

Basel II – Pillar 3 Disclosures

The disclosures given below pertain to National Bank of Ras AL Khaimah P.S.C. and its two subsidiaries (group) and are in accordance with Basel 2, Pillar 3, Market discipline principles where Banks are required to disclose qualitative and quantitative information of its risk and capital management. These disclosures are also in compliance with Circular No 27/2009 dated 17th November 2009 issued by the Central Bank of UAE

1. Subsidiaries and Significant investments:

As at 31 December 2012, the Bank has two subsidiaries incorporated under UAE laws. These subsidiaries are RAK Islamic Finance Pvt. J.S.C in which the Bank owns 99.9% and BOSS FZCO in which the Bank owns 80%. RAK Islamic Finance Pvt. J.S.C has an authorised and issued capital of AED 100 million, and was incorporated to enable the Bank to launch its Islamic operations and sell sharia compliant financial products. BOSS FZCO has been incorporated to provide back office support services to the Bank. BOSS FZCO has an authorised and issued share capital of AED 500,000 and was formed under the Dubai Silicon Oasis Authority guidelines.

2. Capital Structure:

Quantitative Disclosure:

The Group's capital structure is as indicated below.

	AED'000
Tier 1 capital	
Share capital	1,523,859
Share premium account	110,350
Legal reserves	545,768
General reserves	2,332,129
Retained earnings	1,183,109
	<hr/>
	5,695,215
Less: Proposed cash dividend	609,544
	<hr/>
Total eligible capital	<u>5,085,671</u>

Basel II – Pillar 3 Disclosures (continued)

as at 31st December 2012

3. Capital adequacy:

a) Qualitative Disclosure:

National Bank of Ras Al Khaimah P.S.C (The Group) has adopted the Standardized approach for calculation of credit risk and market risk. For operational risk the group has adopted the Alternative Standardized Approach (ASA)

The bank's activities expose it to a variety of financial risks and those activities involve the analysis, evaluation, acceptance and management of some degree of risk or combination of risks. Taking risk is core to the financial services business. The bank's aim is therefore to achieve an appropriate balance between risk and return and minimise potential adverse effects on the bank's financial performance.

The bank's risk management considers a variety of risks. These typically include Credit risk, liquidity risk, concentration risk, market risk, operational risk, Information security risk, Business continuity risk, reputational risk and regulatory and compliance risk. Policies are designed to identify and analyse these risks, to set appropriate risk limits and controls, and to monitor the risks and adherence to limits by means of reliable and up-to-date information systems. The bank regularly reviews its risk management policies and systems to reflect changes in markets, products and emerging best practice.

The Asset and Liability Committee (ALCO), one of the key committee overseeing balance sheet risks is chaired by the Chief Executive Officer and comprises of the Heads of Finance, Treasury, Credit, Corporate Banking and Personal Banking. It meets on a regular basis to monitor and manage market risk.

ALCO is responsible for formalizing the bank's key financial indicators and ratios, set the thresholds to manage and monitor these risks. ALCO also guides the bank's investment decisions and provides guidance in terms of interest rate and currency movements.

The Risk Management Committee (RMC) is chaired by the Chief Executive Officer and is responsible for all other forms of risks which are operational in nature. The committee reviews adequacy and effectiveness of internal control systems, operational risk management procedures and risk assessment methodologies (viz. key risk indicators (KRI), operational risk self-assessment (ORSA) and incident management).

ALCO and Risk Management committee (RMC) reports to the Executive Committee (EXCO) of the bank through them the recommendations are taken to the Board.

As per the supervisory review process (SRP) under Basel 2, pillar 2, the bank periodically submits to the central bank its internal capital adequacy assessment programme (ICAAP) where it sets out all the risks it is exposed to, how it measures, monitors and where possible how it mitigates these risks and how the alignment with capital is achieved. It takes into account any feed-back it gets from its regulator.

The various risks that attract risk assets under Basel 2 are described below:

Credit risk

Credit risk is defined as the risk that the bank's customers, clients or counter parties fail to perform or are unwilling to pay interest, repay the principal or otherwise to fulfil their contractual obligations under loan agreements or other credit facilities, thus causing the bank to suffer a financial loss.

3. Capital adequacy (continued)

a) Qualitative Disclosure (continued)

Credit risk (continued)

Credit risk also arises through the downgrading of counter parties, whose credit instruments are held by the bank, thereby resulting in the value of the assets to fall. As credit risk is the bank's most significant risk, considerable resources, expertise and controls are devoted to managing this risk within the core departments of the bank.

The bank's credit policy provides for the development of a systematic and consistent approach to identifying and managing borrower and counter party risks contained in all retail, corporate and SME assets.

The Head of Credit and his team including Collections are responsible for recognition and management of credit risk both at transaction and portfolio levels and to ensure that risk procedures are adhered to in a manner consistent with the framework set out in the Policy, Product Programs, Credit circulars and comply with regulatory norms.

The bank manages, limits and controls concentration of credit risk wherever it is identified – in particular, to individual counterparties and groups, and to industries and countries. The bank has a Product Program Guide that sets limits of exposure and lending criteria. The bank also has credit limits that set out the lending and borrowing limits to/from other banks.

The bank stratifies the levels of credit risk it undertakes by placing limits on the amount of risk accepted in relation to one borrower, or groups of borrowers, and to geographical and industry segments. Such risks are monitored on an ongoing basis. Limits on the level of credit risk by product, industry sector and by country are approved by the Executive Committee and the Board of Directors.

The exposure to any one borrower, including banks, is further restricted by sub-limits covering on- and off-balance sheet exposures, and daily delivery risk limits in relation to trading items such as forward foreign exchange contracts. Actual exposures against limits are monitored on an ongoing basis.

Market risk

The bank takes on exposure to market risks, which is the risk that the fair value or future cash flows of a financial instrument will fluctuate because of changes in market prices. Market risks arise from open positions in interest rate, currency and equity instruments, all of which are exposed to general and specific market movements and changes in the level of volatility of market rates or prices such as interest rates, credit spreads, foreign exchange rates and equity prices.

The bank does not enter in derivative trades for speculative or hedging purposes. The only exposure to derivatives is in respect of forward exchange contracts which entered into on behalf of the bank's customers.

Basel II – Pillar 3 Disclosures (continued)
as at 31st December 2012

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 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 bank endeavours to minimise it by ensuring that a strong control infrastructure is in place throughout the organisation. The management of operational risk commence with the adoption of a formal governance structure under the Risk Management Committee to provide strategic direction oversight and monitoring of the Operational Risk Framework. The Framework incorporates standards for risk that are based on best practice and codify the core governing principles for operational risk management. It ensures that identification, evaluation, control, measurement, monitoring and reporting of operational risks are consistent across the bank. It also reviews the adequacy of insurances the bank holds, although not viewed as a mitigating factor.

b) Quantitative Disclosure:

	AED'000
Risk Weighted Assets	
Credit risk	16,951,305
Market risk	3,633
Operational risk	714,989
	<hr/>
Total Risk Weighted Assets	17,669,927
	<hr/> <hr/>
Total Tier 1 and eligible capital	5,085,671
Capital adequacy ratio	28.78%

Basel II – Pillar 3 Disclosures (continued)
as at 31st December 2012

4. Credit Risk - Quantitative disclosures

a) Gross credit exposure by currency:

At 31 December 2012 the Group had the following gross exposures:

	AED	USD	Other currencies	Total
	AED'000	AED'000	AED'000	AED'000
On balance sheet items				
Due from other banks	405,517	434,112	356,202	1,195,831
Loans and advances	19,812,575	458,826	12,026	20,283,427
Investment securities	593,096	993,782	-	1,586,878
Total funded	<u>20,811,188</u>	<u>1,886,720</u>	<u>368,228</u>	<u>23,066,136</u>
Off-balance sheet items				
Credit commitments	5,956,983	23,389	-	5,980,372
Guarantees, acceptances and other exposures	396,016	122,940	116,308	635,264
Total Non - Funded	<u>6,352,999</u>	<u>146,329</u>	<u>116,308</u>	<u>6,615,636</u>
Total	<u>27,164,187</u>	<u>2,033,049</u>	<u>484,536</u>	<u>29,681,772</u>

b) Gross credit exposure by geography:

The Group's activities are primarily within UAE. Exposure outside UAE are insignificant and are mainly in the form of Inter-bank placements and Investments amounting to AED 668M, roughly 2 % of the total credit exposure as at 31st December 2012.

Basel II – Pillar 3 Disclosures (continued)
as at 31st December 2012

4. Credit Risk – quantitative disclosures (continued)

c) Gross credit exposure by Industry:

	On balance sheet items			Total funded AED'000	Off balance sheet Items AED'000	Total AED'000
	Loans and advances AED'000	Debt securities AED'000	Due from banks AED'000			
Agriculture, fishing & related activities	18,300			18,300	629	18,929
Crude oil , gas, mining & quarrying	390			390	112,720	113,110
Manufacturing	205,298			205,298	173,003	378,301
Electricity & water	15,131			15,131	735	15,866
Construction	760,245			760,245	104,464	864,709
Trade	2,714,892			2,714,892	500,882	3,215,774
Transport, storage & communication	778,468	73,460		851,928	43,079	895,007
Financial Institutions	27,279	888,510	1,195,831	2,111,620	166,722	2,278,342
Services	596,393	-		596,393	195,234	791,627
Government	-	624,908		624,908	118,685	743,593
Retail and consumer banking	15,360,330			15,360,330	5,197,846	20,558,176
Others	226,131			226,131	1,637	227,768
Total exposures	20,702,857	1,586,878	1,195,831	23,485,566	6,615,636	30,101,202
Less: Interest in suspense	(95,320)	-	-	(95,320)	-	(95,320)
	<u>20,607,537</u>	<u>1,586,878</u>	<u>1,195,831</u>	<u>23,390,246</u>	<u>6,615,636</u>	<u>30,005,882</u>

d) Gross credit exposure by residual contractual maturity:

	< 3 months	3 months to 1 Year AED'000	1 to 5 Years AED'000	Over 5 Years AED'000	Total AED'000
Due from Other Banks	1,195,831	-	-	-	1,195,831
Loans and advances	2,834,064	321,830	6,475,494	10,652,039	20,283,427
Investments Securities	42,688	543,096	963,765	37,329	1,586,878
Total Funded	<u>4,072,583</u>	<u>864,926</u>	<u>7,439,259</u>	<u>10,689,368</u>	<u>23,066,136</u>
Off balance sheet items	<u>6,585,623</u>	<u>28,968</u>	<u>945</u>	<u>100</u>	<u>6,615,636</u>

5. Impairment and provisioning – Qualitative disclosures

a) Past Due and impaired loans with provisioning:

The Group assesses at each balance sheet date whether there is objective evidence that loans and advances are impaired. Loans and advances are impaired and impairment losses are incurred only if there is objective evidence that the bank will not be able to collect all amounts due.

The criteria that the bank uses to determine that there is objective evidence of an impairment loss include:

- Delinquency in contractual payments of principal or interest;
- Cash flow difficulties experienced by the borrower;
- Breach of loan covenants or conditions;
- Initiation of bankruptcy proceedings;
- Deterioration of the borrower's competitive position;
- Deterioration in the value of collateral; and
- Observable data indicating that there is a measurable decrease in the estimated future cash flows from a portfolio of financial assets since the initial recognition of those assets, although the decrease cannot yet be identified with the individual financial assets in the portfolio, including:
 - (i) adverse changes in the payment status of borrowers in the portfolio; and
 - (ii) national or local economic conditions that correlate with defaults on the assets in the portfolio.

Where such an event has had an impact on the estimated future cash flows of the financial asset or group of financial assets, an impairment allowance is recognised. The amount of the loss is measured as the difference between the asset's carrying amount and the present value of estimated future cash flows (excluding future credit losses that have not been incurred) discounted at the financial asset's original effective interest rate. The carrying amount of the asset is reduced through the use of an allowance account and the amount of the loss is recognised in the income statement. If a loan has a variable interest rate, the discount rate for measuring any impairment loss is the current effective interest rate determined under the contract.

Impairment allowances are assessed individually for financial assets that are individually significant. Such individual assessment is used primarily for the bank's corporate lending portfolios. Impairment allowances for portfolios of smaller balance homogenous loans such as most residential mortgages, personal loans and credit card balances in the Bank's retail portfolios that are below the individual assessment thresholds, and for loan losses that have been incurred but not separately identified at the balance sheet date, are determined on a collective basis.

In respect of portfolios of smaller balance, homogenous loans, the asset is included in a group of financial assets with similar risk characteristics and collectively assessed for impairment. Segmentation takes into account factors such as the type of asset, industry sector, geographical location, collateral type, past-due status and other relevant factors. These characteristics are relevant to the estimation of future cash flows for groups of such assets as they are indicative of the borrower's ability to pay all amounts due according to the contractual terms of the assets being evaluated. Generally, the impairment trigger used within the impairment calculation for a loan, or group of loans, is when they reach a pre-defined level of delinquency or where the customer is bankrupt.

5. Impairment and provisioning – Qualitative disclosures

a) Past Due and impaired loans with provisioning (Continued):

In respect of the Bank's secured mortgage portfolios, the impairment allowance is calculated based on a definition of impaired loans which are those three months or more in arrears (or certain cases where the borrower is bankrupt). The estimated cash flows are calculated based on historical experience and are dependent on estimates of the expected value of collateral which takes into account expected future movements in house prices, less costs to sell.

For unsecured personal lending portfolios, the impairment trigger is generally when the balance is three or more installments in arrears or where the customer has exhibited one or more of the impairment characteristics set out above. While the trigger is based on the payment performance or circumstances of each individual asset, the assessment of future cash flows uses historical experience of banks own loan portfolios such that the assessment is considered to be collective. Future cash flows are estimated on the basis of the contractual cash flows of the assets in the banks portfolio and historical loss and recoveries. Historical loss experience is adjusted on the basis of current observable data about economic and credit conditions (for example, changes in unemployment rates, property prices, payment status, or other factors indicative of changes in the probability of losses and their magnitude) to reflect the effects of current conditions that did not affect the period on which the historical loss experience is based and to remove the effects of conditions in the historical period that do not exist currently. The methodology and assumptions used for estimating future cash flows are reviewed regularly by the Bank to reduce any differences between loss estimates and actual loss experience.

In respect of performing portfolios of smaller balance, homogenous loans, the asset is included in a group of financial assets with similar risk characteristics and collectively assessed for unidentified impairment and a general provision is maintained. Further a non-distributable regulatory credit risk reserve to the extent of 1.5% of the credit risk assets is maintained. This is set out in note 18 to the financial statements.

In certain circumstances, the bank will renegotiate the original terms of a customer's loan, either as part of an ongoing customer relationship, aligning to current market interest rates or in response to adverse changes in the circumstances of the borrower. There are a number of different types of loan renegotiation, including the capitalization of arrears, interest rate adjustments and extensions of the due date of payment. Renegotiation may lead to the loan and associated provision being derecognized and a new loan being recognized initially at fair value. The renegotiated loans are no longer considered to be past due but are treated as new loans. The bank monitors the performance of renegotiated loans continuously and the loans which are performing continuously for a period of 12 months are classified as normal loans.

In certain circumstances, the bank will renegotiate the original terms of a customer's loan, either as part of an ongoing customer relationship, aligning to current market interest rates or in response to adverse changes in the circumstances of the borrower. There are a number of different types of loan renegotiation, including the capitalization of arrears, interest rate adjustments and extensions of the due date of payment. Renegotiation may lead to the loan and associated provision being derecognized and a new loan being recognized initially at fair value. The renegotiated loans are no longer considered to be past due but are treated as new loans. The bank monitors the performance of renegotiated loans continuously and the loans which are performing continuously for a period of 12 months are classified as normal loans.

Basel II – Pillar 3 Disclosures (continued)
as at 31st December 2012

5. Impairment and provisioning – Qualitative disclosures

a) Past Due and impaired loans with provisioning (Continued):

When a loan is uncollectable, it is written off against the related provision for impairment. If no related provision exists, it is written off to the income statement. Subsequent recoveries are credited to the income statement. If the amount of impairment subsequently decreases due to an event occurring after the write down, the release of the provision is credited to the income statement.

b) Impaired loan by industry segment:

	Less than 90 days AED'000	Overdue above 90 Days AED'000	Total AED'000	Specific Provision AED'000
Agriculture, fishing & related activities				
Crude oil, gas, mining & quarrying				
Manufacturing	10	2,439	2,449	2,223
Electricity & water				
Construction	3	72,412	72,415	37,494
Trade	177	32,142	32,319	23,462
Transport, storage & communication	1,720	7,747	9,467	8,826
Financial institution				
Services	10	5,126	5,136	4,715
Government				
Retail and consumer banking	12,159	477,884	490,043	195,222
Total impaired loans	<u>14,079</u>	<u>597,750</u>	<u>611,829</u>	<u>271,942</u>
Less: Interest in suspense			(95,320)	-
			<u><u>516,509</u></u>	<u><u>271,942</u></u>

c) Past Due and impaired loans with provisioning (Continued):

The total impairment provision for loans and advances is AED 324.11 million of which AED 271.94 million represents provision in respect of the individually impaired loans and advances and the remaining amount of AED 52.17 million represents the general provision on unidentified impairment.

d) Impaired loan by geographical distribution:

There are no exposures of impaired loans outside the UAE as at 31st December 2012.

Basel II – Pillar 3 Disclosures (continued)
as at 31st December 2012

5. Impairment and provisioning – Qualitative disclosures

e) Reconciliation of Changes in provision of impaired loans:

	Impairment Provisions	
	Specific AED'000	General or Portfolio AED'000
Opening Balance as at 01 Jan 2012	254,329	83,649
Add: Provided during the year	1,259,453	-
Less: Released during the year	977,522	-
Less: Released to current year income during the period	-	31,482
Written off during the year	264,317	-
Balance as at 31 Dec 2012	271,943	52,167

6. Credit risk weighted assets – Quantitative disclosures

	On balance sheet gross outstanding AED '000	Off balance sheet net exposure after credit conversion AED '000	Exposure before CRM AED '000	Credit Risk Mitigation (CRM)		Risk weighted Assets AED '000
				CRM AED '000	After CRM AED '000	
31 December 2012						
Claims on sovereigns	2,755,627	-	2,755,627	-	2,755,627	-
Claims on PSE's	264,639	-	264,639	-	264,639	-
Claims on multi lateral development banks	-	-	-	-	-	-
Claims on banks	1,966,876	-	1,966,876	-	1,966,876	651,759
Claims on securities firms	-	-	-	-	-	-
Claims on corporates	604,689	466,000	1,070,689	161,029	909,660	909,660
Claims included in the regulatory retail portfolio	16,147,797	29,988	16,165,746	89,693	16,076,053	12,163,873
Claims secured by residential property	3,377,306	-	3,377,069	-	3,377,069	1,518,297
Claims secured by commercial real estate	27,750	-	27,750	-	27,750	27,750
Past due loans	618,775	-	263,788	-	263,788	376,527
Higher-risk categories	-	-	-	-	-	-
Other assets	1,906,108	-	1,906,108	-	1,906,108	1,303,439
Total claims	27,669,567	495,988	27,798,292	250,722	27,547,570	16,951,305

Of which :

Rated exposure	2,231,515
Unrated exposure	25,566,777

The rated exposure pertain to interbank placements and investments. All other exposures are unrated.

The bank has used only those ECAI's (External Credit Assessment Institutions) which are approved by the Central Bank of UAE namely S&P, Moody's, Fitch and Capital Intelligence.

Basel II – Pillar 3 Disclosures (continued)
as at 31st December 2012

7. Credit risk mitigation:

a) Qualitative disclosure:

The Head of Credit and his team including Collections are responsible for recognition and management of credit risk both at transaction and portfolio levels and to ensure that risk procedures are adhered to in a manner consistent with the framework set out in the Policy, Product Programs, Credit circulars and comply with regulatory norms.

The bank manages, limits and controls concentration of credit risk wherever it is identified – in particular, to individual counterparties and groups, and to industries and countries. The bank has a Product Program Guide that sets limits of exposure and lending criteria. The bank also has credit limits that set out the lending and borrowing limits to/from other banks. Further mortgage loans and auto loans, which together represent a significant portion of loans and advances, are backed by collateral.

The Group stratifies the levels of credit risk it undertakes by placing limits on the amount of risk accepted in relation to one borrower, or groups of borrowers, and to geographical and industry segments. Such risks are monitored on an ongoing basis. Limits on the level of credit risk by product, industry sector and by country are approved by the Executive Committee and the Board of Directors.

The exposure to any one borrower, including banks, is further restricted by sub-limits covering on- and off-balance sheet exposures, and daily delivery risk limits in relation to trading items such as forward foreign exchange contracts. Actual exposures against limits are monitored on an ongoing basis.

b) Quantitative disclosure:

	Exposure	Risk Weighted Assets
	AED '000	AED '000
Gross exposure prior to Credit Risk Mitigation	27,798,292	17,192,835
Less: Exposures covered by eligible financial collateral	(250,722)	(241,530)
Net Exposures after Credit Risk Mitigation	<u>27,547,570</u>	<u>16,951,305</u>

The eligible financial collaterals above include cash and deposits.

Basel II – Pillar 3 Disclosures (continued)
as at 31st December 2012

8. Market Risk:

a) Capital requirement for Market risk under standardized approach:

	Risk weighted asset	Capital charge
	AED '000	AED '000
Foreign exchange risk	<u>3,633</u>	<u>436</u>

Capital charge for year ended 31 December 2012 has been calculated at 12%

Equity risk:

The Group does not have a trading book in equity or currency or derivatives. For details of investment refer to Note number 8 of the audited financial statement.

Interest rate risk:

Interest rate risk arises due to mismatches of fixed interest rate assets and floating rate interest rate liabilities. This is monitored through the use of detailed gap report and stress testing. Refer to Note number 3.3.2 of the audited financial statement for details of Interest rate risk.

9. Operational Risk:

The Group follows Alternative Standardized Approach (ASA) for calculation of operational risk.

The Group has a formal governance structure which is established under the Risk Management Committee to provide the strategic direction, oversight and monitoring of the Operational Risk Framework of the bank.

The Group endeavours to minimise the operational risk through the framework which includes risk identification, assessment and control, Key risk indicators and operational risk self-assessments through an operational risk data base.

Calculation of Operational risk:

	Three year Average AED '000	M Factor	Beta Factor	Capital Charge AED '000	RWA = Capital Charge x 8.33* AED '000
Trading and Sales	35,658	-	18%	6,418	53,465
Commercial Banking	267,503	0.035	15%	1,404	11,699
Retail Banking	18,573,873	0.035	12%	78,010	649,826
Operational Risk					<u><u>714,989</u></u>

* Total Risk weighted assets are determined by multiplying the Capital Charge for Operational Risk by 8.33 (i.e. the reciprocal of the minimum capital ratio of 12%) and adding the resulting figures to sum the risk – weighted assets.