MUSCAT CAPITAL PILLAR III REPORT - 2020

1. Overview

The Capital Markets Authority of Saudi Arabia have specified requirements for Saudi CMA regulated licensed firm's financial prudence by way of Prudential Guidelines regulations.

The aforesaid rules require all licensed firms as part of "Pillar III" (Disclosure & Reporting) requirements to annually publish disclosure of information on their respective website. 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 the Capital Adequacy of the licensed firms. Muscat Capital ("MC") endeavours to promote good governance, full, fair and transparent disclosure to enable all its stakeholders be able to better judge the risk faced when dealing with the firm. MC has prepared this disclosure document consistent with its scale, complexity and sophistication of the firm's approach to risk management and capital adequacy assessment.

As of December 31, 2020 Muscat Capital is a subsidiary of Bank Muscat (SAOG) Oman. Whereas subsequent to the year end, pursuant to the receipt of regulatory approvals, 72.7% shares of the MC acquired by SICOBank Bahrain.

2. Scope

Muscat Capital (a Single Shareholder Closed Joint Stock Company), which is regulated by the Saudi Arabian Capital Market Authority with license number 08096-37 has been authorised to perform all securities investment business activities such as of dealing as agent & principal, arranging, Managing, Underwriting and Advising & Custody.

3. Capital Structure

CAPITAL BASE	SAR '000
Tier-1 Capital	
Paid-up capital	60,000
Reserves	2,378
Audited retained earnings	18,022
Goodwill and intangible assets (-)	-1,156
Tier-1 capital	79,245

Figures mentioned herein and hereunder are based on amounts for the year ended 31st December 2020 as per the auditors of the Company

4. 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 is now in its 12th year of operation, it always adopted prudent and conservative approach in taking risks, specifically in relation to investing its proprietary money i.e., Capital Funds and funds derived from profits. The company prudently invests its capital in a mix of Deposit and Funds under its own management. All proprietary investments are made in line with the Investment Policy Manual for Proprietary Investments approved by the Board.

The firm deploys an Internal Capital Adequacy Assessment Process which is a structured process conducted annually 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.

5. 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.

5.1 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.

5.2 Credit risk

This represents risk of loss resulting from fluctuations in the credit standing of issuers of securities, counterparties, Margin Lending 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.

Muscat Capital commenced the activity of Margin Lending during the year 2018. The firm adopts collateral standards which are greater than the minimum regulatory requirement for providing Margin Loans. It has well-established systems & controls and documentation management procedures with to ensure that it manages the Margin Lending activity in a well-controlled manner. While MC's capital adequacy ratio has been reduced compared with previous years, it still maintains its actual capital well above the regulatory minimum of 1.2x. MC finances its margin financing from its parent Bank, Bank Muscat (SAOG).

Currently, MC deposits 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. Credit Risk for Margin lending is mitigated by implementing strict requirements for Margin Coverage Ratio and force sell in case of coverage rations going below accepted thresholds.

5.3 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. MC has a well laid out and robust Proprietary Investment Policy which is annually reviewed and updated when required. The Board is responsible for setting out the Risk appetite and profile of the Company. The firm sets limits & stop losses for each product / activity and risk type that it invests in, in order to ensure that the firm's market risk is managed well. As a general practice, 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. The current investments of the firm comprise of the below Investments:-

a) Muscat Capital Trade Finance Fund
b) Riyadh Real Estate Fund
c) Fixed Deposits and Bank Placements

5.4 Operational risk

Operational risk: considers a wide range of "non-financial" problems such as inadequate computer systems (technology risk), insufficient internal controls, incompetent management, fraud, human error and natural disasters. 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 bets 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.

5.5 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.

5.6 Reputation risk.

Reputation risk consists of two parts: (1) the general perceived trustworthiness of an entity (e.g. able and willing to meet its obligations to its customers, creditors and counterparties) and (2) the general perception that the entity engages in fair dealing and conducts business in an ethical manner. 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/independent consultants.

- Asset Management: MC manages mutual funds (both private and public), discretionary portfolio mandates, private placements, Real Estate mutual funds and REIT. 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.

5.7 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

5.8 Settlement risk.

All settlements are currently performed using established clearing and settlement systems with securities being settled via the Tadawul automated settlement system. We do not foresee material risk of settlement of client securities in the Tadawul system. The risk emanating from the settlor banks as a corporate banking entity has been considered elsewhere in this document extensively and hence; risk of settlement is negligible. 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.

6. Muscat Capital Credit Risk details.

Illustrative Disclosure on Credit Risks								
Risk Weights	AP's and banks	Margin Financing	Corporates	Investments	Other assets	Total Exposure after netting and credit Risk Mitigation	Total Risk weighted Assets	Capital requirement
0%					2	2	-	-
20%	64,677					64,677	12,935	1,811
50%						-		
100%						-		
150%		25,064		601		25,665	39,273	5,498
225%						-		
300%				3,724	956	4,679	14,112.97	1,598.07
714% (incl prohibited exposure)			1,412		262	1,674	11,102.05	1,932.04
Prohibited Exposures								
Total							77,424	10,839

Counterparty	Governments/central banks with credit quality step (CQS) 1	Governments/central banks with CQS 2 & 3, APs/banks/companies with CQS 1 & 2 (residual term ≤6 months)	Governments/central banks with CQS 2 & 3, APs/banks/companies with CQS 1 & 2 (residual term >6, ≤24 months)	Governments/central banks with CQS 2 & 3, APs/banks/companies with CQS 1 & 2 (residual term > 24 months)	Governments/central banks with CQS 4 & 5, APs/banks with CQS 3-5, Companies with CQS 3 & 4	Governments/central banks with CQS 6 & unrated, APs/banks with CQS 6 & unrated, Companies with CQS 5,6 and unrated
Risk Weight	0.0%	0.5%	1.8%	2.8%	14.0%	21.0%

7. Disclosure on Credit Risk Mitigation (CRM)

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

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