Gulf International Bank B.S.C.
ABU DHABI BRANCH

Basel III Pillar 3

RISK MANAGEMENT AND CAPITAL ADEQUACY

For the year ended 31st December 2020

Risk management and capital adequacy report

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Executive summary

The Central Bank of the UAE (CBUAE) Basel 3 guidelines prescribe the capital adequacy framework for banks incorporated in the UAE and are applicable to branches of foreign banks operating in the UAE. Gulf International Bank B.S.C. – Abu Dhabi (the "Branch") is a branch of a Bahraini Shareholding Company, Gulf International Bank B.S.C. (the "Head Office" or "GIB"). The Abu Dhabi branch is registered as a wholesale bank branch with the Central Bank of the UAE under license number 13/420/2017 and commenced its operations on 9th December 2014. The registered office of the Branch is Al Falah Tower, Sh. Rashid Bin Saeed Road, Abu Dhabi, United Arab Emirates.

The Branch is principally engaged in the provision of wholesale commercial banking services.

This Risk Management and Capital Adequacy report encompasses the Pillar 3 disclosure requirements prescribed by the CBUAE based on the Basel Committee's Pillar 3 guidelines. The report contains a description of GIB risk management and capital adequacy policies and practices, including detailed information on the capital adequacy process.

For regulatory purposes, the Branch has adopted the standardised approach for credit risk. The Branch uses the standardised approach for market risk and the basic indicator approach for determining the capital requirement for operational risk.

The disclosed tier 1 and total capital adequacy ratios comply with the minimum capital requirements under the CBUAE Basel 3 framework.

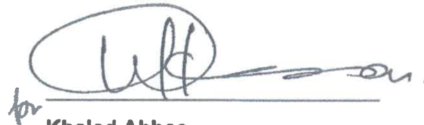
The Branch's total risk-weighted assets at 31st December 2020 amounted to AED 1,382.1 million. Tier 1 and total regulatory capital were AED 562.3 million and AED 579.1 million respectively.

At 31st December 2020, the Branch tier 1 and total capital adequacy ratios were 40.7 per cent and 41.9 per cent respectively. The Branch aims to maintain a tier 1 capital adequacy ratio above 10.5 per cent and a total capital adequacy ratio in excess of 15.0 per cent.

The Branch views the Pillar 3 disclosures as an important contribution to increased risk transparency within the banking industry, and particularly important during market conditions characterised by high uncertainty. In this regard, the Branch has provided more disclosure in this report than is required in accordance with the CBUAE Pillar 3 guidelines in order to provide the level of transparency that is believed to be appropriate and relevant to the Branch's various stakeholders and market participants.

All figures presented in this report are as at 31st December 2020 unless otherwise stated.

Marwan El Abiad
Group Chief Financial Officer



for **Khaled Abbas**
UAE Country Head

1. The Basel 3 framework

The CBUAE Basel 3 framework is based on three pillars, consistent with the Basel 3 framework developed by the Basel Committee, as follows:-

- Pillar 1: the calculation of the risk-weighted assets (RWAs) and capital requirement.
- Pillar 2: the supervisory review process, including the Internal Capital Adequacy Assessment Process (ICAAP).
- Pillar 3: the disclosure of risk management and capital adequacy information.

1.1 Pillar 1

Pillar 1 prescribes the basis for the calculation of the regulatory capital adequacy ratio. Pillar 1 set out the definition and calculations of the RWAs, and the derivation of the regulatory capital base. The capital adequacy ratio is calculated by dividing the regulatory capital base by the total RWAs.

The table below summarises the approaches applied for calculating RWAs for each risk type in accordance with the CBUAE Basel 3 capital adequacy framework:-

Approaches for determining regulatory capital requirements		
Credit risk	**Market risk**	**Operational risk**
Standardised approach	Standardised approach	Basic indicator approach

1.2 Pillar 2

Pillar 2 defines the process of supervisory review of an institution's risk management framework and, ultimately, its capital adequacy.

Pillar 2 comprises two processes:-

- an Internal Capital Adequacy Assessment Process (ICAAP), and
- a supervisory review and evaluation process.

The ICAAP incorporates a review and evaluation of risk management and capital relative to the risks to which the Branch is exposed. The Branch's ICAAP has been developed around its economic capital framework which is designed to ensure that the Branch has sufficient capital resources available to meet regulatory and internal capital requirements, even during periods of economic or financial stress. The ICAAP addresses all components of the Branch's risk management, from the daily management of more material risks to the strategic capital management.

The supervisory review and evaluation process represents the CBUAE review of the Branch's capital management and an assessment of internal controls and corporate governance. The supervisory review and evaluation process is designed to ensure that institutions identify their material risks and allocate adequate capital, and employ sufficient management processes to support such risks.

The supervisory review and evaluation process also encourages institutions to develop and apply enhanced risk management techniques for the measurement and monitoring of risks in addition to the credit, market and operational risks addressed in the core Pillar 1 framework. Other risk types which are not covered by the minimum capital requirements in Pillar 1 include liquidity risk, interest rate risk in the banking book, business risk and concentration risk. These are covered either by capital, or risk management and mitigation processes under Pillar 2.

1.3 Pillar 3

In the CBUAE Basel 3 framework, the third pillar prescribes how, when, and at what level information should be disclosed about an institution's risk management and capital adequacy practices.

The disclosures comprise detailed qualitative and quantitative information. The purpose of the Pillar 3 disclosure requirements is to complement the first two pillars and the associated supervisory review process. The disclosures are designed to enable stakeholders and market participants to assess an institution's risk appetite and risk exposures and to encourage all banks, via market pressures, to move toward more advanced forms of risk management.

In this report, the Branch's disclosures are beyond the minimum regulatory requirements and provide disclosure of the risks to which it is exposed, both on- and off-balance sheet. The disclosures in this report are in addition to the disclosures set out in the financial statements presented in accordance with International Financial Reporting Standards (IFRS).

2. Risk and capital management

The Branch maintains a prudent and disciplined approach to risk taking by upholding a comprehensive set of risk management policies, processes and limits, employing professionally qualified people with the appropriate skills, investing in technology and training, and actively promoting a culture of sound risk management at all levels. A key tenet of this culture is the clear segregation of duties and reporting lines between personnel transacting business and personnel processing that business. The Branch's risk management is underpinned by its ability to identify, measure, aggregate and manage the different types of risk it faces.

The Board of Directors for the GIB Group has created from among its members a Board Risk Policy Committee to review the Group's risk-taking activities including those at the Abu Dhabi Branch and report to the Board in this regard. The Board has the ultimate responsibility for setting the overall risk parameters and tolerances within which the Group and the Branch conducts its activities, including responsibility for setting the capital ratio targets. The Board reviews the Group's overall risk profile and significant risk exposures as well as the Group's major risk policies, processes and controls. These policies, processes and controls are disseminated to the Branch.

The GIB Group Management Committee, chaired by the Chief Executive Officer (CEO), has the primary responsibility for sanctioning risk-taking policies and activities within the tolerances defined by the Board. The GIB Group Risk Committee assists the Management Committee in performing its risk related functions, through all the branches.

The GIB Group Risk Committee, under the chairmanship of the Group Chief Risk Officer (CRO) and comprising the Group's most senior risk professionals, provides a forum for the review and approval of new products, risk measurement methodologies and risk control processes. The Group Risk Committee also reviews all risk policies and limits that require approval by the Management Committee. The Group Assets and Liabilities Committee (ALCO), chaired by the Group Chief Financial Officer (CFO), provide a forum for the review of asset and liability activities within GIB including the Branch. It co-ordinates the asset and liability functions and serves as a link between the funding sources and usage in the different business areas.

From a control perspective, the process of risk management is facilitated through a set of independent functions, which report directly to senior management. These functions include Credit Risk, Market Risk, Operational Risk, Financial Control and Internal Audit. This multi-faceted approach aids the effective management of risk by identifying, measuring and monitoring risks from a variety of perspectives.

Internal Audit is responsible for carrying out a risk-based programme of work designed to provide assurance that assets are being safeguarded. This involves ensuring that controls are in place and working effectively in accordance with Group policies and procedures as well as with laws and regulations. The work carried out by Internal Audit includes providing assurance on the effectiveness of the risk management functions, as well as that of controls operated by the business units in all of the Group's geographic locations. The Board Audit Committee approves the annual audit plan and also receives regular reports of the results of audit work.

The Group's policy is to maintain a strong capital base so as to maintain investor, creditor and market confidence and to sustain the entire Branch's future business development. The Branch manages its capital structure and makes adjustments to the structure taking account of changes in economic conditions and strategic business plans. The capital structure may be adjusted through the dividend payout or the issue of new shares.

The Group CFO is responsible for the capital planning process. Capital planning includes capital adequacy reporting, economic capital and parameter estimation, i.e. probability of default (PD) and loss given default (LGD) estimates, used for the calculation of economic capital. The CFO is also responsible for the balance sheet management framework.

The governance structure for risk and capital management is set out in the table below: -

Board of Directors		
Board Audit Committee	Board Risk Policy Committee	
Chief Executive Officer		
Management Committee (Chairman: CEO)	Group Risk Committee (Chairman: CRO)	Assets and Liabilities Committee (Chairman: CFO)

The risk, liquidity and capital management responsibilities are set out in the table below:-

Chief Executive Officer	
Chief Financial Officer (CFO)	**Chief Risk Officer (CRO)**
Balance sheet management framework Capital management framework	Risk management framework and policies Group credit control Credit risk Market risk Operational risk Liquidity risk

2.1 Risk types

The major risks associated with the Branch's business activities are credit, market, operational and liquidity risk. These risks together with a commentary on the way in which the risks are managed and controlled are set out in the following sections, based on the Basel 3 pillar in which the risks are addressed.

2.2 Risk in Pillar 1

Pillar 1, which forms the basis for the calculation of the regulatory capital requirement, addresses three specific risk types: credit, market and operational risk.

a) Credit risk

Credit risk is the risk that a customer, counterparty or an issuer of securities or other financial instruments fails to perform under its contractual payment obligations thus causing the Branch to suffer a loss in terms of cash flow or market value. Credit risk is the predominant risk type faced by the Branch in its banking, investment and treasury activities, both on- and off-balance sheet. Where appropriate, the Branch seeks to minimise its credit exposure using a variety of techniques including, but not limited to, the following: -

- entering netting agreements with counterparties that permit the offsetting of receivables and payables
- obtaining collateral
- seeking third party guarantees of the counterparty's obligations
- imposing restrictions and covenants on borrowers

Credit risk is actively managed and rigorously monitored in accordance with well-defined credit policies and procedures. Prior to the approval of a credit proposal, a detailed credit risk assessment is undertaken which includes an analysis of the obligor's financial condition, market position, business environment and quality of management. The risk assessment generates an internal credit risk rating for each counterparty, which affects the credit approval decision and the terms and conditions of the transaction. For cross-border transactions, an analysis of country risk is also conducted. The credit decision for an individual counterparty is based on the aggregate Group exposure to that counterparty and all its related entities. Group wide credit limit setting and approval authorisation requirements are conducted within Group Board approved guidelines, and the measurement, monitoring and control of credit exposures are done on a Group wide basis in a consistent manner. Overall exposures are evaluated to ensure broad diversification of credit risk. Potential concentration risks by product, industry, single obligor, credit risk rating and geography are regularly assessed with a view to improving overall portfolio diversification. Established limits and actual levels of exposure are regularly reviewed by the Group Chief Risk Officer, Group Chief Credit Officer and other members of senior management. All credit exposures are reviewed at least once a year. Credit policies and procedures are designed to identify, at an early stage, exposures which require more detailed monitoring and review.

The credit risk associated with foreign exchange and derivative instruments is assessed in a manner similar to that associated with on-balance sheet activities. The Branch principally utilises derivative transactions to facilitate customer transactions and for the management of interest and foreign exchange risks associated with the longer-term lending, borrowing and investment activities. Unlike on-balance sheet products, where the principal amount and interest generally represent the maximum credit exposure, the notional amount relating to a foreign exchange or derivative transaction typically exceeds the credit exposure by a substantial margin. The measure of credit exposure for foreign exchange and derivative instruments is therefore more appropriately considered to be the replacement cost at current market rates plus an add-on amount commensurate with the position's size, volatility and remaining life. Derivative contracts may also carry legal risk; the Branch seeks to minimise these risks by the use of standard contract agreements.

b) Market risk

Market risk is the risk of loss of value of a financial instrument or a portfolio of financial instruments as a result of adverse changes in market prices and rates, and market conditions such as liquidity. Market risk arises from the Branch's asset and liability management and investment activities.

The categories of market risk to which the Branch is exposed, or potentially exposed to, are as follows: -

Interest rate risk results from exposure to changes in the level, slope, curvature and volatility of interest rates and credit spreads. The credit spread risk is the risk that the interest yield for a security will increase, with a reduction in the security price, relative to benchmark yields as a result of the general market movements for that rating and class of security.

Foreign exchange risk results from exposure to changes in the price and volatility of currency spot and forward rates.

The Branch seeks to manage exposure to market risk through the diversification of exposures across dissimilar markets and the establishment of hedges in related securities or off-balance sheet derivative instruments. To manage the Branch's exposures, in addition to the exercise of business judgement and management experience, the Branch utilises limit structures including those relating to positions, portfolios, maturities and maximum allowable losses.

c) Operational risk

Operational risk is the risk of loss arising from inadequate or failed internal processes, people and systems or from external events, whether intentional, unintentional or natural. It is an inherent risk faced by all businesses and covers a large number of potential operational risk events including business interruption and systems failures, internal and external fraud, employment practices and workplace safety, customer and business practices, transaction execution and process management, and damage to physical assets.

Whilst operational risk cannot be eliminated in its entirety, the Branch endeavours to minimise the risk by ensuring that a strong control infrastructure is in place throughout the organisation. The various procedures and processes used to manage operational risk include effective staff training, appropriate controls to safeguard assets and records, regular reconciliation of accounts and transactions, close monitoring of risk limits, segregation of duties, and financial management and reporting. In addition, other control strategies, including business continuity planning and insurance, are in place to complement the control processes, as applicable.

The Branch has an independent operational risk function. As part of the Group's Operational Risk Management Framework (ORMF), comprehensive risk assessments are conducted, which identify operational risks inherent in the Branch's activities, processes and systems. The controls in place to mitigate these risks are also reviewed, and enhanced if necessary.

2.3 Risk in Pillar 2

Other risk types are measured and assessed in Pillar 2. GIB Group measures and manages these risk types although they are not included in the calculation of the Branch's regulatory capital adequacy ratio. Most of the Pillar 2 risks are included in the Group calculation of internal economic capital. Pillar 2 risk types include liquidity risk, interest rate risk in the banking book, business risk and concentration risk.

a) Liquidity risk

Liquidity risk is the risk that sufficient funds are not available to meet the Branch's financial obligations on a punctual basis as they fall due. The risk arises from the timing differences between the maturity profiles of the Branch's assets and liabilities. It includes the risk of losses arising from the following:-

- forced sale of assets at below normal market prices
- raising of deposits or borrowing funds at excessive rates
- the investment of surplus funds at below market rates

Liquidity management policies are designed to ensure that funds are available at all times to meet the funding requirements of the Branch, even in adverse conditions. In normal conditions, the objective is to ensure that there are sufficient funds available not only to meet current financial commitments but also to facilitate business expansion. These objectives are met through the application of prudent liquidity controls. These controls provide access to funds without undue exposure to increased costs from the liquidation of assets or the aggressive bidding for deposits.

The Branch's liquidity controls ensure that, over the short-term, the future profile of cash flows from maturing assets is adequately matched to the maturity of liabilities. Liquidity controls also provide for the maintenance of a stock of liquid and readily realisable assets and a diversified deposit base in terms of both maturities and range of depositors.

The management of liquidity and funding is primarily conducted at the Branch within approved limits. The limits ensure that contractual net cash flows occurring over the following 30 day period do not exceed the eligible stock of available liquid resources.

The Group's liquidity management policies, applicable to the Branch include the following: -

- the monitoring of (i) future contractual cash flows against approved limits, and (ii) the level of liquid resources available in a stress event
- the monitoring of balance sheet liquidity ratios
- the monitoring of the sources of funding in order to ensure that funding is derived from a diversified range of sources
- the monitoring of depositor concentrations in order to avoid undue reliance on individual depositors, and
- the maintenance of liquidity and funding contingency plans. These plans identify early indicators of stress conditions and prescribe the actions to be taken in the event of a systemic or other crisis, while minimising adverse long-term implications for the Branch's business activities.

b) Interest rate risk in the banking book

Structural interest rate risk arises in the Branch's core balance sheet as a result of mismatches in the repricing of interest rate sensitive financial assets and liabilities. The associated interest rate risk is managed within VaR limits and through the use of models to evaluate the sensitivity of earnings to movements in interest rates.

c) Business risk

Business risk represents the earnings volatility inherent in all businesses due to the uncertainty of revenues and costs associated with changes in the economic and competitive environment. Business risk is evaluated based on the observed volatility in historical profits and losses.

d) Concentration risk

Concentration risk is the risk related to the degree of diversification in the credit portfolio, i.e. the risk inherent in doing business with large customers or not being equally exposed across industries and regions.

Concentration risk is captured in GIB's Group–level economic capital framework through the use of a credit risk portfolio model which considers single-name concentrations in the credit portfolio. Economic capital add-ons are applied where counterparty exposures exceed specified thresholds.

Potential concentration risks by product, industry, single obligor, and geography are regularly assessed with a view to improving overall portfolio diversification. Established limits and actual levels of exposure are regularly reviewed by senior management and the Group's Board of Directors.

2.4 Monitoring and reporting

The monitoring and reporting of risk is conducted on a daily basis for market and liquidity risk, and on a monthly or quarterly basis for credit and operational risk.

Risk reporting is regularly made to Group senior management and the Board of Directors. The Group's Board of Directors receives internal risk reports covering market, credit, operational and liquidity risks.

Capital management, including regulatory and internal economic capital ratios, is reported to the Group senior management and the Group Board of Directors on a monthly basis.

3. Regulatory capital requirements and the capital base

This section describes the Bank's regulatory capital requirements and capital base.

3.1 Capital requirements for credit risk

For regulatory reporting purposes, the Branch calculates the capital requirements for credit risk based on the standardised approach. Under the standardised approach, on- and off-balance sheet credit exposures are assigned to exposure categories based on the type of counterparty or underlying exposure. Following the assignment of exposures to the relevant standard portfolios, the RWAs are derived based on prescribed risk-weightings. Under the standardised approach, the risk-weightings are provided by the CBUAE and are determined based on the counterparty's external credit rating. The external credit ratings are derived from eligible external rating agencies approved by the CBUAE. The Branch uses ratings assigned by Standard & Poor's, Moody's and Fitch.

The Branch's total credit risk-weighted assets at 31st December 2020 amounted to AED 1,342.5 million. An overview of the exposures, RWAs and capital requirements for credit risk analysed by standard portfolio is presented in the table below: -

	Total exposure	Average risk weight	RWA	Capital requirement
	AED millions	% millions	AED millions	AED millions
Sovereigns	448.3	0%	-	-
Banks	322.7	20%	64.7	8.4
Corporates	1,516.2	84%	1,270.0	165.1
Other assets	8.2	95%	7.8	1.0
	2,295.4	**58%**	**1,342.5**	**174.5**

3.2 Capital requirements for market risk

Market risk is the risk of loss due to adverse changes in interest rates, foreign exchange rates, equity prices and market conditions, such as liquidity. The principal market risks to which the Branch is exposed is foreign exchange risk associated with its investment activities. The Branch's total market risk at 31st December 2020 amount is very minimal due to the limited operations of the bank.

3.3 Capital requirements for operational risk

Whilst operational risk cannot be eliminated in its entirety, the Branch endeavours to minimise it by ensuring that a strong control infrastructure is in place throughout the organisation. The various procedures and processes used to manage operational risk include effective staff training, appropriate controls to safeguard assets and records, regular reconciliation of accounts and transactions, close monitoring of risk limits, segregation of duties, and financial management and reporting. In addition, other control strategies, including business continuity planning and insurance, are in place to complement the procedures, as applicable.

The capital requirement for operational risk is calculated for regulatory purposes according to the basic indicator approach, in which the regulatory capital requirement is calculated based on the bank's total gross income as a risk indicator for the bank's operational risk exposure and sets the required level of operational risk capital as 15% of the bank's annual positive gross income. The Branch's total operational risk at 31st December 2020 amounted to AED 39.6 million.

3.4 Capital base

The regulatory capital base is set out in the table below: -

	CET & Tier 1 AED millions	Tier 2 AED millions	Total AED millions
Share capital	550.0	-	550.0
CBUAE regulatory concessionary measures	12.3	-	12.3
General Provisions	-	16.8	16.8
Tier 1 and tier 2 capital base	**562.3**	**16.8**	**579.1**

Tier 1 capital is defined as capital of the same or close to the character of paid up capital and comprises share capital.

Tier 2 capital comprises general provisions. General provisions are based on 1.25 per cent of the credit risk weighted assets.

4. Credit-related contingent items

The Branch applies the standardised approach for credit risk measurement. Under this approach the Branch is required to use ratings from External Credit Rating Agencies to quantify required capital for credit risk

For credit-related contingent items, the notional principal amount is converted to an exposure at default (EAD) through the application of a credit conversion factor (CCF). The CCF factors range from 20 per cent to 100 per cent depending on the type of contingent item and is intended to convert off-balance sheet notional amounts into equivalent on-balance sheet exposures.

Unutilised approved credit facilities represent commitments that have not been drawn down or utilised. The notional amount provides the calculation base to which a CCF is applied for calculating the EAD. The CCF ranges between 0 per cent and 100 per cent depending on the approach, product type and whether the unutilised amounts are unconditionally cancellable or irrevocable.

The table below summarises the notional principal amounts, RWAs and capital requirements for each credit-related contingent category: -

	Notional amount AED millions	CCF %	RWA AED millions	Capital requirement AED millions
Transaction-related contingent items	229.4	50.0	114.7	14.9
Direct credit substitutes	76.3	100.0	76.3	9.9
Short term self-liquidating trade letters	283.2	20.0	56.6	7.4
	588.9		**247.6**	**32.2**

5. Glossary of abbreviations

ALCO	Assets and Liabilities Committee
CBB	Central Bank of Bahrain
CBUAE	Central Bank of the United Arab Emirates
CEO	Chief Executive Officer
CFO	Chief Financial Officer
CCO	Chief Credit Officer
CRO	Chief Risk Officer
GIB and GROUP	Gulf International Bank B.S.C. Group
Head Office	Gulf International Bank B.S.C. Group
ICAAP	Internal Capital Adequacy Assessment Process
IFRS	International Financial Reporting Standards
LGD	Loss Given Default
ORMF	Operational Risk Management Framework
PD	Probability of Default
PSE	Public Sector Entity
RWA	Risk-weighted Assets
VaR	Value-at-Risk