

# **UBS Saudi Arabia**

(A SAUDI JOINT STOCK COMPANY)

## **Pillar III Disclosure**

As of 31 December 2014

UBS Saudi Arabia is a Saudi closed joint stock company incorporated in the Kingdom of Saudi Arabia with a paid capital of 110,000,000 Saudi Riyals under commercial register number 1010257812 having its registered office at Tatweer Towers, P.O. Box 75724, Riyadh 11588, Kingdom of Saudi Arabia. UBS Saudi Arabia is authorised and regulated by the Capital Market Authority to conduct securities business under licence number 08113-37.

UBS Saudi Arabia is a subsidiary of UBS AG. UBS AG is a public company limited by shares, incorporated in Switzerland with its registered offices at Aeschenvorstadt 1, CH-4051 Basel and Bahnhofstrasse 45, CH-8001 Zurich

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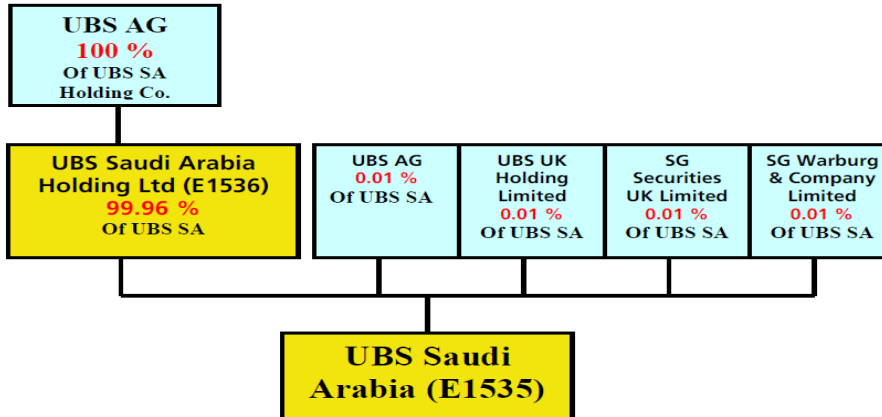
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## A. SPECIFIC DISCLOSURE REQUIREMENTS

### 1. SCOPE OF APPLICATION

UBS SA is a Saudi closed joint stock company registered with the CMA under license number 08113-37 dated 04 Rajab 1429H (corresponding to 07 July 2008). The Company is licensed in dealing as principal, agent (except in the local market), and underwriting, in managing, in arranging, advising, and in custody of securities.

The Company is owned 99.96% by UBS Saudi Arabia Holding Limited, 0.01% by S.G. Securities U.K. Limited, 0.01% by S.G. Warburg and Company Limited, 0.01% by UBS AG and 0.01% by UBS U.K. Holding Limited. UBS Saudi Arabia Holding Limited is owned 100% by UBS AG.



UBS Group AG is the holding company of the UBS Group. Under Swiss company law, UBS Group AG is organized as an Aktiengesellschaft, a corporation that has issued shares of common stock to investors. The operational structure of the Group comprises the Corporate Center and five business divisions: Wealth Management, Wealth Management Americas, Retail & Corporate, Global Asset Management and the Investment Bank.

### 2. CAPITAL STRUCTURE

The Company's authorised, issued and fully paid up share capital is 11,000,000 shares of SR 10 each. The Company has not issued any capital instruments of innovative, complex, or hybrid nature.

The Capital of the Company as of December 31, 2014 consists of Pillar 1 only as

- (i) Paid-up Capital SR 110m
- (ii) Accumulated Losses of SR 15m.

### 3. CAPITAL ADEQUACY

The Prudential Rules are based on three pillars. Pillar 1 regulates the minimum capital requirements for credit risk, market risk and operational risk, large and excess exposures and liquidity requirements. Pillar 2 regulates the authorized person's internal capital assessment, risk management and governance. Pillar 3 regulates how information regarding risk management, capital requirements, capital adequacy etc. should be made public. The total capital ratio shall not be allowed to be lower than 1. Whenever the ratio is lower than 1, the authorized person shall decrease its exposures or increase its capital base. The Company will consistently maintain its capital adequacy ratio well above the regulatory minimum of 1%.

The audited capital base, minimum capital requirement and capital adequacy ratio of the Company as per the CMA's Prudential Rules are as follows:

	2014 SR '000	2013 SR '000
<i>Capital Base:</i>		
Tier 1 Capital	94,481	93,894
Tier 2 Capital	-	-
<b>Total Capital Base</b>	<b>94,481</b>	<b>93,894</b>
<i>Minimum Capital Requirement:</i>		
Market Risk	176	184
Credit Risk	5,571	6,133
Operational Risk	3,387	3,324
<b>Total Minimum Capital Required</b>	<b>9,134</b>	<b>9,641</b>
<i>Capital Adequacy Ratio:</i>		
<b>Total Capital Ratio (time)</b>	<b>10.34</b>	9.74
<b>Tier 1 Capital Ratio (time)</b>	<b>10.34</b>	9.74
<b>Surplus / (Deficit) in the capital</b>	<b>85,347</b>	84,253

The capital base consists of Tier 1 capital (which includes share capital and audited retained earnings). The company does not have Tier 2 capital as per article 4 and 5 of the Prudential Rules. The minimum capital requirements for market, credit and operational risk are calculated as per the requirements specified in part 3 of the Prudential Rules.

The Company manages its capital base in light of Pillar I and Pillar II of the Prudential Rules - the capital base should not be less than the minimum capital requirement.

The Company’s business objectives when managing capital adequacy is to comply with the capital requirements set forth by the CMA to safeguard the Company’s ability to continue as a going concern, and to maintain a strong capital base.

The Group’s risk and capital assessment policies are designed to identify and quantify these risks, set appropriate limits in line with defined risk appetite, ensuring control and monitoring adherence to the limits. The principal risks associated with the Company’s business are credit risk, market risk, liquidity risk, operational risk and reputation risk.

The table below describes the approaches the Company has adopted for determining the capital base requirements for the Pillar 1 risks:

<b>Credit Risk</b>	<b>Market Risk</b>	<b>Operational Risk</b>
<b>Standardized Approach</b>	<b>Standardized Approach</b>	<b>Basic Indicator Approach</b>

The Company aims to maximise shareholders’ value through an optimal capital structure that protects the stakeholders’ interests under extreme stress conditions, and provides sufficient capacity for growth whilst ensuring compliance with the regulatory requirements and meeting shareholders’ expectations.

At the Group level, the risk appetite is established within our risk capacity as determined by a complementary set of firm-wide risk metrics, and is approved under Board of Directors (BoD) authority. It is administered and enforced by a detailed framework of portfolio and position limits at both Group and business division levels. Each element of our risk control framework plays a key role in the decision-making processes within the firm. All material risks are reported to the respective authority holders at least monthly. Five pillars support our efforts to achieve an appropriate balance between risk and return:

1. Protecting the financial strength of UBS by controlling our risk exposures and avoiding potential risk concentrations at individual exposure levels, at specific portfolio levels and at an aggregate firm-wide level across all risk types.
2. Protecting our reputation through a sound risk culture characterized by a holistic and integrated view of risk, performance and reward, and through full compliance with our standards and principles, particularly our Code of Business Conduct and Ethics.
3. Ensuring management accountability, whereby business management, as opposed to Risk Control, owns all risks assumed throughout the firm and is responsible for the continuous and active management of all risk exposures to ensure that risk and return are balanced.
4. Independent control functions which monitor the effectiveness of the business’s risk management and oversee risk-taking activities.
5. Disclosure of risks to senior management, the BoD, shareholders, regulators, rating agencies and other stakeholders with an appropriate level of comprehensiveness and transparency.

## **4. RISK MANAGEMENT**

### **4.1 General Qualitative Disclosure for Risks**

At the Group level, the risk management and control principles are implemented through a risk management and control framework. This framework comprises qualitative elements such as policies, procedures and authorities, and quantitative components including risk measurement methodologies and risk limits. The framework is dynamic and continuously adapted to our evolving businesses and the market environment. It includes clearly defined processes to deal with new business initiatives as well as large and complex transactions.

Risk identification in any business line, product or transaction is, in the first instance, the responsibility of the originating business unit, as the owner and manager of the risk. This applies not only when a business, a product or a transaction commences, but also during the life of the business and as its risk profile changes.

The UBS AG's Group Chief Risk Officer (CRO) and their risk officers will assist in the identification and analysis of risk. They and the local Compliance must be consulted when a risk is identified (unless such risk is already authorized and there is no requirement for specific transaction pre-approval), and in all cases of doubt.

Risk reporting is a culmination of the processes and requirements described in this policy. Risk reporting ensures that material risk, significant internal control deficiencies and any material findings from risk assessment process are identified and reported to the Board of Directors and the Audit Committee of UBS SA.

The Head of Compliance is responsible for providing an overview of the current level of risk and associated remediation activities to the Board of Directors of UBS SA on quarterly basis. This reporting covers all risk categories including relevant weaknesses in internal controls that give rise to legal, liability, and compliance risks.

The Board of Directors and the Audit Committee of UBS SA are the governance bodies for oversight and active discussion of risk management activities, including making risk appetite decisions on specific sources of risk and whether the cost of mitigating actions are adequately balanced against the acceptable level of risk.

### **4.2 Credit Risk Disclosure**

Credit risk is the risk of loss resulting from failure by a counterparty (including issuers) to meet its contractual obligations with UBS SA. The business model of the Company is such that it does not grant funding to third parties. The small amount of credit risk exposure that arises in the Company is mainly as a result of bank deposits and receivables. Any credit exposure arising in the Company is subject to the general policies and controls for the recognition of the financial strength of the counterparties involved. The Company is not subject to significant credit risk since most of its receivables are from related parties and the term deposits and bank balances are with a counterparty that has an investment grade credit rating (i.e. where the counterparty is rated at 'BBB' or higher by Standard and Poor's or Moody's).

UBS SA follows the Group's stress loss which is a scenario-based measure which complements statistical modelling approach. It is used to assess our potential loss in various stress scenarios based on the assumption that one or more of the key credit risk parameters will deteriorate substantially. UBS AG Run stress tests on a regular basis to monitor and limit the potential impact of extreme, but nevertheless plausible events on our portfolios and apply limits on this basis.

The above would be tailored to what is really done in the Company and after obtaining the CMA approval. Currently, the Company is not subject to significant credit risk since most of its receivables are from related parties and the term deposits and bank balances are with a counterparty that has an investment grade credit rating.

Y2014	RWA	CAPITAL REQUIREMENT
	In SR'000	In SR'000
Exposures to banks (On balance sheet - Deposit)	17,963	2,515
Tangible assets and Other items	21,826	3,056
<b>TOTAL CREDIT RISKS</b>	<b>39,789</b>	<b>5,571</b>

#### 4.3 Credit Risk Mitigation Exposure

The Group has developed tools and models to measure **credit risk**. Exposures to individual counterparties are measured based on three generally accepted parameters: probability of default, exposure at default and loss given default. These parameters are the basis for the majority of our internal measures of credit risk, and are key inputs for the regulatory capital calculation under the advanced internal ratings-based approach of the Basel III framework governing international convergence of capital. The Group also uses models to derive the portfolio credit risk measures of expected loss, statistical loss and stress loss.

Credit risk is principally controlled by establishing and enforcing authorization limits, including set-off limits, and by defining exposure levels to counterparties and checking the creditworthiness of counterparties that are not parent undertakings.

The Company did not undertake significant transactions with credit risk exposure class covered by guarantee or credit derivatives or other eligible Collaterals during the year.

#### 4.4 Counterparty Credit Risk (CCR) and Off-Balance Sheet Disclosure

The Company did not undertake significant transactions with counterparty credit risk and off-balance sheet during the year.

#### 4.5 Market Risk Disclosure

Market risk is the risk of loss resulting from adverse movements in the level and in the volatility of market prices of assets, liabilities and financial instruments. The business model of UBS SA is such that it is not exposed to risks associated with trading as it does not perform proprietary investments. The business is an agency business whereby there is no intention to hold open positions in the normal course of business.

The Group has two major portfolio measures of market risk: value-at-risk (VaR) and stress loss. Both are common to all our business divisions and subject to limits that are approved by the BoD. VaR is a statistical measure of market risk, representing the market risk losses that could potentially be realized over a set time horizon at an established level of confidence. This assumes no change in the firm's trading positions over the relevant time period. UBS AG's scenarios capture the liquidity characteristics of different markets, asset classes and positions. UBS AG's market risk stress testing framework is designed to provide a control framework that is forward-looking and responsive to changing market conditions.

The stress scenarios are reviewed regularly by UBS in the context of the macroeconomic and geopolitical environment by a committee comprised of representatives from the business divisions and Risk Control. In response to changing market conditions and new developments around the world, ad hoc stress scenarios are run to assess the potential impact on its portfolio.

The above is being tailored to the actual risk taken in the Company and after obtaining the CMA approval. Currently, the Company is only exposed to fluctuations on its foreign currency bank balances denominated in Swiss Francs.

Apart from that, the Company did not undertake significant transactions in currencies other than Saudi Riyals or US Dollars during the year.

Y2014	CAPITAL REQUIREMENT In SR'000
Equity	
Investment funds	
Bonds	
Commodities	
Foreign exchange rate	176
Underwriting	
Excess exposure	
Settlement	
<b>TOTAL MARKET RISKS</b>	<b>176</b>



#### **4.6 Operational Risk Disclosure**

Operational risk is the risk resulting from inadequate or failed internal processes, people and systems, or from external causes (deliberate, accidental or natural). An Operational Risk Event may be a direct financial loss (e.g. negative cash flow, asset write down, claim, litigation , fines or other penalties imposed on UBS SA) or indirect in the form of revenue forgone as a result of business suspension.

Responsibility for the front-to back control environment in the business divisions is the responsibility of the respective business divisions' CEOs but is delegated to the respective business divisions' Chief Operating Officers (including the Corporate Center COO). Management in all functions (business, logistics and control functions) is responsible for establishing an appropriate operational risk management environment, including the establishment and maintenance of robust internal controls, effective supervision and a strong risk culture. Controls must be regularly assessed, utilizing evidence to confirm design and operating effectiveness.

The Group's operational risk framework describes general requirements for managing and controlling operational risk at UBS. The framework is built on four main pillars:

1. Classification of inherent risks through the operational risk taxonomy.
2. Assessment of the design and operating effectiveness of controls through the internal control assessment process.
3. Assessment of residual risk through the operational risk assessment process.
4. Remediation to address identified deficiencies which are outside accepted levels of residual risk.

The Group measures operational risk exposure and calculates operational risk regulatory capital by utilizing the advanced measurement approach (AMA) in accordance with FINMA requirements. For regulated subsidiaries, including UBS SA, the basic indicator or standardized approaches are adopted as agreed with local regulators.

The above would be tailored to what is really done in the Company and after obtaining the CMA approval. Currently, the Company has adopted the Basic Indicator Approach for determining the capital requirements for Operational Risk. All the total gross operating incomes reported under Basic Indicator approach are taken from the last 3 years annual audited financial statements.

Operational Risk <i>See Article 39 - 44 and Annex 4</i>	GROSS OPERATING INCOME			AVERAGE GROSS OPERATING INCOME	RISK CAPITAL CHARGE (%)	CAPITAL REQUIREMENT
	2012	2013	2014			
<b>1. BASIC INDICATOR APPROACH</b>	13,428	13,391	13,667	13,495	15.0	2,024
CORPORATE FINANCE				0	18.0	0
RESEARCH AND ADVISORY				0	18.0	0
TRADING AND SALES				0	18.0	0
CUSTODY				0	15.0	0
ASSET MANAGEMENT				0	12.0	0
<b>2. STANDARDISED APPROACHES</b>						0
	OVERHEAD EXPENSES (YEAR -1)				RISK CAPITAL CHARGE (%)	CAPITAL REQUIREMENT
<b>3. EXPENDITURE BASED APPROACH</b>	13,547				25.0	3,387
<b>CAPITAL REQUIREMENT FOR OPERATIONAL RISK</b>						<b>3,387</b>

#### 4.7 Liquidity Risk Disclosure

Liquidity risk is the risk that UBS SA will not be able to meet efficiently both expected and unexpected current and future cash flows needs without affecting either daily operations or the financial condition of the Company. The nature of the business model translates to low levels of liquidity risk. The Company manages its liquidity risk by ensuring that sufficient cash and cash equivalents are available to meet liabilities as they arise.

As a global financial intermediary, liquidity and funding risk is one of the primary risks to which UBS is exposed. Group Treasury is responsible for the Liquidity and Funding Risk Management within UBS overall. The management of Liquidity and Funding Risk is an integral part of UBS's risk management approach. The liquidity and funding strategy is proposed by Group Treasury, approved by the Group Asset and Liability Management Committee (Group ALCO) and overseen by the Risk Committee. Group Treasury performs liquidity stress testing to determine the optimum asset and liability structure to maintain an appropriately balanced liquidity and funding position under various scenarios. Liquidity crisis scenario analysis and contingency funding planning support the liquidity management process, which ensures that immediate corrective measures to absorb potential sudden liquidity shortfalls can be put into effect. The Company manages its liquidity risk by ensuring that sufficient cash and cash equivalents are available to meet liabilities as they arise. Liquidity Risk is not an issue to the Company as the Company is under the cost-plus 10 % (Transfer Pricing) Methodology until the revenues from the clients exceeds their associated costs and the Company becomes profitable. The aim of the Fund Transfer Pricing Model is to ensure that each Division's assets are funded with the appropriate liability structure at the correct price.

## APPENDICES

**1. Appendix I: Illustrative Disclosure on Capital Base**

<b>App 1: Illustrative Disclosure on Capital Base</b>	
<b>Capital Base</b>	<b>SAR '000</b>
<b>Tier-1 capital</b>	
Paid-up capital	110,000
Audited retained earnings	-15,151
Share premium	
Reserves (other than revaluation reserves)	
Tier-1 capital contribution	
Deductions from Tier-1 capital	-368
<b>Total Tier-1 capital</b>	<b>94,481</b>
<b>Tier-2 capital</b>	
Subordinated loans	
Cumulative preference shares	
Revaluation reserves	
Other deductions from Tier-2 (-)	
Deduction to meet Tier-2 capital limit (-)	
<b>Total Tier-2 capital</b>	
<b>TOTAL CAPITAL BASE</b>	<b>94,481</b>

## 2. Appendix II: Illustrative Disclosure on Capital Adequacy

App II: Illustrative 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
<b>Credit Risk</b>				
<i>On-balance Sheet Exposures</i>				
Governments and Central Banks				
Authorised Persons and Banks	89,817	89,817	17,963	2,515
Corporates				
Retail				
Investments				
Securitisation				
Margin Financing				
Other Assets	7,271	7,271	21,826	3,056
<b>Total On-Balance sheet Exposures</b>	<b>97,088</b>	<b>97,088</b>	<b>39,789</b>	<b>5,571</b>
<i>Off-balance Sheet Exposures</i>				
OTC/Credit Derivatives				
Repurchase agreements				
Securities borrowing/lending				
Commitments				
Other off-balance sheet exposures				
<b>Total Off-Balance sheet Exposures</b>				
<b>Total On and Off-Balance sheet Exposures</b>	<b>97,088</b>	<b>97,088</b>	<b>39,789</b>	<b>5,571</b>
<b>Prohibited Exposure Risk Requirement</b>				
<b>Total Credit Risk Exposures</b>	<b>97,088</b>	<b>97,088</b>	<b>39,789</b>	<b>5,571</b>
<b>Market Risk</b>				
	Long Position	Short Position		
Interest rate risks				
Equity price risks				
Risks related to investment funds				
Securitisation/resecuritisation positions				
Excess exposure risks				
Settlement risks and counterparty risks				
Foreign exchange rate risks	4,669	0		176
Commodities risks.				
<b>Total Market Risk Exposures</b>	<b>4669</b>	<b>0</b>		<b>176</b>
<b>Operational Risk</b>				<b>3,387</b>
<b>Minimum Capital Requirements</b>				<b>9,134</b>
<b>Surplus/(Deficit) in capital</b>				<b>85,347</b>
<b>Total Capital ratio (time)</b>				<b>10.34</b>

### 3. Appendix III: Illustrative Disclosure on Credit Risk's Risk Weight

App III: Illustrative Disclosure on Credit Risk's Risk Weight														
Risk Weights	Exposures after netting and credit risk mitigation												Total Exposure after netting and Credit Risk Mitigation	Total Risk Weighted Assets
	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			
0%												13	13	0
20%			89,817										89,817	17,963
50%														
100%														
150%														
200%														
300%												7,246	7,246	21,738
400%														
500%														
714% (include prohibited exposure)												12	12	89
Average Risk Weight			17,963									21,826	97,088	39,790
Deduction from Capital Base												-368		

### 4. Appendix IV: Illustrative Disclosure on Credit Risk's Rated Exposure

App IV: Illustrative 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
<b>On and Off-balance-sheet Exposures</b>									
Governments and Central Banks									
Authorised Persons and Banks									
Corporates									
Retail									
Investments									
Securitisation									
Margin Financing									
Other Assets									
<b>Total</b>									
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			
<b>On and Off-balance-sheet Exposures</b>									
Governments and Central Banks									
Authorised Persons and Banks		85,209	4,609						
Corporates									
Retail									
Investments									
Securitisation									
Margin Financing									
Other Assets									
<b>Total</b>		85,209	4,609						

## 5. Appendix V: Illustrative Disclosure on Credit Risk Mitigation

App V: Illustrative Disclosure on Credit Risk Mitigation (CRM)						
Exposure Class	Exposures before CRM	Exposures covered by Guarantees/ Credit derivatives	Exposures covered by Financial Collateral	Exposures covered by Netting Agreement	Exposures covered by other eligible collaterals	Exposures after CRM
<b><i>Credit Risk</i></b>						
<i>On-balance Sheet Exposures</i>						
Governments and Central Banks						
Authorised Persons and Banks	89,817					89,817
Corporates						
Retail						
Investments						
Securitisation						
Margin Financing						
Other Assets	7,271					7,271
<b>Total On-Balance sheet Exposures</b>	<b>97,088</b>					<b>97,088</b>
<i>Off-balance Sheet Exposures</i>						
OTC/Credit Derivatives						
Exposure in the form of repurchase agreements						
Exposure in the form of securities lending						
Exposure in the form of commitments						
*Other Off-Balance sheet Exposures						
<b>Total Off-Balance sheet Exposures</b>						
<b>Total On and Off-Balance sheet Exposures</b>	<b>97,088</b>					<b>97,088</b>
* Refer to Chapter 2 of Annex 3.						