

مشاركة
Musharaka



Musharaka Capital Company

Pillar III Disclosure Report

31.12.2016

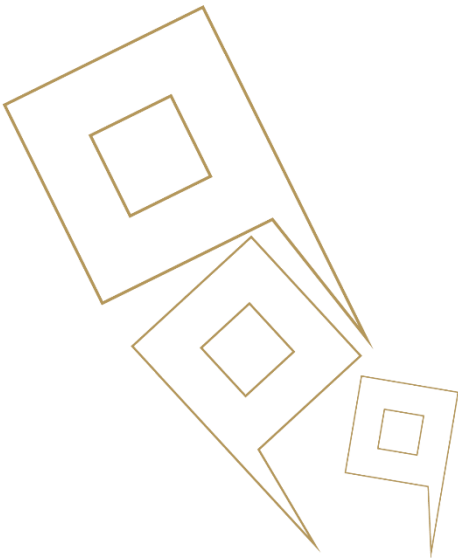




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Overview:

These discourses have been prepared by Musharaka Capital Co (the “Company”) a Saudi Arabian closed joint stock company with commercial registration number 2051056409 dated 29 Rabie Alawwal 1435H (corresponding to 30 Jan, 2014), licensed by Saudi Capital Market Authority (“CMA” or the “authority”) to conduct securities business in:

- Dealing as principal,
- Managing mutual funds
- Advisory
- Arranging
- Custody

Under license number 13169-27 dated 2nd Dhu Al-Hejjah 1434H (corresponding to 7 Oct, 2013). The company started its operations based on the commencement letter from CMA dated 13 Rajab 1435H (corresponding to 12 May, 2014). The company’s paid up capital is SAR 65 million. The company’s activities necessitate full compliance with the three “Pillars” of the Capital Requirements as defined in Prudential Rules (“PRs”). These are:

- Pillar 1, which sets out the minimum amount of capital that Musharaka needs in order to meet its basic regulatory obligations;
- Pillar 2: requires Musharaka to determine whether Pillar 1 capital is adequate to cover these risks and additional defined risks. This is achieved through the Musharaka’s risk based Internal Capital Adequacy Assessment Process (“ICAAP”) and is subject to annual review.
- Pillar 3, which require Musharaka to disclose key information about the underlying risks, risk assessment, management, controls and capital position hence the adequacy of capital.

The purpose of this document is to adhere to Pillar 3 requirements. Musharaka confirms there are no actual or foreseen legal impediments or liability that may affect the capital or require payment.

All disclosures hereunder were prepared based on the company’s first financial operating period starting from 1.1.2016 up to 31.12.2016.

The Company invested in the following subsidiaries:

- **Musharaka IPO Fund:**
A Sharia’h compliant open-ended fund that invests in Initial Public Offerings (IPOs) and companies’ shares newly listed in Saudi equity market. The Fund aims to achieve capital growth over the medium term. The company owns 30.6% of the fund’s total outstanding units.
- **Musharaka Real Estate Income Fund:**
A Sharia’h compliant close-ended fund that invests in income generating properties. The Fund aims to achieve capital growth and annual dividend over the medium term. The company’s investment representing 13.75% of the fund’s total outstanding units (5 Million out of 36.3 Million SAR).



Capital structure

Musharaka's capital structure includes the following elements which form the capital base:

- **Paid-up share Capital:**
An authorized and issued paid up capital of SAR 65 million distributed over 6.5 million shares of SAR 10 each.
- **An audited Retained Earnings (Loss):**
Represents an accumulated loss of SAR 16,913 million as of December 31, 2016
- **Tier 2 Capital:**
There are no applicable elements related to Tier 2 as of 31.12.2016.
- **Net Capital base of SAR 48,087 million.**
- **The sum of market risk, credit risk and operational risk (Pillar I) requirements of SAR 10,184 million.**

The following table represent the capital adequacy for the years ended December 31, 2016 & 2015, taking into consideration the year ended December 31 2016 was presented as a consolidated financial statement.

The capital base calculation (Tier 1&2) adjusted for applicable deductions was as follow:

Description	Dec, 2016 SR '000'	Dec, 2015 SR '000'	Change	Change %
Capital base				
Tier-1 capital	48,087	50,388	(2,301)	(4.6%)
Tier-2 capital	-	-	-	-
Total Capital Base	48,087	50,388	(2,301)	(4.6%)
Minimum capital				
Credit risks	6,545	2,529	4,016	159%
Market risks	925	5,025	(4,100)	(81.6%)
Operations risks	2,714	3,549	(835)	(23.5%)
Total minim capital requirement	10,184	11,100	(916)	(8.25%)
Capital adequacy ratio	4.72	4.54	(.18)	(.4%)
Surplus	37,902	50,388	(12,486)	(24.78%)



Capital adequacy

To ensure that it is in compliance with the Prudential Rules, the company maintains its capital above the minimum level set by the regulatory body. In this respect, Musharaka capital calculates its Capital Adequacy Ratio (CAR) considering the eligible proprietary investments and its risky activities as frequent as every month. Musharaka's CAR as of December 31st, 2016 was 4.72 ratio, and it is considered as a good ratio which is above the minimum required ratio of 1.7 ratio.

During 2015 all numbers for the capital adequacy calculated under the consolidated financial statements, and all numbers for the year of 2016 was calculated under the unconsolidated financial statement due to the deconsolidation during this year.

It is Musharaka's policy to maintain sufficient capital to:

- Meet regulatory requirements;
- Keep an appropriate credit standing with counterparties by maintaining financial prudence, and Maintain sufficient liquid funds to meet working capital requirements.

Calculation of the Musharaka's capital resources requirement

The company's capital resources requirement for regulatory reporting purposes is the sum of the credit risk, market risk and operational risk.

			Amount '000'	
Exposure class	Exposure before CRM	Net exposure after CRM	Risk weighted assets	Capital requirements
Market Risks				
Equity Risk	5,141	5,141		925
Fund Risk				0
Interest Rate Risk				0
Commodities Risk				0
FX Risk				0
Underwriting Risk				0
Excess Exposure Risk				0
Settlement Risk				0
Total market risks	5,141	5,141	0	925
Credit Risks				
Exposures to government, central banks				0
Exposures to corporates, admin bodies, NPO				0
Exposures to APs, banks	21,878	21,878	4,376	613
Listed shares				0
Investment funds	21,925	21,925	38,216	5,350
High risk investments				0
Securitizations, resecuritisations				0
Margin financing				0
Prohibited risks				0
Other on-balance sheet exposures	1,387	1,387	4,162	583
Off-balance sheet commitments				0
Total credit risks	45,190	45,190	46,754	6,545
Operational Risks				2,714
MINIMUM CAPITAL REQUIREMENTS				10,184
CAPITAL RATIO (time)				4.72
SURPLUS / (DEFICIT) (SAR '000)				37,902

Risk management

A. Risk Management Purpose:

The purpose of Musharaka's Risk Management is to develop effective risk management policies and procedures to adhere to regulatory requirements. Through the efficient implementation of these policies, Musharaka is able to identify the risks relating to its activities, processes and systems and, where appropriate, to set the level of risk Musharaka is willing to undertake as a risk appetite. In addition, the risk management strategies and processes will facilitate the process of an on-going assessment and maintenance of the amounts, types and distribution of internal capital that Musharaka considers adequate to cover the level of risks to which it might be exposed.

B. Risk Management Policy:

This risk management policy is set and defined directly by the Board of Directors who has the full responsibility of updating it. The Board is also responsible for overseeing and approving the risk management strategy and policies, internal compliance and internal controls. Risk governing and supervision are carried out at the Board level who has direct oversight on all risk issues. Audit committee conducts annual review for the risk management policy taking into consideration



various changes in internal and external business environment and possible impacts on Musharaka's businesses and accordingly updates the policy. Senior Management of Musharaka assesses risk, associated internal compliance, control procedures and report on the efficiency and effectiveness of risk management practices. The process of risk management and internal compliance and control includes:

- Identifying and assessing significant risks that might impact the achievement of the Musharaka's objectives through preventive controls.
- Developing risk management strategies to manage identified risks, designing and implementing appropriate risk management policies and procedures.
- Monitoring the performance and improving the effectiveness of risk management procedures.

Market risk

Market risk is the risk that the value of an investment decreases due to fluctuations in market prices and in particular, due to changes in interest rates, foreign exchange rates and equity and commodity prices. The associated market risk factors are the interest rate risk, the currency risk, the equity risk and the commodity risk. The associated market risks are captured in policies:

- Equity risk, the risk that stock prices and/or the implied volatility will change.
- Interest rate risk, the risk that interest rates and/or the implied volatility will change.
- Preventive measure identifies, measures, monitors, and reports market risk using a combination of tools including securities analysis, value-at-risk and stress testing.
- Assurance Musharaka's limits are in line with its policies and prudential requirements.
- Appraisal of concentration ratios including asset class and geographical coverage considering liquidity as major element.

Musharaka's Risk Management Framework incorporates market risk principles that aims to maintain prudent levels of exposure to market risks that may have adverse effects on profitability within the bounds of the company's risk tolerance.

14. Equity Price Risks			
Equity investments	Net Long	Net Short	Capital Requirements
Specific Risk			
1. High quality, liquid and diversified share portfolios			0
2. Other equities	5,141		206
Total net equity investment	5,141	0	
General Risk			720
Total Equity Price Risk			925



Credit risk

Credit risk is defined as the probability of a counterparty to fail in meeting his/her obligations in accordance with agreed terms. The goal of credit risk management is to maximize returns by maintaining optimal credit risk exposure within acceptable parameters. Credit risk is inherent in the entire portfolio as well as in individual transactions. The effective credit risk management is a critical component of a comprehensive approach to risk management and essential to the long-term success of the company.

Credit risk management assists the management in developing quality counter-party base. Audit Committee, provides the necessary oversight in risk governance, management, assessment guidelines, and reports its comments and remarks to the BOD. Audit committee reviews the general risk structure on annual basis to ensure that it is commensurate with the changes in internal and external business environment. Management established policies and procedures to document following activities being undertaken to manage the credit risk. The following controls are adopted to manage the credit risk:

- Assess and reviews overall investment quality.
- Monitors and improves credit risk management techniques in order to implement the internal risk based approaches on counter parties.
- Concentration Limits are in place, reviewed and monitored.

Credit Risks	SAR '000'
<i>Exposures to APs, banks</i>	613
<i>Investment funds</i>	5,350
<i>Other on-balance sheet exposures</i>	583
Total credit risk	6,545



Operational risk

Operational risk is the risk of loss resulting from inadequate or lack of internal control processes, mechanisms, people and systems or external events. It includes legal risk as well. It is inherent in all Company's business functions and can occur from a variety of circumstances such as fraud, error, omission or system failure.

For this reason, Musharaka has in place a business continuity policy that in the case of business interruption, it enables the preservation or at least the timely recovery and continuation of essential operations and functions. Also the exposure it has to its data providers is mitigated by ensuring the regular backup of its data and the maintenance, monitoring and update of its servers and networks and effectively built disaster recovery site that will be available online for its alternate recovery requirements. In addition to this has proper controls, authorization matrices and limits are in place with dual control concept on operations and well defined framework in respect of policies and procedures. Audit committee and Compliance reviews are carried out to identify control weakness. For calculating its capital requirements for operational risk the company follows the Basic Indicator Approach as described in Prudential Rules, since there is no long history extend for more than 2 years.

Expenditure-based approach ²	2016	Risk charge %	Capital requirements (SAR '000')
Overhead expenses (SAR '000)	10,854	25	2,714
Total Operational Risks			2,714

Liquidity risk

The Company assesses the liquidity risk through mismatch of assets and liabilities maturities over at least next one year's horizon.

The company evaluates the liquidity risk using the maturity ladder approach which involves analysing liquidity gaps in different time periods. This approach enables the Company in the evaluation of the gaps between the inflows and the outflows so that remedial measures could be taken in time.

The negative differences due to mismatches between the maturities of the assets and liabilities are made and adjusted with operational cash flows that are already stressed at 10%. An annual average funding requirement is computed using the net negative gaps and the cost of fund. This cost is taken as capital charge because it is presumed to have direct effect on the earning.

Currently, the maturity mismatch of the Company is in positive condition. Hence the measured amount of risk is also Nil.

Currently the liquidity is monitored by the management and BOD through projected cash in certain future period.



Other major risk

Reputation Risk

Is the probability of loss resulting from damages to the company's reputation, in lost revenue, increased operating, capital or regulatory costs, or destruction of shareholder value, consequent to an adverse or potentially criminal event even if the company is not found guilty. Adverse events typically associated with reputation risk include ethics, safety, security, sustainability, quality, and innovation. Reputational risk can be a matter of corporate trust.

Due to limitation of data and any other measure in the absence of the Company's market capitalization the following steps are used to qualitatively keep the risk mitigated:

- Detailed Anti-Money Laundering policy and procedures;
- Effective communication with stakeholders; and
- Enforcement of controls on governance, business and legal compliance.
- Promoting high standards of professional ethics by promoting the employees commitment to the Code of conduct.

Concentration Risk

The investment portfolio of the Company consists of exposures in one business line namely equity portfolio/investment funds. Since all the equity investments are classified as HFT and individually none of those has a significant value or excessive exposure.

Any exposure above the 25% of the total available capital of the Company is considered as highly concentrated and is considered for risk measurement. Any amount that is higher than the sated limit is subjected to maximum credit risk weight of 714% minus its regular credit risk weight already applied in credit risk measurement. The resultant amount is factored by 14% to arrive at capital charge.

The capital limit is taken from regulatory guidelines as the Company is allowed to have an exposure over and above this amount

Business Risk

Business risk encompasses the exposure to uncertainty in the wider economic and competitive environment. The impact of that environment on Musharaka's ability to carry out its stated business plan. This risk is managed by a long-term focus, assisted by appropriate management oversight and a documented diversified corporate strategy and business plan.

Compliance Risk

Operating in highly regulated environment may result in general non-compliances of regulatory requirements therefore to mitigate any financial and reputational impacts the Compliance function is responsible for monitoring adherence to regulatory standards and for reporting its findings to relevant senior management, appropriate committees and to the Board. The Compliance function is also responsible for the provision of technical regulatory/compliance advice and support.

In this regard, Musharaka has established and implemented a comprehensive compliance program subject to an annual review.



Risk mitigation

Musharaka considering its risks arising out of its activities. Musharaka has adopted appropriate policies commensurate with its risk requirements which include various elements of risk mitigating techniques as following:

a) Credit risk

The Company does not regularly make investments in any of the categories other than HFT. Hence, credit risk is identified pertaining to investment in marketable securities and equity funds sector, which mainly comprises of equity funds in Saudi Arabia.

The Company calculates the capital charge for credit risk by applying the Standardized Approach as used in regulatory return for Pillar I. In using this approach, all balances (Company and others assets) and investments, excluding the trading portfolio, are categorized into the relevant buckets as prescribed in guidelines. Appropriate risk weights, based on credit ratings of counterparties are applied to determine the Company's overall credit risk weighted assets. The Investment portfolio of the Company includes investments in shares, which have been classified as HFT investment. The investment in equity funds is carried at cost and is subject to credit risk under the standardized approach as promulgated by CMA through its regulation.

b) Concentration risk

The financing and investment portfolio of the Company consists of exposures in two economic sectors namely equity portfolio/investment funds and real estate. Since all the equity investments are classified as HFT and individually none of those hold a significant value or excessive exposure.

Any exposure over and above the 25% of the total available capital of the Company is considered as highly concentrated and is considered for risk measurement. Any amount that is higher than the stated limit is subjected to maximum credit risk weight of 714% minus its regular credit risk weight already applied in credit risk measurement. The resultant amount is factored by 14% to arrive at capital charge.

The capital limit is taken from regulatory guidelines as the Company is allowed to have an exposure over and above this amount.

c) Liquidity risk

The Company's liquidity risk is assessed through mismatch of assets and liabilities maturities over at least next one year's horizon.

The liquidity risk is assessed using the maturity ladder approach which involves analysing liquidity gaps in different time periods. This approach enables the Company in assessing the gaps between the inflows and the outflows so that remedial measures could be taken in time.

The negative gaps due to mismatches between the maturities of the assets and liabilities are taken and adjusted with operational cash flows that are already stressed at 10%. An annual average funding requirement is computed using the net negative gaps and a cost of fund is arrived at. This cost is taken as capital charge because it is presumed to have direct effect on the earning.



Currently, the maturity mismatch of the Company is in positive condition, hence, the measured amount of risk is also Nil.

Currently the liquidity is monitored by the management and BOD through projected cash in certain future period.

d) Legal risk

Legal risk is arising from uncertainty due to legal actions or uncertainty in the applicability or interpretation of contracts, laws or regulations. Legal risk also includes risk arising from the lack of proper documentation of contracts.

The Company assesses the extent of legal risk by monitoring certain indicators which are indicative of risk concerns. The indicators are:

- Internally identified erroneous non-compliances;
- History of non-compliance events identified by CMA;
- No. of cases filed against the company;
- Duration of time for each case;
- Strength of documentation of each case. e.g. the strength of collateral documentation;
- Value of the claim; and
- Complexity involved in the case i.e. regulatory concerns, cross-border cases.

The risk is measured by taking the un-avoidable and covered legal cases against the Company. These are factored at business growth factor to arrive at capital charge amount.

Legal risk is monitored rigorously by compliance department that ensures the Company's compliance with applicable rules and regulations on a regular basis and exception noted are resolved and followed in accordance with its procedural manual, as approved by the BOD.

e) Reputational risk

The reputation risk can arise from following sources:

- No. of complaints lodged by customers;
- Failure to comply with regulatory or legal obligations;
- Failure to deliver minimum standards of service and product quality to customers;
- Unethical practices in the conduct of business;
- Failure to achieve financial performance targets;
- Association with suppliers, partners and alliances with poor reputations; and
- Employee dissatisfaction and negative publicity by media.

The following steps are used to qualitatively keep the risk under controlled.

- Detailed Anti-Money Laundering policy and procedures;
- Effective communication with stakeholders; and
- Enforcement of controls on governance, business and legal compliance.



Appendix:

1- Balance Sheet:

MUSHARAKA CAPITAL COMPANY
(A Saudi Closed Joint Stock Company)
Balance sheet
(All amounts in Saudi Riyals unless otherwise stated)

		As at December 31,	
		2016	2015
		(see Note 1)	
Assets			
Current assets			
Cash at bank		21,877,772	73,981,729
Held-for-trading investments	4	5,140,540	27,915,598
Prepayments and other receivable	5	931,368	721,334
		27,949,680	102,618,661
Non-current assets			
Investments in associates	6	21,709,958	-
Property and equipment	7	671,374	456,955
		22,381,332	456,955
Total assets		50,331,012	103,075,616
Liabilities			
Current liabilities			
Accrued and other liabilities	8	645,469	481,795
Zakat payable	9	1,203,115	-
		1,848,584	481,795
Non-current liabilities			
Employee termination benefits	10	395,638	230,250
Total liabilities		2,244,222	712,045
Equity			
Equity attributable to shareholders of the Company:			
Share capital	12	65,000,000	65,000,000
Accumulated deficit		(16,913,210)	(8,694,503)
Total shareholders' equity		48,086,790	56,305,497
Non-controlling interests	1	-	46,058,074
Total equity		48,086,790	102,363,571
Total liabilities and equity		50,331,012	103,075,616

The accompanying notes from 1 to 19 form an integral part of these financial statements.

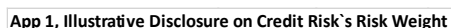


2- Income Statement:

MUSHARAKA CAPITAL COMPANY
(A Saudi Closed Joint Stock Company)
Income statement
(All amounts in Saudi Riyals unless otherwise stated)

		For the year ended December 31, 2016	For the period from February 20, 2014 to December 31, 2015
			(see Note 1)
Revenues			
Income from asset management services	14	1,973,022	1,391,597
Unrealized loss on held-for-trading investments	4	(214,389)	(5,917,770)
Realized (loss) / gain from sale of held-for-trading investments	4	(84,567)	12,203,774
Dividends income		220,800	2,302,234
Other		-	164,498
		1,894,866	10,144,333
Operating expenses			
General and administrative	15	(9,620,429)	(12,376,367)
Loss from operations		(7,725,563)	(2,232,034)
Share in net income of associates	6	740,753	-
Pre-operating expenses		-	(1,810,564)
Loss before zakat and non-controlling interest		(6,984,810)	(4,042,598)
Zakat	9	(1,233,897)	(1,439,472)
Loss before non-controlling interest		(8,218,707)	(5,482,070)
Non-controlling interest	1	-	(3,212,433)
Net loss for the year / period		(8,218,707)	(8,694,503)
Loss per share:	16		
• Loss from operations		(1.19)	(0.34)
• Net loss for the year / period		(1.26)	(1.34)
Weighted average number of outstanding shares		6,500,000	6,500,000

The accompanying notes from 1 to 19 form an integral part of these financial statements.



App 2, Illustrative Disclosure on Credit Risk's Rated Exposure SAR ('000')

App 3, Illustrative Disclosure on Credit Risk's Rated Exposure SAR ('000')

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