>0%</i>										2		2	
<i>20%</i>			54,982									54,982	1,540
<i>50%</i>			711		510							1,221	85
<i>100%</i>													
<i>150%</i>								259				259	54
<i>200%</i>													



300%						588		8,681		702		9,971	4,188
400%													
500%													
714% (include prohibited exposure)					2,075					403		2,478	2,477
Average Risk Weight												-	
Deduction from Capital Base												-	



App IV: Disclosure on Credit Risk's Rated Exposure								
Exposure Class	Long term Ratings of counterparties							
	Credit quality step	1	2	3	4	5	6	Unrated
	S&P	AAA TO AA-	A+ TO A-	BBB+ TO BBB-	BB+ TO BB-	B+ TO B-	CCC+ and below	Unrated
	Fitch	AAA TO AA-	A+ TO A-	BBB+ TO BBB-	BB+ TO BB-	B+ TO B-	CCC+ and below	Unrated
	Moody's	Aaa TO Aa3	A1 TO A3	Baa1 TO Baa3	Ba1 TO Ba3	B1 TO B3	Caa1 and below	Unrated
	Capital Intelligence	AAA	AA TO A	BBB	BB	B	C and below	Unrated
<u>On and Off-balance-sheet Exposures</u>								
Governments and Central Banks								
Authorised Persons and Banks		39,000	711					
Corporates								
Retail								
Investments								
Securitisation								
Margin Financing								
Other Assets								
Total		39,000	711	0	0	0	0	0
Exposure Class	Short term Ratings of counterparties							
	Credit quality step	1	2	3	4	Unrated		



	S & P	A-1+, A-1	A-2	A-3	Below A-3	Unrated		
	Fitch	F1+, F1	F2	F3	Below F3	Unrated		
	Moody's	P-1	P-2	P-3	Not Prime	Unrated		
	Capital Intelligence	A1	A2	A3	Below A3	Unrated		
<u>On and Off-balance-sheet Exposures</u>								
Governments and Central Banks								
Authorised Persons and Banks		15,927	7					
Corporates			510					
Retail								
Investments								
Securitisation								
Margin Financing								
Other Assets								
Total		15,927	517					

App V: Disclosure on Credit Risk Mitigation (CRM)

Muscat Capital does not have any Credit Risk Mitigation programs in place at this stage.

=====END OF REPORT=====