# The Saudi British Bank
# Consolidated Financial Statements
# For the year ended

# 31 December 2016

SABB ساب

**The Saudi British Bank**

## CONSOLIDATED STATEMENT OF FINANCIAL POSITION

| **As at 31 December** | **Notes** | **2016 SAR'000** | 2015 SAR'000 |
|---|---|---|---|
| **ASSETS** | | | |
| Cash and balances with SAMA | 3 | **24,121,821** | 10,942,268 |
| Due from banks and other financial institutions | 4 | **8,217,746** | 11,452,978 |
| Positive fair value derivatives | 10 | **721,912** | 872,865 |
| Investments, net | 5 | **29,273,055** | 35,527,045 |
| Loans and advances, net | 6 | **120,964,815** | 125,946,636 |
| Investment in a joint venture and an associate | 7 | **642,297** | 693,235 |
| Property and equipment, net | 8 | **1,038,352** | 991,455 |
| Other assets | 9 | **1,075,896** | 1,323,941 |
| **Total assets** | | **186,055,894** | 187,750,423 |
| **LIABILITIES AND SHAREHOLDERS' EQUITY** | | | |
| **Liabilities** | | | |
| Due to banks and other financial institutions | 11 | **3,419,174** | 1,834,906 |
| Customers' deposits | 12 | **140,639,785** | 148,887,178 |
| Debt securities in issue | 13 | **4,517,636** | 4,512,938 |
| Borrowings | 14 | **1,709,958** | 46,988 |
| Negative fair value derivatives | 10 | **604,793** | 895,429 |
| Other liabilities | 15 | **3,885,620** | 3,398,447 |
| **Total liabilities** | | **154,776,966** | 159,575,886 |
| **Shareholders' equity** | | | |
| Share capital | 16 | **15,000,000** | 15,000,000 |
| Statutory reserve | 17 | **8,557,339** | 7,583,656 |
| Other reserves | 18 | **24,052** | (340,608) |
| Retained earnings | | **7,127,537** | 5,361,489 |
| Proposed dividends | 26 | **570,000** | 570,000 |
| **Total shareholders' equity** | | **31,278,928** | 28,174,537 |
| **Total liabilities and shareholders' equity** | | **186,055,894** | 187,750,423 |

The accompanying notes 1 to 39 form an integral part of these consolidated financial statements.

## CONSOLIDATED STATEMENT OF INCOME

| For the year ended 31 December | Notes | 2016 SAR'000 | 2015 SAR'000 |
|---|---|---|---|
| Special commission income | 20 | **6,075,102** | 4,813,421 |
| Special commission expense | 20 | **1,318,187** | 559,543 |
| **Net special commission income** | | **4,756,915** | 4,253,878 |
| Fees and commission income, net | 21 | **1,340,843** | 1,550,271 |
| Exchange income, net | | **478,045** | 465,755 |
| Income from FVIS financial instruments | | **6,994** | 3,750 |
| Trading income, net | 22 | **261,648** | 252,382 |
| Dividend income | | **37,844** | 37,050 |
| Gains on non-trading investments, net | 23 | **26,297** | 66,634 |
| Other operating income, net | | **18** | 907 |
| **Total operating income** | | **6,908,604** | 6,630,627 |
| Salaries and employee related expenses | 24 | **1,228,958** | 1,252,725 |
| Rent and premises related expenses | | **142,470** | 131,791 |
| Depreciation | 8 | **110,903** | 96,557 |
| General and administrative expenses | | **601,219** | 529,267 |
| Provision for credit losses, net | 6 | **944,560** | 429,716 |
| Impairment/(impairment reversal) of other financial assets, net | 5 | **49,540** | (9,631) |
| **Total operating expenses** | | **3,077,650** | 2,430,425 |
| **Income from operating activities** | | **3,830,954** | 4,200,202 |
| Share in earnings of a joint venture and associate | 7 | **63,777** | 130,345 |
| **Net income for the year** | | **3,894,731** | 4,330,547 |
| **Basic and diluted earnings per share (in SAR)** | 25 | **2.60** | 2.89 |

The accompanying notes 1 to 39 form an integral part of these consolidated financial statements.

**The Saudi British Bank**

**CONSOLIDATED STATEMENT OF COMPREHENSIVE INCOME**
**For the year ended 31 December**

| | Notes | 2016 SAR' 000 | 2015 SAR' 000 |
|---|---|---|---|
| **Net income for the year** | | **3,894,731** | 4,330,547 |
| **Other comprehensive income to be reclassified to statement of income in subsequent years** | | | |
| Available for sale financial assets | | | |
| - Net change in fair value | 18 | **405,301** | (295,809) |
| - Transfer to consolidated statement of income | 18 | **(26,297)** | (66,635) |
| Cash flow hedges | | | |
| - Net change in fair value | 18 | **11,326** | (31,964) |
| - Transfer to consolidated statement of income | 18 | **(6,080)** | (791) |
| Other comprehensive income / (loss) for the year | | **384,250** | (395,199) |
| **Total comprehensive income for the year** | | **4,278,981** | 3,935,348 |

The accompanying notes 1 to 39 form an integral part of these consolidated financial statements

## CONSOLIDATED STATEMENT OF CHANGES IN SHAREHOLDERS' EQUITY
**For the year ended 31 December**

| | Notes | Share capital SAR '000 | Statutory reserve SAR '000 | Other reserves SAR '000 | Retained earnings SAR '000 | Proposed dividends SAR '000 | Total SAR '000 |
|---|---|---|---|---|---|---|---|
| **2016** | | | | | | | |
| Balance at beginning of the year | | **15,000,000** | **7,583,656** | **(340,608)** | **5,361,489** | **570,000** | **28,174,537** |
| Total comprehensive income for the year | | | | | | | |
| Net income for the year | | - | - | - | **3,894,731** | - | **3,894,731** |
| Net changes in fair value of cash flow hedges | 18 | - | - | **11,326** | - | - | **11,326** |
| Net changes in fair value of available for sale investments | 18 | - | - | **405,301** | - | - | **405,301** |
| Transfer to consolidated statement of income | 18 | - | - | **(32,377)** | - | - | **(32,377)** |
| | | | | **384,250** | **3,894,731** | | **4,278,981** |
| Treasury shares | | - | - | **(18,357)** | - | - | **(18,357)** |
| Employee share plan reserve | | - | - | **(1,233)** | - | - | **(1,233)** |
| Transfer to statutory reserve | 17 | - | **973,683** | - | **(973,683)** | - | - |
| 2015 Final dividend paid | 26 | - | - | - | - | **(570,000)** | **(570,000)** |
| 2016 Interim dividend paid | 26 | - | - | - | **(585,000)** | - | **(585,000)** |
| 2016 Final proposed dividend | 26 | - | - | - | **(570,000)** | **570,000** | - |
| Balance at end of the year | | **15,000,000** | **8,557,339** | **24,052** | **7,127,537** | **570,000** | **31,278,928** |
| 2015 | | | | | | | |
| Balance at beginning of the year | | 10,000,000 | 9,001,019 | 61,614 | 5,858,579 | 1,150,000 | 26,071,212 |
| Total comprehensive income for the year | | | | | | | |
| Net income for the year | | - | - | - | 4,330,547 | - | 4,330,547 |
| Net changes in fair value of cash flow hedges | 18 | - | - | (31,964) | - | - | (31,964) |
| Net changes in fair value of available for sale investments | 18 | - | - | (295,809) | - | - | (295,809) |
| Transfer to consolidated statement of income | 18 | - | - | (67,426) | - | - | (67,426) |
| | | | | (395,199) | 4,330,547 | | 3,935,348 |
| Bonus share issue | | 5,000,000 | (2,500,000) | - | (2,500,000) | - | - |
| Treasury shares | | - | - | (25,792) | - | - | (25,792) |
| Employee share plan reserve | | - | - | 18,769 | - | - | 18,769 |
| Transfer to statutory reserve | 17 | - | 1,082,637 | - | (1,082,637) | - | - |
| 2014 Final dividend paid | | - | - | - | - | (1,150,000) | (1,150,000) |
| 2015 Interim dividend paid | 26 | - | - | - | (675,000) | - | (675,000) |
| 2015 Final proposed dividend | 26 | - | - | - | (570,000) | 570,000 | - |
| Balance at end of the year | | 15,000,000 | 7,583,656 | (340,608) | 5,361,489 | 570,000 | 28,174,537 |

The accompanying notes 1 to 39 form an integral part of these consolidated financial statements.

**The Saudi British Bank**

**CONSOLIDATED STATEMENT OF CASH FLOWS**
**For the year ended 31 December**

| | Notes | 2016 SAR'000 | 2015 SAR'000 |
|---|---|---|---|
| **OPERATING ACTIVITIES** | | | |
| **Net income for the year** | | **3,894,731** | 4,330,547 |
| **Adjustments to reconcile net income to net cash from (used in) operating activities:** | | | |
| Amortisation of premium on non-trading investments | | **40,192** | 50,814 |
| Gains on non-trading investments, net | 23 | **(26,297)** | (66,634) |
| Depreciation | 8 | **110,903** | 96,557 |
| Income from FVIS financial instruments | | **(6,994)** | (3,750) |
| Cash Flow Hedge gain transfer to consolidated statement of income | | **(6,080)** | (791) |
| Share in earnings of a joint venture and associate | 7 | **(63,777)** | (130,345) |
| Provision for credit losses, net of reversal | 6 | **944,560** | 429,716 |
| Charge against employee share plan reserve | | **10,710** | 18,769 |
| Impairment/(impairment reversal) of other financial assets | | **49,540** | (9,631) |
| | | **4,947,488** | 4,715,252 |
| **Net (increase) decrease in operating assets:** | | | |
| Statutory deposit with SAMA | 3 | **203,452** | (379,521) |
| Due from banks and other financial institutions with an original maturity of more than three months from date of acquisition | | **(527,223)** | 93,573 |
| Loans and advances | | **4,037,261** | (10,769,848) |
| Other assets and derivatives | | **410,324** | 1,263,629 |
| **Net increase (decrease) in operating liabilities:** | | | |
| Due to banks and other financial institutions | | **1,584,268** | (2,259,318) |
| Customers' deposits | | **(8,247,393)** | 2,853,680 |
| Other liabilities and derivatives | | **65,171** | (1,789,216) |
| **Net cash from/(used in) operating activities** | | **2,473,348** | (6,271,769) |
| **INVESTING ACTIVITIES** | | | |
| Proceeds from sale and maturities of non-trading investments | | **73,459,574** | 33,789,979 |
| Purchase of non-trading investments | | **(66,883,021)** | (24,238,088) |
| Purchase of property and equipment | 8 | **(157,800)** | (424,611) |
| Dividend from a joint venture and associate | 7 | **114,715** | 88,784 |
| **Net cash from investing activities** | | **6,533,468** | 9,216,064 |
| **FINANCING ACTIVITIES** | | | |
| Debt securities in issue | | **4,698** | (768,749) |
| Borrowings | | **1,662,970** | (31,326) |
| Treasury shares purchased | | **(30,300)** | (25,792) |
| Dividends paid | | **(1,023,634)** | (1,792,242) |
| **Net cash from/(used in) financing activities** | | **613,734** | (2,618,109) |
| **Increase in cash and cash equivalents** | | **9,620,550** | 326,186 |
| Cash and cash equivalents at beginning of the year | | **13,338,227** | 13,012,041 |
| **Cash and cash equivalents at end of the year** | 27 | **22,958,777** | 13,338,227 |
| Special commission received during the year | | **4,398,029** | 4,707,176 |
| Special commission paid during the year | | **894,760** | 478,314 |
| **Supplemental non-cash information** | | | |
| Other comprehensive income / (loss) for the year | | **384,250** | (395,199) |

The accompanying notes 1 to 39 form an integral part of these consolidated financial statements.

## 1. General

The Saudi British Bank ("SABB") is a Saudi Joint Stock Company and was established by Royal Decree No. M/4 dated 12 Safar 1398H (21 January 1978). SABB formally commenced business on 26 Rajab 1398H (1 July 1978) with the taking over of the operations of The British Bank of the Middle East in the Kingdom of Saudi Arabia. SABB operates under Commercial Registration No. 1010025779 dated 22 Dhul Qadah 1399H (13 October 1979) as a commercial bank through a network of 84 branches (2015: 84 branches) in the Kingdom of Saudi Arabia. SABB employed 3,317 staff as at 31 December 2016 (2015: 3,451). The address of SABB's head office is as follows:

The Saudi British Bank
P.O. Box 9084
Riyadh 11413
Kingdom of Saudi Arabia

The objectives of SABB are to provide a range of banking services. SABB also provides Shariah approved products, which are approved and supervised by an independent Shariah Board established by SABB.

SABB has 100% (2015:100%) ownership interest in a subsidiary, SABB Securities Limited, a Saudi limited liability company formed in accordance with Capital Market Authority's Resolution No. 2007-35-7 dated 10 Jamada II 1428H (25 June 2007) and registered in the Kingdom of Saudi Arabia under Commercial Registration No. 1010235982 dated 8 Rajab 1428H (22 July 2007). The subsidiary is currently not carrying out any activity and is in the process of being liquidated.

SABB has 100% (2015:100%) ownership interest in a subsidiary, SABB Insurance Agency, a Limited Liability Company registered in the Kingdom of Saudi Arabia under commercial registration No. 1010235187 dated 18 Jumada II 1428H (3 July 2007). SABB has 98% direct and 2% indirect ownership interest in its subsidiary (the indirect ownership is held via a subsidiary registered in the Kingdom of Saudi Arabia). The principal activity of the subsidiary is to act as a sole insurance agent for SABB Takaful Company (an associate company of SABB - see note 7) within the Kingdom of Saudi Arabia as per the agreement between the subsidiary and the associate. However, the articles of association of the subsidiary do not restrict the subsidiary from acting as an agent to any other insurance company in the Kingdom of Saudi Arabia.

SABB has 100% (2015:100%) ownership interest in a subsidiary, Arabian Real Estate Company Limited, a limited liability company registered in the Kingdom of Saudi Arabia under commercial registration No. 1010188350 dated 12 Jumada I 1424H (12 July 2003). SABB has 99% direct and 1% indirect ownership interest in its subsidiary (the indirect ownership is held via a subsidiary registered in the Kingdom of Saudi Arabia). The subsidiary is engaged in the purchase, sale and lease of land and real estate for investment purpose.

SABB has 100% (2015:100%) ownership interest in a subsidiary, SABB Real Estate Company Limited, a limited liability company registered in the Kingdom of Saudi Arabia under commercial registration No. 1010428580 dated 12 Safar 1436H (4 December 2014). SABB has 99.8% direct and 0.2% indirect ownership interest in its subsidiary (the indirect ownership is held via a subsidiary registered in the Kingdom of Saudi Arabia). The subsidiary's main purpose is the registration of real estates and to hold and manage collaterals on behalf of the Bank

SABB has participated in three Structured Entities for the purpose of effecting syndicated loan transactions and to secure collateral rights over specific assets of the borrowers under Islamic financing structures. The entities have no other business operations.

1. Saudi Kayan Assets Leasing Company.
2. Rabigh Asset Leasing Company.
3. Yanbu Asset Leasing Company.

SABB owns 50% (2015: 50%) share in each entity. SABB does not consolidate the entities as it does not have the right to variable returns from its involvement with the entities and ability to affect those returns through its power over the entities. The related underlying funding to the borrower is recorded on SABB's books.

## 1.1. Basis of preparation

### a) Statement of compliance

The consolidated financial statements have been prepared in accordance with the Accounting Standards for Commercial Banks issued by the Saudi Arabian Monetary Authority (SAMA) and International Financial Reporting Standards (IFRS) and interpretation issued by the IFRS Interpretation Committee (IFRIC) as issued by the International Accounting Standards Board (IASB). SABB prepares its consolidated financial statements to comply with the Banking Control Law, the Regulations for Companies in the Kingdom of Saudi Arabia and its Articles of Association.

### b) Basis of measurement

These consolidated financial statements have been prepared under the historical cost convention except for the measurement at fair value of derivatives, financial assets held at fair value through income statement (“FVIS”) and available for sale. In addition, assets and liabilities that are hedged in a fair value hedging relationship are carried at fair value to the extent of the risks that are being hedged.

### c) Functional and presentation currency

These consolidated financial statements are expressed in Saudi Arabian Riyals (SAR), rounded off to the nearest thousands, which is the functional currency of SABB.

### d) Presentation of consolidated financial statements

The Bank presents its consolidated statement of financial position in order of liquidity. An analysis regarding recovery or settlement within 12 months after the reporting date (current) and more than 12 months after the reporting date (non–current) is presented in note 31 (b).

### e) Basis of consolidation

The consolidated financial statements comprise the financial statements of SABB and its subsidiaries (collectively referred to as “the Bank”). The financial statements of the subsidiaries are prepared for the same reporting year as that of SABB, using consistent accounting policies.

Subsidiaries are entities which are directly or indirectly controlled by SABB. SABB controls an entity (the “investee”) over which it is exposed, or has rights, to variable returns from its involvement with the investee and has the ability to affect those returns through its power over the investee. Subsidiaries are consolidated from the date on which control is transferred to SABB and cease to be consolidated from the date on which the control is transferred from SABB.

Intra-group transactions and balances have been eliminated upon consolidation.

### f) Critical accounting judgements and estimates

The preparation of consolidated financial statements in conformity with IFRS requires the use of certain critical accounting judgements, estimates, and assumptions that affect the reported amounts of assets and liabilities. It also requires management to exercise its judgement in the process of applying the Bank’s accounting policies. Such estimates, assumptions and judgements are continually evaluated and are based on historical experience and other factors, including obtaining professional advice and expectations of future events that are believed to be reasonable under the circumstances. Actual results may differ from these estimates. Revisions to accounting estimates are recognised in the period in which the estimate is revised and future periods. Significant areas where management has used estimates, assumptions or exercised judgements are as follows:

#### i. Impairment losses on loans and advances

*Impairment methodology*
The Bank’s policy is to create impairment allowances for impaired loans promptly and appropriately, when there is objective evidence that impairment of a loan or portfolio of loans has occurred.

Loan impairment allowances represent management’s best estimate of losses incurred in the loan portfolios at the consolidated statement of financial position date. Management is required to exercise judgement in making assumptions and estimates when calculating loan impairment allowances on both individually and collectively assessed loans and advances.

Collective impairment allowances are subject to estimation uncertainty, in part because it is not practicable to identify losses on an individual loan basis due to the large number of individually insignificant loans in the portfolio. The estimation methods include the use of statistical analyses of historical information, supplemented with significant management judgement, to assess whether current economic and credit conditions are such that the actual level of incurred losses is likely to be greater or less than historical experience.

Where changes in economic, regulatory or behavioural conditions result in the most recent trends in portfolio risk factors being not fully reflected in the models, risk factors are taken into account by adjusting the impairment allowances derived from historical loss experience. Risk factors include loan portfolio growth, product mix, unemployment rates, concentration, geographical concentrations, loan product features, economic conditions such as trends in housing markets, the level of interest rates, portfolio seasoning, account management policies and practices, changes in laws and regulations, and other influences on customer payment patterns.

The methodology and the assumptions used in calculating impairment losses are reviewed regularly in the light of differences between loss estimates and actual loss experience.

Losses for impaired loans are recognised when there is objective evidence that impairment of a loan or portfolio of loans has occurred. Impairment allowances that are calculated on individual loans or on groups of loans assessed collectively, are recorded as charges to the income statement and are recorded against the carrying amount of impaired loans on the Statement of Financial Position. Losses which may arise from future events are not recognised.

*Individually assessed loans and advances*
The factors considered in determining whether a loan is individually significant for the purposes of assessing impairment include the size of the loan, the number of loans in the portfolio, and the importance of the individual loan relationship, and how this is managed. Loans that meet these criteria will be individually assessed for impairment, except when volumes of defaults and losses are sufficient to justify treatment under a collective assessment methodology (see below).

Loans considered as individually significant are typically to corporate and commercial customers, are for larger amounts and are managed on an individual basis. For these loans, the Bank considers on a case-by-case basis at each reporting date whether there is any objective evidence that a loan is impaired. The criteria used to make this assessment include:

- known cash flow difficulties experienced by the borrower;
- contractual payments of either principal or interest being past due for more than 90 days;
- the probability that the borrower will enter bankruptcy or other financial realisation;
- a concession granted to the borrower for economic or legal reasons relating to the borrower's financial difficulty that results in forgiveness or postponement of principal, interest or fees, where the concession is not insignificant; and
- there has been deterioration in the financial condition or outlook of the borrower such that its ability to repay is considered doubtful.

For loans where objective evidence of impairment exists, impairment losses are determined considering the following factors:

- The Bank's aggregate exposure to the customer;
- the viability of the customer's business model and their capacity to trade successfully out of financial difficulties and generate sufficient cash flow to service debt obligations;
- the amount and timing of expected receipts and recoveries;
- the likely dividend available on liquidation or bankruptcy;
- the extent of other creditors' commitments ranking ahead of, or pari passu with, the bank and the likelihood of other creditors continuing to support the company;
- the complexity of determining the aggregate amount and ranking of all creditor claims and the extent to which legal and insurance uncertainties are evident;
- the realisable value of security (or other credit mitigants) and likelihood of successful repossession;
- the likely costs of obtaining and selling collateral as part of foreclosure;

- the ability of the borrower to obtain, and make payments in, the currency of the loan if not denominated in local currency; and
- when available, the secondary market price of the debt.

The determination of the realisable value of security is based on the market value at the time the impairment assessment is performed. The value is not adjusted for expected future changes in market prices, though adjustments are made to reflect local conditions such as forced sale discounts.

Impairment losses are calculated by discounting the expected future cash flows of a loan, which includes expected future receipts of contractual interest, at the loan's original effective interest rate and comparing the resultant present value with the loan's current carrying amount. The impairment allowances on individually significant accounts are reviewed at least quarterly and more regularly when circumstances require.

*Collectively assessed loans and advances*
Impairment is assessed collectively to cover losses which have been incurred but have not yet been identified on loans subject to individual assessment or for homogeneous groups of loans that are not considered individually significant. Retail lending portfolios are generally assessed for impairment collectively as the portfolios are generally large homogeneous loan pools.

*Incurred but not yet identified impairment*
Individually assessed loans for which no evidence of impairment has been specifically identified on an individual basis are grouped together according to their credit risk characteristics for a collective impairment assessment. These credit risk characteristics may include country of origination, type of business involved, type of products offered, security obtained or other relevant factors. This assessment captures impairment losses that the bank has incurred as a result of events occurring before the reporting date, which the bank is not able to identify on an individual loan basis, and that can be reliably estimated. When information becomes available which identifies losses on individual loans within the group, those loans are removed from the group and assessed individually.

The collective impairment allowance is determined after taking into account:

- historical loss experience in portfolios of similar credit risk characteristics (for example, by industry sector);
- the estimated period between impairment occurring and the loss being identified and evidenced by the establishment of an appropriate allowance against the individual loan; and
- management's judgement as to whether current economic and credit conditions are such that the actual level of inherent losses at the reporting date is likely to be greater or less than that suggested by historical experience.

The period between a loss occurring and its identification is estimated by management for each identified portfolio based on economic and market conditions, customer behaviour, portfolio management information, credit management techniques and collection and recovery experiences in the market. An estimated period may vary over time as these factors change.

Statistical methods are used to determine collective impairment losses for homogeneous groups of loans not considered individually significant. Losses in these groups of loans are recorded individually when individual loans are removed from the group and written off.

The methods that are used to calculate collective allowances are:

- When appropriate empirical information is available, The bank uses roll-rate methodology, which employs statistical analyses of historical data and experience of delinquency and default to reliably estimate the amount of the loans that will eventually be written off as a result of the events occurring before the reporting date but which the bank is not able to identify individually. Individual loans are grouped using ranges of past due days; statistical analysis is then used to estimate the likelihood that loans in each range will progress through the various stages of delinquency and become irrecoverable. Additionally, individual loans are segmented based on their credit characteristics as described above. In applying this methodology, adjustments are made to estimate the periods of time between a loss event occurring and its discovery, for example through a missed payment, (known as the emergence period) and the period of time between discovery and write-off (known as the outcome period). Current economic conditions are also evaluated when calculating the appropriate level of allowance required to cover inherent loss.
- When the portfolio size is small or when information is insufficient or not reliable enough to adopt a roll-rate methodology, the bank adopts a basic formulaic approach based on historical loss rate experience, or a discounted cash flow model. Where a basic formulaic approach is undertaken, the period between a loss event

occurring and its identification is estimated by local management, and is typically between six and twelve months.

The inherent loss within each portfolio is assessed on the basis of these models using historical data observations, which are updated periodically to reflect recent portfolio and economic trends. When the most recent trends arising from changes in economic, regulatory or behavioural conditions are not fully reflected in the models, they are taken into account by adjusting the impairment allowances derived from the models to reflect these changes as at the reporting date.

*Write-off of loans and advances*
Loans (and the related impairment allowance accounts) are normally written off, either partially or in full, when there is no realistic prospect of recovery. Where loans are secured, this is generally after receipt of any proceeds from the realisation of security.

*Collateral and other credit enhancements held*
The Bank's practice is to lend on the basis of customers' ability to meet their obligations out of cash flow resources rather than rely on the value of security offered. Depending on a customer's standing and the type of product, facilities may be provided without security. For other lending, a charge over collateral is obtained and considered in determining the credit decision and pricing. In the event of default, the bank may utilise the collateral as a source of repayment.

Depending on its form, collateral can have a significant financial effect in mitigating our exposure to credit risk.

Additionally, risk may be managed by employing other types of collateral and credit risk enhancements such as second charges, other liens and unsupported guarantees, but the valuation of such mitigants is less certain and their financial effect has not been quantified.

**ii. Fair value of financial instruments**

The Bank measures financial instruments, such as, derivatives, and non-financial assets such as investment properties, at fair value at each reporting date. Also, fair values of financial instruments measured at amortized cost are disclosed in Note 33 to these consolidated financial statements.

Fair value is the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date. The fair value measurement is based on the presumption that the transaction to sell the asset or transfer the liability takes place either:

- In the principal market for the asset or liability, or
- In the absence of a principal market, in the most advantageous market for the asset or liability

The principal or the most advantageous market must be accessible to by the Bank.

The fair value of an asset or a liability is measured using the assumptions that market participants would use when pricing the asset or liability, assuming that market participants act in their economic best interest.

A fair value measurement of a non-financial asset takes into account a market participant's ability to generate economic benefits by using the asset in its highest and best use or by selling it to another market participant that would use the asset in its highest and best use.

The Bank uses valuation techniques that are appropriate in the circumstances and for which sufficient data are available to measure fair value, maximizing the use of relevant observable inputs and minimizing the use of unobservable inputs.

All assets and liabilities for which fair value is measured or disclosed in the consolidated financial statements are categorized within the fair value hierarchy, described as follows, based on the lowest level input that is significant to the fair value measurement as a whole:

- Level 1 — Quoted (unadjusted) market prices in active markets for identical assets or liabilities
- Level 2 — Valuation techniques for which the lowest level input that is significant to the fair value measurement is directly or indirectly observable
- Level 3 — Valuation techniques for which the lowest level input that is significant to the fair value measurement is unobservable

For assets and liabilities that are recognised in the consolidated financial statements on a recurring basis, the Bank determines whether transfers have occurred between Levels in the hierarchy by re-assessing categorization (based on the lowest level input that is significant to the fair value measurement as a whole) at the end of each reporting period.

For the purpose of fair value disclosures, the Bank has determined classes of assets and liabilities on the basis of the nature, characteristics and risks of the asset or liability and the level of the fair value hierarchy as explained above.

**iii. Impairment of available for sale equity investments and debt instruments**

The Bank exercises judgement to consider impairment on the available for sale equity investments. This includes determination of a significant or prolonged decline in the fair value below its cost. The determination of what is 'significant' or 'prolonged' requires judgement. In making this judgement, the Bank evaluates among other factors, the normal volatility in share price. In addition, the Bank considers impairment to be appropriate when there is evidence of deterioration in the financial health of the investee, industry and sector performance, changes in technology, and operational and financing cash flows.

**iv. Classification of held to maturity investments**

The Bank follows the guidance of IAS 39 when classifying non-derivative financial assets with fixed or determinable payments and fixed maturity as held to maturity. In making this judgement, the Bank evaluates its intention and ability to hold such investments to maturity.

**v. Classification of fair value through income statement**

The Bank follows criteria set in IAS 39 when classifying financial assets and liabilities to fair value through income statement. In making this judgement, the Bank evaluates its compliance with the conditions as prescribed in IAS 39.

**vi. Determination of control over investees**

The control indicators set out note 1.1 (e) are subject to management's judgements.

**vii. Provisions for liabilities and charges**

The Bank receives legal claims against it in the normal course of business. Management has made judgments as to the likelihood of any claim succeeding in making provisions. The time of concluding legal claims is uncertain, as is the amount of possible outflow of economic benefits. Timing and cost ultimately depends on the due process being followed as per law.

**g) Going concern**

The Bank's management has made an assessment of the Bank's ability to continue as a going concern and is satisfied that the Bank has the resources to continue in business for the foreseeable future. Furthermore, the management is not aware of any material uncertainties that may cast significant doubt upon the Bank's ability to continue as a going concern. Therefore, the consolidated financial statements continue to be prepared on the going concern basis.

## 2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

The significant accounting policies adopted in the preparation of these consolidated financial statements are set out below.

**a) Changes in accounting policies**

The accounting policies used in the preparation of these consolidated financial statements are consistent with those used in the preparation of the annual consolidated financial statements for the year ended December 31, 2015 except for the adoption of the following new standards and other amendments to existing standards and a new interpretation mentioned below which has had no material impact on the consolidated financial statements of the Bank on the current period or prior periods and is expected to have an insignificant effect in future periods:

**Amendments to existing standards**

- Amendments to IFRS 10 - "Consolidated Financial Statements", IFRS 12 - "Disclosure of Interests in Other Entities" and IAS 28 - "Investments in Associates", applicable for the annual periods beginning on or after 1 January 2016, address three issues that have arisen in applying the investment entities exception under IFRS 10. The amendments to IFRS 10 clarify that the exemption from presenting consolidated financial statements applies to a parent entity that is a subsidiary of an investment entity, when the investment entity measures its subsidiaries at fair value. Furthermore, only a subsidiary of an investment entity that is not an investment entity itself and that provides support services to the investment entity is consolidated. All other subsidiaries of an investment entity are measured at fair value. The amendments to IAS 28 allow the investor, when applying the equity method, to retain the fair value measurement applied by the investment entity associate or joint venture to its interests in subsidiaries.

- Amendments to IFRS 11 - "Joint Arrangements", applicable for the annual periods beginning on or after 1 January 2016, require an entity acquiring an interest in a joint operation, in which the activity of the joint operation constitutes a business, to apply, to the extent of its share, all of the principles in IFRS 3 - "Business Combinations" and other IFRSs that do not conflict with the requirements of IFRS 11 Joint Arrangements. Furthermore, entities are required to disclose the information required by IFRS 3 and other IFRSs for business combinations. The amendments also apply to an entity on the formation of a joint operation if, and only if, an existing business is contributed by one of the parties to the joint operation on its formation. Furthermore, the amendments clarify that, for the acquisition of an additional interest in a joint operation in which the activity of the joint operation constitutes a business, previously held interests in the joint operation must not be remeasured if the joint operator retains joint control.

- Amendments to IAS 1 – "Presentation of Financial Statements", applicable for the annual periods beginning on or after 1 January 2016, clarify, existing IAS 1 requirements in relation to;

  - The materiality requirements in IAS 1

  - That specific line items in the statement(s) of profit or loss and other comprehensive income ("OCI") and the statement of financial position may be disaggregated

  - That entities have flexibility as to the order in which they present the notes to financial statements

  - That the share of OCI of associates and joint ventures accounted for using the equity method must be presented in aggregate as a single line item, and classified between those items that will or will not be subsequently reclassified to profit or loss.

The amendments further clarify the requirements that apply when additional subtotals are presented in the statement of financial position and the statement(s) of profit or loss and OCI.

- Amendments to IAS 16 – "Property, Plant and Equipment" and IAS 38 – "Intangible Assets", applicable for the annual periods beginning on or after 1 January 2016, restricts the use of ratio of revenue generated to total revenue expected to be generated to depreciate property, plant and equipment and may only be used in very limited circumstances to amortise intangible assets.

- Amendments to IAS 27 - "Separate Financial Statements", applicable for the annual periods beginning on or after 1 January 2016, allows an entity to use the equity method as described in IAS 28 to account for its investments in subsidiaries, joint ventures and associates in its separate financial statements.

- Annual improvements to IFRS 2012-2014 cycle applicable for annual periods beginning on or after 1 January 2016. A summary of the amendments is as follows:

  i. IFRS 5 – "Non-current Assets Held for Sale and Discontinued Operations", amended to clarify that changing from one disposal method to the other would not be considered a new plan of disposal, rather it is a continuation of the original plan. There is, therefore, no interruption of the application of the requirements in IFRS 5.

  ii. IFRS 7 "Financial Instruments: Disclosures" has been amended to clarify that a servicing contract that includes a fee can constitute continuing involvement in a financial asset. The nature of the fee and the arrangement should be assessed in order to consider whether the disclosures are required under IFRS 7 and the assessment must be done retrospectively. IFRS 7 has been further amended to clarify that the offsetting disclosure requirements do not apply to condensed interim financial statements, unless such disclosures provide a significant update to the information reported in the most recent annual report.

iii. IAS 19 – "Employee Benefits" – amendment clarifies that market depth of high quality corporate bonds is assessed based on the currency in which the obligation is denominated, rather than the country where the obligation is located. When there is no deep market for high quality corporate bonds in that currency, government bond rates must be used.

**b) Trade date accounting**

All regular way purchases and sales of financial assets are recognised and derecognised on the trade date i.e. the date on which the Bank becomes a party to the contractual provisions of the instrument. Regular way purchases and sales are purchases and sales of financial assets that require delivery of assets within the time frame generally established by regulation or convention in the market place.

**c) Derivative financial instruments and hedge accounting**

Derivative financial instruments including foreign exchange contracts, special commission rate futures, forward rate agreements, currency and special commission rate swaps, currency and special commission rate options (both written and purchased), are measured at fair value (premium received for written options). All derivatives are carried at their fair value as assets where the fair value is positive and as liabilities where the fair value is negative.

Fair values are generally obtained by reference to quoted market prices, discounted cash flow models or pricing models, as appropriate.

The treatment of changes in their fair value depends on their classification into the following categories:

**i) Derivatives held for trading**

Any changes in the fair value of derivatives that are held for trading purposes are taken directly to the consolidated statement of income for the year. Derivatives held for trading also include those derivatives which do not qualify for hedge accounting.

**ii) Embedded derivatives**

Derivatives embedded in other financial instruments are treated as separate derivatives and recorded at fair value if their economic characteristics and risks are not closely related to those of the host contract, and the host contract is not itself held for trading or designated at fair value through profit or loss. The embedded derivatives separated from the host are carried at fair value in the trading derivatives portfolio with changes in fair value recognised in the consolidated statement of income.

**iii) Hedge accounting**

The Bank designates certain derivatives as hedging instruments in qualifying hedging relationships. For the purpose of hedge accounting, hedges are classified into two categories; (a) fair value hedges which hedge the exposure to changes in the fair value of a recognised asset or liability, and (b) cash flow hedges which hedge exposure to variability in cash flows that is either attributable to a particular risk associated with a recognised asset or liability, or a highly probable forecasted transaction that will affect the reported net gain or loss.

In order to qualify for hedge accounting, it is required that the hedge should be expected to be highly effective i.e. the changes in fair value or cash flows of the hedging instrument should effectively offset corresponding changes in the hedged item, and should be reliably measurable. At the inception of the hedge, the risk management objective and strategy is documented including the identification of the hedging instrument, the related hedged item, the nature of risk being hedged, and how the Bank will assess the effectiveness of the hedging relationship. Subsequently, the effectiveness of the hedge is assessed on an ongoing basis.

In relation to fair value hedges, which meet the criteria for hedge accounting, any gain or loss from remeasuring the hedging instruments to fair value is recognised immediately in the consolidated statement of income. The related portion of the hedged item is recognised in the consolidated statement of income. Where the fair value hedge of a special commission bearing financial instrument ceases to meet the criteria for hedge accounting, the adjustment in the carrying value is amortised to the consolidated statement of income over the remaining life of the instrument. If the hedged item is derecognised, the unamortised fair value adjustment is recognised immediately in the consolidated statement of income.

In relation to cash flow hedges, which meet the criteria for hedge accounting, the portion of the gain or loss on the hedging instrument that is determined to be an effective hedge is recognised in the consolidated statement of comprehensive income. The ineffective portion, if any, is recognised in the consolidated statement of income. For cash flow hedges affecting future transactions, the gains or losses recognised in other reserves are transferred to the consolidated statement of income in the same period in which the hedged transaction affects the consolidated statement of income.

Hedge accounting is discontinued when the hedging instrument expires or is sold, terminated or exercised, or no longer qualifies for hedge accounting. On discontinuation of hedge accounting on cash flow hedges any cumulative gain or loss that was recognised in other reserves, is retained in shareholders' equity until the forecasted transaction occurs. Where the hedged forecasted transaction is no longer expected to occur, the net cumulative gain or loss recognised in other reserves is transferred to the consolidated statement of income for the year.

**d) Foreign currencies**

The consolidated financial statements are denominated and presented in Saudi Arabian Riyals, which is also the functional currency of the Bank.

Transactions in foreign currencies are translated into Saudi Arabian Riyals at the spot exchange rates prevailing at transaction dates. Monetary assets and liabilities at year-end, denominated in foreign currencies, are translated into Saudi Arabian Riyals at the exchange rates prevailing at the reporting date. The foreign currency gain or loss on monetary items is the difference between amortised cost in the functional currency at the beginning of the year adjusted for effective interest and payments during the year, and the amortised cost in foreign currency translated at the exchange rate at the end of the year. All differences arising on non-trading activities are transferred to exchange income in the consolidated statement of income, with the exception of differences on foreign currency borrowings that provide an effective hedge against a net investment in foreign entity. Foreign exchange gains or losses on translation of monetary assets and liabilities denominated in foreign currencies are recognised in the consolidated statement of income, except for differences arising on the retranslation of available for sale equity instruments or when deferred in equity as qualifying cash flow hedges and qualifying net investment hedges to the extent hedges are effective. Translation gains or losses on non-monetary items carried at fair value are included as part of the fair value adjustment either in the consolidated statement of income or in equity depending on the underlying financial asset.

**e) Offsetting financial instruments**

Financial assets and liabilities are offset and are reported net in the consolidated statement of financial position when there is a currently legally enforceable right to set off the recognised amounts and when the Bank intends to settle on a net basis, or to realise the asset and settle the liability simultaneously.

Income and expenses are not offset in the consolidated statement of income unless required or permitted by any accounting standard or interpretation, and as specifically disclosed in the accounting policies of the bank.

**f) Revenue/expenses recognition**

*Special commission income and expense*

Special commission income and expense for all commission-bearing financial instruments is recognised in the consolidated statement of income on an effective yield basis. The effective commission rate is the rate that exactly discounts the estimated future cash payments and receipts through the expected life of the financial asset or liability (or, where appropriate, a shorter period) to the carrying amount of the financial asset or liability. When calculating the effective commission rate, the Bank estimates future cash flows considering all contractual terms of the financial instrument but not future credit losses.

The carrying amount of the financial asset or financial liability is adjusted if the Bank revises its estimates of payments or receipts. The adjusted carrying amount is calculated based on the original effective commission rate and the change in carrying amount is recorded as special commission income or expense.

If the recorded value of a financial asset or a group of similar financial assets has been reduced due to an impairment loss, special commission income continues to be recognised using the original effective commission rate applied to the new carrying amount.

The calculation of the effective yield takes into account all contractual terms of the financial instruments (prepayment, options etc.) and includes all fees paid or received related transaction costs, and discounts or premiums that are an integral part of the effective commission rate. Transaction costs are incremental costs that are directly attributable to the acquisition, issue or disposal of financial asset or liability.

When the Bank enters into special commission rate swap to change special commission from fixed to floating (or vice versa) the amount of special commission income or expense is adjusted by the net special commission on the swap.

Special commission income on Shariah approved products received but not earned is netted off against the related assets.

*Exchange income/ loss*
Exchange income/loss is recognised when earned/incurred.

*Dividend income*
Dividend income is recognised when the right to receive income is established.

*Fees and commission income and expenses*
Fees and commission income are recognised on an accrual basis when the related services have been provided. Loan commitment fees for loans that are likely to be drawn down are generally deferred and, together with the related direct cost are recognised as an adjustment to the effective yield on the loan. Portfolio and other management advisory and service fees are recognised based on the applicable service contract, usually on a time proportionate basis. Fees received on asset management, wealth management, financial planning, custody services and other similar services that are provided over an extended period of time are recognised rateably over the period when the service is being provided. When a loan commitment is not expected to result in the drawdown of a loan, loan commitment fees are recognised on a straight-line basis over the commitment period. Other fees and commission expense relate mainly to transaction and service fees, which are expensed as the service is received. Any fee income received but not earned is classified under other liabilities.

*Net trading income*
Results arising from trading activities include all gains and losses from changes in fair value and related special commission income or expense, dividends from financial assets and financial liabilities held for trading and foreign exchange differences. This includes any ineffectiveness recorded in hedging transactions.

*Day one profit*
Where the transaction price differs from the fair value of other observable current market transactions in the same instrument or based on a valuation technique whose variables include only data from observable markets, the Bank immediately recognises the difference between the transaction price and fair value (a 'Day 1' profit) in the consolidated statement of income in 'Net trading income'. In cases where use is made of data which is not observable, the difference between the transaction price and model value is only recognised in the consolidated statement of income when the inputs become observable, or when the instrument is derecognised.

**g) Sale and repurchase agreements**

Assets sold with a simultaneous commitment to repurchase at a specified future date (repos) continue to be recognised in the consolidated statement of financial position as the Bank retains substantially all the risks and reward of ownership and continued to be measured in accordance with related accounting policies for the underlying financial assets held as FVIS, available for sale, held to maturity and other investments held at amortised cost. The counterparty liability for amounts received under these agreements is included in "due to banks and other financial institutions" or "customers' deposits", as appropriate. The difference between sale and repurchase price is treated as special commission expense and amortised over the life of the repo agreement, using the effective yield method.

Assets purchased with a corresponding commitment to resell at a specified future date (reverse repo) are not recognised in the consolidated statement of financial position, as the Bank does not obtain control over the assets. Amounts paid under these agreements are included in "Cash and balances with SAMA", "Due from banks and other financial institutions" or "Loans and advances", as appropriate. The difference between purchase and resale price is treated as special commission income and amortised over the life of the reverse repo agreement, using the effective yield method.

**h) Investments**

All investment securities are initially recognised at their fair value which represents the consideration given, including acquisition charges associated with the investment (except for investments held as FVIS, where acquisition charges are not added to the cost at initial recognition and are charged to the consolidated statement of income). Premiums are amortised and discounts accreted using the effective yield method and are taken to special commission income.

Following initial recognition, for securities traded in organised financial markets, fair value is determined by reference to exchange quoted market bid prices at the close of business on the reporting date. Investments in listed equity instruments are valued at the exchange quoted prices as of day close. Fair value of managed assets and investments in mutual funds are determined by reference to declared net asset values which approximate the fair value.

Following initial recognition, for securities where there is no quoted market price, a reasonable estimate of the fair value is determined by reference to the current market value of another instrument which is substantially the same, or is based on the expected cash flows or the underlying net asset base of the security.

Following initial recognition, subsequent transfers between the various classes of investments are not ordinarily permissible. The subsequent period end reporting values for each class of investment are determined on the basis as set out in the following paragraphs:

*(i) Held as FVIS*
Investments in this category are classified as either investment held for trading or those designated as FVIS at inception or on adoption of the revised IAS 39. Investments classified as trading are acquired principally for the purpose of selling or repurchasing in the short term. An investment may be designated as FVIS by the management if it satisfies the criteria set out below (except for equity instruments that do not have a quoted market price in an active market and whose fair values cannot be reliably measured):

- it is a financial instrument containing one or more embedded derivatives that significantly modify the cash flows resulting from the financial instrument, or
- it is a financial instrument with an embedded derivative that is required to be separated from the host contract under IAS 39, but the Bank is unable to measure reliably the embedded derivative separately either at acquisition or at a subsequent reporting date

The fair value designation is made in accordance with the Risk Management Strategy approved by the Bank's Assets and Liabilities Committee (ALCO) and is irrevocable. Designated financial assets are recognised when the Bank enters into the contractual provisions of the arrangements with counterparties on trade date and derecognised when sold.

After initial recognition, investments at FVIS are measured at fair value and any change in the fair value is recognised in the consolidated statement of income for the period in which it arises. Special commission income and dividend income received on financial assets held as FVIS are reflected as income from financial instruments designated as FVIS in the consolidated statement of income. Transaction costs, if any, are not added to the fair value measurement at initial recognition of FVIS investments.

*(ii) Available for sale*
Available-for-sale investments are those non-derivative equity and debt securities which are neither classified as Held to maturity investments, loans and receivables nor designated as FVIS, that are intended to be held for an unspecified period of time, which may be sold in response to needs for liquidity or changes in special commission rates, exchange rates or equity prices.

Investments classified as "available for sale", are subsequently measured at fair value. For an available-for-sale investment where the fair value has not been hedged, any gain or loss arising from a change in its fair value is recognised directly in the consolidated statement of comprehensive income. On derecognition, any cumulative gain or loss previously recognised in the consolidated statement of comprehensive income is included in the consolidated statement of income for the period.

Equity investments classified under available-for-sale investments whose fair value cannot be reliably measured are carried at cost.

*(iii) Held at amortised cost*
Investment securities with fixed or determinable payments that are not quoted in an active market are classified as "held at amortised cost". Such investments whose fair values have not been hedged are stated at amortised cost, less provision for impairment. Investments in a fair value hedge relationship are adjusted for fair value changes to the extent of the risk being hedged. Any gain or loss is recognised in the consolidated statement of income when

the investment is derecognised and is disclosed as gains/ (losses) on non-trading investments. Amortised cost is calculated by taking into account any discount or premium on acquisition using the effective yield method.

*(iv) Held to maturity*

Investments having fixed or determinable payments and fixed maturity that the Bank has the positive intention and ability to hold to maturity other than those that meet the definition of “held at amortised cost” are classified as held to maturity. Held to maturity investments are subsequently measured at amortised cost, less provision for impairment in value. Amortised cost is calculated by taking into account any discount or premium on acquisition using the effective yield method. Any gain or loss on such investments is recognised in the consolidated statement of income when the investment is derecognised or impaired.

Investments classified as held to maturity cannot ordinarily be sold or reclassified without impacting the Bank’s ability to use this classification and cannot be designated as a hedged item with respect to special commission rate or prepayment risk, reflecting the intention to hold them to maturity.

**i) Investment in equity-accounted investees**

The Bank’s interests in equity-accounted investees comprise interests in an associate and a joint venture.

Associate is an entity in which the Bank has significant influence, but not control or joint control, over the financial and operating policies. A joint venture is an arrangement in which the Bank has joint control, whereby the Bank has rights to the net assets of the arrangement, rather than rights to its assets and obligation for its liabilities.

Interests in an associate and the joint venture are accounted for using the equity method. They are initially recognised at cost, which includes transaction costs. Subsequent to initial recognition, the consolidated financial statements include the Bank’s share of the profit or loss and Other Comprehensive Income (“OCI”) of equity-accounted investees, until the date on which significant influence or joint control ceases.

The statement of income reflects the Bank’s share of the results of operations of the associate and the joint venture.

The reporting dates of the associate and joint venture are identical to the Bank and their accounting policies conform to those used by the Bank for like transactions and events in similar circumstances.

Unrealised profits and losses resulting from transactions between the Bank and its associate and joint venture are eliminated to the extent of the Bank’s interest in the associate and joint venture.

**j) Loans and advances**

Loans and advances are non-derivative financial assets originated or acquired by the Bank with fixed or determinable payments that are not quoted in an active market.

All loans and advances are initially measured at cost, being the fair value of consideration given, including acquisition charges associated with the loans and advances.

The Bank's loans and advances are classified as held at amortised cost less any amount written off and provisions for impairment.

For loans and advances, which are hedged, the related portion of the hedged fair value is adjusted against the carrying amount.

**k) Due from banks and other financial institutions**

Due from banks and other financial institutions are financial assets which are mainly money market placements with fixed or determinable payments and fixed maturities that are not quoted in an active market. Money market placements are not entered into with the intention of immediate or short-term resale. Due from banks and other financial institutions are initially measured at cost, being the fair value of the consideration given.

Following initial recognition, due from banks and other financial institutions are stated at cost less any amount written off and provisions for impairment, if any.

**l) Impairment of financial assets**

An assessment is made at each reporting date to determine whether there is objective evidence that a financial asset or group of financial assets may be impaired. If such evidence exists, the estimated recoverable amount of that asset is determined and any impairment loss, based on the net present value of future anticipated cash flows, is recognised for changes in its carrying amounts.

When a financial asset is uncollectible, it is written off against the related provision for impairment. Financial assets are written off only in circumstances where effectively all possible means of recovery have been exhausted, and the amount of the loss has been determined.

Once a financial asset has been written down to its estimated recoverable amount, special commission income is thereafter recognised based on the rate of special commission that was used to discount the future cash flows for the purpose of measuring the recoverable amount.

If, in a subsequent period, the amount of the impairment loss on investments other than available for sale equity investments decreases and the decrease can be related objectively to an event occurring after the impairment was recognised (such as an improvement in the debtor's credit rating), the previously recognised impairment loss is reversed by adjusting the allowance account. The amount of the reversal is recognised in the consolidated statement of income in provision for credit losses.

i. *Impairment of financial assets held at amortised cost*

A financial asset is classified as impaired when there is objective evidence of credit related impairment as a result of one or more loss events that occurred after the initial recognition of the asset and that a loss event(s) has an impact on the estimated future cash flows of the financial asset or group of financial assets that can be reliably estimated.

A specific provision for credit losses due to impairment of a loan or any other financial asset held at amortised cost, including those arising from sovereign risk exposures, is established if there is objective evidence that the Bank will not be able to collect all amounts due. The amount of the specific provision is the difference between the carrying amount and the estimated recoverable amount. The estimated recoverable amount is the present value of expected cash flows, including amounts estimated to be recoverable from guarantees and collateral, discounted based on the original effective special commission rate.

Loans and advances are generally renegotiated either as part of an ongoing customer relationship or in response to an adverse change in the circumstances of the borrower. Renegotiation can result in an extension of the due date of payment or repayment plans under which the Bank offers a revised rate of commission to genuinely distressed borrowers. This may result in the asset continuing to be overdue and individually impaired as the renegotiated payments of commission and principal do not recover the original carrying amount of the loan. In other cases, renegotiation leads to a new agreement, this is treated as a new loan. Restructuring policies and practices are based on indicators or criteria which, indicate that payment will most likely continue. The loans continue to be subject to an individual or collective impairment assessment, calculated using the loan's original effective yield rate.

Consumer loans are considered to be impaired when a payment is overdue for specified number of days as per related product programs. Since the risk metrics for consumer loans are based on a collective "pool" basis, rather than on individual loans, the provisions for consumer loans are also computed on a "pool basis" using the 'flow rate" methodology. The provision coverage is 100% for such non-performing loans (other than home loans), which reach the "write-off point" (write-off points which are set at 180 days past due). Write off decisions are generally based on a product specific past due status. When a financial asset is uncollectible, it is written off against the related provision for impairment, if any, and any amounts in excess of available provision are directly charged to consolidated statement of income.

In addition to specific provision for credit losses, provision for collective impairment is made on a portfolio basis for credit losses where there is objective evidence that unidentified losses exist at the reporting date. These are based on any deterioration in the risk rating (i.e. downward migration of risk ratings) of the financial assets since it was originally granted. This provision is estimated based on various factors including credit ratings allocated to a borrower or group of borrowers, the current economic conditions, the experience the Bank has had in dealing with a borrower or group of borrowers and available historical default information.

The carrying amount of the asset is adjusted through the use of an allowance account and the amount of the adjustment is included in the consolidated statement of income.

*ii. Impairment of financial assets held at fair value*

For financial assets held at fair value, where a loss has been recognised directly through the consolidated statement of comprehensive income under shareholders' equity, the cumulative net loss recognised in shareholders' equity is transferred to the consolidated statement of income when the asset is considered to be impaired.

*iii. Impairment of available for sale investments*

For equity investments held as available-for-sale, a significant or prolonged decline in fair value below its cost represents objective evidence of impairment. Unlike debt securities, the previously recognised impairment loss cannot be reversed through the consolidated statement of income as long as the asset continues to be recognised i.e. any increase in fair value after impairment has been recorded can only be recognised in equity. On derecognition, any cumulative gain or loss previously recognised in shareholders' equity is included in consolidated statement of income for the period.

The Bank writes off its financial assets when the respective business units together with Risk Management determine that the financial assets are uncollectible. This determination is reached after considering information such as the occurrence of significant changes in the borrower/issuer's financial position such that the borrower/issuer can no longer pay the obligations, or that proceeds from collateral will not be sufficient to pay back the entire exposure. The financial assets are, then, written off only in circumstances where effectively all possible means of recovery have been exhausted.

The Bank seeks to use collateral, where possible, to mitigate its risks on financial assets. The collateral comes in various forms such as cash, securities, letters of credit/guarantees, real estate, receivables, inventories, other non-financial assets and credit enhancements such as netting agreements. The fair value of collateral is generally assessed, at a minimum, at inception and based on the Bank's quarterly reporting schedule. However, some collateral, for example, cash or securities relating to margining requirements, is valued daily.

To the extent possible, the Bank uses active market data for valuing financial assets, held as collateral. Other financial assets which do not have a readily determinable market value are valued using models. Non-financial collateral, such as real estate, is valued based on data provided by third parties such as mortgage brokers, housing price indices, audited financial statements, and other independent sources.

*iv. Impairment of available for sale- debt securities*

In assessing objective evidence of impairment at the reporting date, the Bank considers all available evidence, including observable data or information about events specifically relating to the securities which may result in a shortfall in recovery of future cash flows. Financial difficulties of the issuer, as well as other factors such as information about the issuers' liquidity, business and financial risk exposures, levels of and trends in default for similar financial assets, national and local economic trends and conditions, and the fair value of collateral and guarantees may be considered individually, or in combination, to determine if there is objective evidence of impairment.

**m) Property and equipment**

Property and equipment are stated at cost and presented net of accumulated depreciation and impairment loss. Freehold land is not depreciated.

The cost of other property and equipment is depreciated on the straight-line method over the estimated useful lives of the assets as follows:

| | |
|---|---|
| Buildings | 33 years |
| Leasehold improvements | over the period of the lease contract |
| Furniture, equipment, vehicles and software | 3 to 4 years |

Gains and losses on disposals are determined by comparing proceeds with the carrying amount. These are included in the consolidated statement of income.

The assets' residual values and useful lives are reviewed for impairment whenever events or changes in circumstances indicate that the carrying amount may not be recoverable. Any carrying amount is written down immediately to its recoverable amount if the asset's carrying amount is greater than its estimated recoverable amount.

**n) Financial liabilities**

All money market deposits, customer deposits, borrowing and debt securities in issue are initially recognised at cost, being fair value of consideration received.

Subsequently all commission bearing financial liabilities where fair values have not been hedged are measured at amortised cost. Amortised cost is calculated by taking into account any discount or premium. Premiums are amortised and discounts accreted on an effective yield basis to maturity and taken to special commission expense.

Financial liabilities in a fair value hedge relationship are adjusted for fair value changes to the extent of the risk being hedged. The resultant gain or loss is recognised in the consolidated statement of income.

**o) Provisions**

Provisions are recognised when a reliable estimate can be made by the Bank of a present legal or constructive obligation as a result of past events and it is more likely than not that an outflow of resources will be required to settle the obligation. The expense relating to any provision is presented in the consolidated statement of income net of any reimbursement.

**p) Guarantees and loan commitments**

Financial guarantees are initially recognised in the consolidated financial statements at fair value in other liabilities, being the value of the premium received. Subsequent to the initial recognition, the Bank's liability under each guarantee is measured at the higher of the amortised premium and the best estimate of expenditure required to settle any financial obligations arising as a result of guarantees. Any increase in the liability relating to the financial guarantee is taken to the consolidated statement of income in "provision for credit losses".

The premium received is recognised in the consolidated statement of income in "Fees and commission income, net" on a straight-line basis over the life of the guarantee.

Loan commitments are firm commitments to provide credit under pre-specified terms and conditions.

**q) Accounting for leases**

Leases entered into by the Bank as a lessee are all operating leases. Payments made under these operating leases are charged to the consolidated statement of income on a straight-line basis over the period of the lease.

**r) Cash and cash equivalents**

For the purpose of the consolidated statement of cash flows, cash and cash equivalents comprise cash, balances with SAMA and placements with SAMA excluding the statutory deposit, and due from banks and other financial institutions with an original maturity of three months or less from date of acquisition.

**s) Derecognition of financial instruments**

A financial asset (or a part of a financial asset, or a part of a group of similar financial assets) is derecognised, when the contractual rights to the cash flows from the financial asset expires.

In instances where the Bank is assessed to have transferred a financial asset, the asset is derecognised if the Bank has transferred substantially all the risks and rewards of ownership. Where the Bank has neither transferred nor retained substantially all the risks and rewards of ownership, the financial asset is derecognised only if the Bank has not retained control of the financial asset. The Bank recognises separately as assets or liabilities any rights and obligations created or retained in the process.

A financial liability (or a part of a financial liability) can only be derecognised when it is extinguished, that is when the obligation specified in the contract is discharged, cancelled or expires.

**t) Assets held in trust or in fiduciary capacity**

Assets held in trust or in a fiduciary capacity are not treated as assets of the Bank and, accordingly, are not included in the accompanying consolidated financial statements.

**u) Zakat and income taxes**

Zakat is computed on the Saudi shareholders' share of equity and net income using the basis defined under the zakat regulations. Income taxes are computed on the foreign shareholders share of net income for the year.

Zakat and income taxes are not charged to the Bank's consolidated statement of income as they are the liabilities of the shareholders and therefore are deducted from the dividends paid to the shareholders.

**v) Shariah approved banking products**

In addition to conventional banking, the Bank offers its customers certain Shariah approved banking products, which are approved by its Shariah Board.

All Shariah approved banking products are accounted for using IFRS and are in conformity with the accounting policies described in these consolidated financial statements.

**w) End of service benefits**

The provision for end of service benefits is made in accordance with local regulations and custom. Net obligation, with respect to end of service benefits, to the Bank is reviewed quarterly by using a discounted cash flow valuation model. The assumptions used to calculate the scheme obligations include assumptions such as expected future salaries growth, expected employee resignation rates, and discount rate to discount the future cash flows.

**x) Share Based payments**

Under the terms of the Equity Based Long Term Bonus Plan, eligible employees of the Bank are offered shares at a predetermined price for a fixed period of time. At the vesting dates determined under the terms of the plan, the Bank delivers the underlying allotted shares to the employees, subject to the satisfactory completion of the vesting conditions.

The cost of the plans is recognized over the period in which the service condition is fulfilled, ending on the date on which the relevant employees become fully entitled to the shares ('the vesting date'). The cumulative expense recognized for these plans at each reporting date until the vesting date, reflects the extent to which the vesting period has expired and the Bank's best estimate of the number of equity instruments that will ultimately vest.

### 3. Cash and balances with SAMA

| | 2016 SAR'000 | 2015 SAR'000 |
|---|---|---|
| Cash in hand | **1,444,680** | 1,520,252 |
| Statutory deposit | **8,852,915** | 9,056,367 |
| Placements with SAMA | **13,545,153** | 150,994 |
| Other balances | **279,073** | 214,655 |
| **Total** | **24,121,821** | 10,942,268 |

In accordance with the Banking Control Law and regulations issued by SAMA, SABB is required to maintain a statutory deposit with SAMA at stipulated percentages of its deposit liabilities calculated at the end of each month. The statutory deposit with SAMA is not available to finance SABB's day-to-day operations and therefore is not part of cash and cash equivalents. Placements with SAMA represents securities purchased under an agreement to re-sell (reverse repo) with SAMA.

### 4. Due from banks and other financial institutions

| | 2016 SAR'000 | 2015 SAR'000 |
|---|---|---|
| Current accounts | **6,504,871** | 7,677,105 |
| Money market placements | **1,712,875** | 3,775,873 |
| **Total** | **8,217,746** | 11,452,978 |

### 5. Investments, net

#### a) Investment securities are classified as follows:

| | Domestic | | International | | Total | |
|---|---|---|---|---|---|---|
| **i) Available for sale** | **2016 SAR'000** | 2015 SAR'000 | **2016 SAR'000** | 2015 SAR'000 | **2016 SAR'000** | 2015 SAR'000 |
| Fixed rate securities | **9,527,852** | 19,808,798 | **6,484,068** | 6,425,634 | **16,011,920** | 26,234,432 |
| Floating rate securities | **5,235,548** | 4,514,792 | **702,486** | 76,264 | **5,938,034** | 4,591,056 |
| Equities | **1,030,549** | 987,712 | **27,308** | 44,203 | **1,057,857** | 1,031,915 |
| **Available for sale investments, net** | **15,793,949** | 25,311,302 | **7,213,862** | 6,546,101 | **23,007,811** | 31,857,403 |

Available for sale investments, net includes impairment provision of SAR 120.0 million (2015: SAR 70.0 million) for domestic equities and SAR 17.7 million (2015: SAR 18.1 million) for International floating rate securities.

| **ii) Held at amortised cost** | | | | | | |
|---|---|---|---|---|---|---|
| Fixed rate securities | **3,669,682** | 3,669,642 | **-** | - | **3,669,682** | 3,669,642 |
| Floating rate securities | **2,595,562** | - | **-** | - | **2,595,562** | - |
| **Held at amortised cost investment, net** | **6,265,244** | 3,669,642 | **-** | - | **6,265,244** | 3,669,642 |
| **Investments, net** | **22,059,193** | 28,980,944 | **7,213,862** | 6,546,101 | **29,273,055** | 35,527,045 |

**b) The analysis of the composition of investments is as follows:**

| | **2016** | | | 2015 | | |
|---|---|---|---|---|---|---|
| | **Quoted SAR'000** | **Unquoted SAR'000** | **Total SAR'000** | Quoted SAR'000 | Unquoted SAR'000 | Total SAR'000 |
| Fixed rate securities | **12,970,303** | **6,711,299** | **19,681,602** | 8,145,591 | 21,758,484 | 29,904,075 |
| Floating rate securities | **3,849,227** | **4,684,369** | **8,533,596** | - | 4,591,056 | 4,591,056 |
| Equities | **1,022,685** | **35,172** | **1,057,857** | 979,846 | 52,068 | 1,031,914 |
| **Investments, net** | **17,842,215** | **11,430,840** | **29,273,055** | 9,125,437 | 26,401,608 | 35,527,045 |

**c) The analysis of unrealised gains and the fair values of held at amortised cost investments, are as follows:**

| | **2016 SAR'000** | | | | 2015 SAR'000 | | | |
|---|---|---|---|---|---|---|---|---|
| | **Carrying value** | **Gross unrealised gain** | **Gross unrealised loss** | **Fair value** | Carrying value | Gross unrealised gain | Gross unrealised loss | Fair value |
| **Held at amortised cost** | | | | | | | | |
| Fixed rate securities | **3,669,682** | **-** | **(5,141)** | **3,664,541** | 3,669,642 | - | - | 3,669,642 |
| Floating rate securities | **2,595,562** | **8,900** | **-** | **2,604,462** | - | - | - | - |
| **Total** | **6,265,244** | **8,900** | **(5,141)** | **6,269,003** | 3,669,642 | - | - | 3,669,642 |

**d) The analysis of investments by counterparty is as follows:**

| | 2016 SAR'000 | 2015 SAR'000 |
|---|---|---|
| Government and quasi government | **22,059,012** | 29,747,189 |
| Corporate | **5,987,324** | 3,841,373 |
| Banks and other financial institutions | **1,218,007** | 1,929,731 |
| Other | **8,712** | 8,752 |
| **Total** | **29,273,055** | 35,527,045 |

Others includes available for sale investments in unquoted shares of SAR 8.7 million (2015: SAR 8.7 million) that are carried at cost, as their fair value cannot be reliably measured.

**e) Credit quality of investments**

| | 2016 SAR'000 | 2015 SAR'000 |
|---|---|---|
| Saudi sovereign debt | **15,419,496** | 21,723,663 |
| Investment grade | **5,079,765** | 8,542,709 |
| Non-investment grade | **375,476** | 97,018 |
| Unrated investments including equities | **8,398,318** | 5,163,655 |
| **Total** | **29,273,055** | 35,527,045 |

Unrated investments include equity investments of SAR 1,057.9 million (2015: SAR 1,031.9 million).

The Saudi sovereign debt comprise of Saudi Government Development Bonds, Saudi International Bonds and Treasury Bills.

Investment Grade includes those investments having credit exposure equivalent to Standard and Poor's rating of AAA to BBB.

The unrated category mainly comprises of Saudi corporate bonds, private equity, quoted and unquoted equities.

**f) Movements of allowance for impairment of investments**

| | 2016 SAR'000 | 2015 SAR'000 |
|---|---|---|
| Balance at beginning of the year | **88,176** | 97,807 |
| Provided during the year | **50,000** | - |
| Amounts recovered during the year | **(460)** | (9,631) |
| **Balance at end of the year** | **137,716** | 88,176 |

## 6. Loans and advances, net

**a) Loans and advances are classified as follows:**

| | 2016 | | | SAR' 000 |
|---|---|---|---|---|
| | Credit cards | Consumer loans | Commercial loans and overdrafts | Total |
| Performing loans and advances-gross | 2,308,508 | 24,380,165 | 95,510,374 | 122,199,047 |
| Non-performing loans and advances, net | 3,858 | 121,815 | 1,529,806 | 1,655,479 |
| **Total loans and advances** | 2,312,366 | 24,501,980 | 97,040,180 | 123,854,526 |
| Provision for credit losses (specific and collective) | (102,355) | (356,714) | (2,430,642) | (2,889,711) |
| **Loans and advances, net** | 2,210,011 | 24,145,266 | 94,609,538 | 120,964,815 |

| | 2015 | | | SAR' 000 |
|---|---|---|---|---|
| | Credit cards | Consumer loans | Commercial loans and overdrafts | Total |
| Performing loans and advances-gross | 2,172,280 | 25,440,045 | 99,303,585 | 126,915,910 |
| Non-performing loans and advances, net | 2,261 | 91,284 | 1,423,727 | 1,517,272 |
| Total loans and advances | 2,174,541 | 25,531,329 | 100,727,312 | 128,433,182 |
| Provision for credit losses (specific and collective) | (89,998) | (268,520) | (2,128,028) | (2,486,546) |
| Loans and advances, net | 2,084,543 | 25,262,809 | 98,599,284 | 125,946,636 |

Loans and advances, net include Shariah approved products totalling SAR 96,096.9 million (2015: SAR 99,039.0 million) which are stated at cost less provision for credit losses of SAR 1,490.5 million (2015: SAR 1,570.0 million).

Non-performing loans and advances are disclosed net of accumulated special commission in suspense of SAR 217.3 million (2015: SAR 216.6 million).

**b) Movement in provision for credit losses**

| | **2016** | | | **SAR' 000** |
|---|---|---|---|---|
| | **Credit cards** | **Consumer loans** | **Commercial loans and overdrafts** | **Total** |
| Balance at beginning of the year | **89,998** | **268,520** | **2,128,028** | **2,486,546** |
| Bad debts written off | **(95,659)** | **(324,583)** | **(333,675)** | **(753,917)** |
| Provided during the year, net of reversals | **108,016** | **412,777** | **640,025** | **1,160,818** |
| Recoveries of amounts previously provided | **-** | **-** | **(3,736)** | **(3,736)** |
| Balance at the end of the year | **102,355** | **356,714** | **2,430,642** | **2,889,711** |

| | 2015 | | | SAR' 000 |
|---|---|---|---|---|
| | Credit cards | Consumer loans | Commercial loans and overdrafts | Total |
| Balance at beginning of the year | 98,543 | 222,605 | 2,081,397 | 2,402,545 |
| Bad debts written off | (100,043) | (292,567) | (121,467) | (514,077) |
| Provided during the year, net of reversals | 91,498 | 338,482 | 194,449 | 624,429 |
| Recoveries of amounts previously provided | - | - | (26,351) | (26,351) |
| Balance at the end of the year | 89,998 | 268,520 | 2,128,028 | 2,486,546 |

The allowance for credit losses related to commercial loans and overdrafts as mentioned above includes a collective allowance amounting to SAR 1,200.2 million (2015: SAR 1,173.0 million) related to the performing portfolio.

Provision for credit losses charged to the consolidated statement of income related to Shariah approved products is SAR 351.5 million (2015: SAR 390.9 million).

The net charge to consolidated statement of income on account of provision for credit losses is SAR 944.5 million (2015: SAR 429.7 million), which is net of recoveries of amounts previously provided as shown above and recoveries of debts previously written off amounting to SAR 212.5 million (2015 : SAR 168.4 million).

### c) Credit quality of loans and advances

#### i) Neither past due nor impaired loans

| | 2016 | | | SAR' 000 |
|---|---|---|---|---|
| **Grades** | **Credit cards** | **Consumer loans** | **Commercial loans and overdrafts** | **Total** |
| Undoubted | **-** | **-** | **550,025** | **550,025** |
| Good | **-** | **10,625,968** | **32,855,566** | **43,481,534** |
| Satisfactory | **2,146,964** | **12,073,697** | **61,168,374** | **75,389,035** |
| **Total** | **2,146,964** | **22,699,665** | **94,573,965** | **119,420,594** |

| | 2015 | | | SAR' 000 |
|---|---|---|---|---|
| Grades | Credit cards | Consumer loans | Commercial loans and overdrafts | Total |
| Undoubted | - | - | 524,014 | 524,014 |
| Good | 297,988 | 12,246,880 | 34,541,756 | 47,086,624 |
| Satisfactory | 1,725,913 | 11,754,201 | 63,349,284 | 76,829,398 |
| **Total** | 2,023,901 | 24,001,081 | 98,415,054 | 124,440,036 |

**Undoubted**: The strongest credit risk with a negligible probability of default. Such entities would have an extremely strong capacity to meet long term commitments in adverse market conditions

**Good**: A strong credit risk with a low probability of default. These entities have a strong capacity to meet long term commitments but some sensitivity to market events.

**Satisfactory**: A satisfactory credit risk with a moderate probability of default. These entities have the capacity to meet medium term and short term commitments however there is likely to be a need for periodic monitoring due to a higher sensitivity to market events.

#### ii) Ageing of loans and advances (past due but not impaired)

| | 2016 | | | SAR' 000 |
|---|---|---|---|---|
| | **Credit cards** | **Consumer loans** | **Commercial loans and overdrafts** | **Total** |
| From 1 day to 30 days | **59,645** | **1,349,201** | **888,173** | **2,297,019** |
| From 31 days to 90 days | **51,195** | **193,494** | **10,839** | **255,528** |
| From 91 days to 180 days | **50,704** | **137,805** | **37,397** | **225,906** |
| Over 180 days | **-** | **-** | **-** | **-** |
| **Total** | **161,544** | **1,680,500** | **936,409** | **2,778,453** |

| | 2015 | | | SAR' 000 |
|---|---|---|---|---|
| | Credit cards | Consumer loans | Commercial loans and overdrafts | Total |
| From 1 day to 30 days | 68,645 | 1,164,874 | 723,835 | 1,957,354 |
| From 31 days to 90 days | 43,629 | 180,842 | 17,716 | 242,187 |
| From 91 days to 180 days | 36,105 | 93,248 | 1,813 | 131,166 |
| Over 180 days | - | - | 145,167 | 145,167 |
| Total | 148,379 | 1,438,964 | 888,531 | 2,475,874 |

**iii) Economic sector risk concentrations for the loans and advances and provision for credit losses are as follows:**

| **2016 SAR'000** | **Performing** | **Non performing, net** | **Provision for credit losses** | **Loans and advances, net** |
|---|---|---|---|---|
| Government and quasi Government | **4,023,873** | **-** | **-** | **4,023,873** |
| Finance | **9,439,355** | **-** | **-** | **9,439,355** |
| Agriculture and fishing | **462,334** | **-** | **-** | **462,334** |
| Manufacturing | **22,010,886** | **127,552** | **(62,378)** | **22,076,060** |
| Mining and quarrying | **2,649,341** | **-** | **-** | **2,649,341** |
| Electricity, water, gas and health services | **3,672,439** | **-** | **-** | **3,672,439** |
| Building and construction | **10,852,909** | **680,253** | **(519,831)** | **11,013,331** |
| Commerce | **28,600,331** | **277,331** | **(245,287)** | **28,632,375** |
| Transportation and communication | **4,829,263** | **77,966** | **(77,966)** | **4,829,263** |
| Services | **5,529,610** | **16,426** | **(16,206)** | **5,529,830** |
| Consumer loans and credit cards | **26,688,673** | **125,673** | **(459,069)** | **26,355,277** |
| Others | **2,765,222** | **350,278** | **(308,730)** | **2,806,770** |
| Accrued special commission | **674,811** | **-** | **-** | **674,811** |
| Collective impairment provision for commercial loans | **-** | **-** | **(1,200,244)** | **(1,200,244)** |
| **TOTAL** | **122,199,047** | **1,655,479** | **(2,889,711)** | **120,964,815** |

| 2015 SAR'000 | Performing | Non performing, net | Provision for credit losses | Loans and advances, net |
|---|---|---|---|---|
| Government and quasi Government | 3,842,663 | - | - | 3,842,663 |
| Finance | 10,658,734 | - | - | 10,658,734 |
| Agriculture and fishing | 610,384 | - | - | 610,384 |
| Manufacturing | 22,204,654 | 86,387 | (65,560) | 22,225,481 |
| Mining and quarrying | 2,179,336 | - | - | 2,179,336 |
| Electricity, water, gas and health services | 4,508,998 | - | - | 4,508,998 |
| Building and construction | 10,316,030 | 375,004 | (231,484) | 10,459,550 |
| Commerce | 27,869,631 | 472,083 | (338,254) | 28,003,460 |
| Transportation and communication | 3,341,913 | 74,153 | (77,966) | 3,338,100 |
| Services | 7,106,031 | 9,564 | (13,823) | 7,101,772 |
| Consumer loans and credit cards | 27,563,276 | 93,545 | (358,518) | 27,298,303 |
| Others | 6,191,928 | 406,536 | (227,945) | 6,370,519 |
| Accrued special commission | 522,332 | - | - | 522,332 |
| Collective impairment provision for commercial loans | - | - | (1,172,996) | (1,172,996) |
| TOTAL | 126,915,910 | 1,517,272 | (2,486,546) | 125,946,636 |

The provision for credit losses on the consumer loans and advances is calculated on a collective basis.

The collective impairment provision is based on an asset quality matrix, which includes the grading structure in respect of the credit risk of the customers as well as general economic outlook.

**d) Collateral**

The Bank in the ordinary course of lending activities holds collaterals as security to mitigate credit risk in the loans and advances. These collaterals mostly include time and demand and other cash deposits, financial guarantees, local and international equities, real estate and other fixed assets.

As of 31 December 2016, the carrying amount of non-performing loans and advances comprising of commercial loans and overdrafts amounted to SAR 1,529.8 million (2015: SAR 1,423.7 million) and the value of identifiable collateral held against those loans and advances amount to SAR 1,400.2 million (2015: SAR 973.0 million).

The table below set out the principal types of collateral held against loan and advances;

| | **2016** | 2015 | Principal type of Collateral held |
|---|---|---|---|
| **Credit Card and Consumer Loans** | | | |
| Mortgage Finance | **100%** | 100% | Residential Property |
| Personal Finance | **-** | - | |
| Credit Cards | **0.02%** | 0.03% | Cash |
| **Commercial Loans and Overdrafts** | | | |
| Commercial Real Estate | **100%** | 100% | Commercial and Residential Property |
| Other Finance | **42%** | 70% | Marketable equity securities, Property and Cash |

## 7. Investment in a joint venture and an associate

SABB owns 51% (2015: 51%) of the shares of HSBC Saudi Arabia Limited, a joint venture with HSBC. SABB does not consolidate the entity as it does not have rights to variable returns from its involvement with the entity and ability to affect those returns through its power over the entity. The main activities of HSBC Saudi Arabia Limited are to provide a full range of investment banking services including investment banking advisory, brokerage, debt and project finance as well as Islamic finance. It also manages mutual funds and discretionary portfolios.

SABB owns 32.5% (2015: 32.5%) of the shares of SABB Takaful, a Saudi Joint Stock Company. SABB Takaful carries out Shariah compliant insurance activities and offers family and general Takaful products. The market value of investment in SABB Takaful as of 31 December 2016 is SAR 321.2 million (2015: SAR 363.4 million).

| | **2016** | | | 2015 | | |
|---|---|---|---|---|---|---|
| | **HSBC Saudi Arabia Limited SAR' 000** | **SABB Takaful SAR' 000** | **Total SAR' 000** | HSBC Saudi Arabia Limited SAR' 000 | SABB Takaful SAR' 000 | Total SAR' 000 |
| Balance at beginning of the year | **565,898** | **127,337** | **693,235** | 526,221 | 125,453 | 651,674 |
| Share of undistributed profits | **62,495** | **1,282** | **63,777** | 128,461 | 1,884 | 130,345 |
| Dividend received | **(114,715)** | **-** | **(114,715)** | (88,784) | - | (88,784) |
| **Balance at end of the year** | **513,678** | **128,619** | **642,297** | 565,898 | 127,337 | 693,235 |

| **Share of joint venture and associate financial statements:** | **2016** | | 2015 | |
|---|---|---|---|---|
| | **HSBC Saudi Arabia Limited SAR' 000** | **SABB Takaful SAR' 000** | HSBC Saudi Arabia Limited SAR' 000 | SABB Takaful SAR' 000 |
| Total assets | **524,486** | **122,392** | 595,506 | 119,011 |
| Total liabilities | **124,007** | **5,002** | 133,316 | 3,613 |
| Total equity | **400,479** | **117,390** | 462,190 | 115,398 |
| Total income | **206,914** | **4,491** | 294,907 | 2,814 |
| Total expenses | **135,642** | **638** | 166,446 | 1,631 |

## 8. Property and equipment, net

| | Land and buildings SAR'000 | Leasehold improvements SAR'000 | Equipment, furniture and vehicles SAR'000 | Software SAR'000 | 2016 Total SAR'000 | 2015 Total SAR'000 |
|---|---|---|---|---|---|---|
| **Cost** | | | | | | |
| As at 1 January | **897,840** | **587,859** | **573,728** | **81,607** | **2,141,034** | 1,720,566 |
| Additions | **4,526** | **44,619** | **100,393** | **8,262** | **157,800** | 424,611 |
| Disposals | **-** | **-** | **(5,195)** | **-** | **(5,195)** | (4,143) |
| **As at 31 December** | **902,366** | **632,478** | **668,926** | **89,869** | **2,293,639** | 2,141,034 |
| **Accumulated depreciation** | | | | | | |
| As at 1 January | **357,849** | **359,284** | **370,919** | **61,527** | **1,149,579** | 1,057,145 |
| Charge for the year | **12,511** | **38,484** | **47,518** | **12,390** | **110,903** | 96,557 |
| Disposals | **-** | **-** | **(5,195)** | **-** | **(5,195)** | (4,123) |
| **As at 31 December** | **370,360** | **397,768** | **413,242** | **73,917** | **1,255,287** | 1,149,579 |
| **Net book value** | | | | | | |
| **As at 31 December 2016** | **532,006** | **234,710** | **255,684** | **15,952** | **1,038,352** | |
| As at 31 December 2015 | 539,991 | 228,575 | 202,809 | 20,080 | | 991,455 |

Property and equipment, net includes work in progress as at 31 December 2016 amounting to SAR 237.6 million (2015: SAR 182.4 million).

## 9. Other assets

| | 2016 SAR'000 | 2015 SAR'000 |
|---|---|---|
| Accounts receivable | **448,166** | 147,386 |
| Advance tax | **254,098** | 251,823 |
| Others | **373,632** | 924,732 |
| **Total** | **1,075,896** | 1,323,941 |

## 10. Derivatives

In the ordinary course of business, the Bank uses the following derivative financial instruments for both trading and hedging purposes:

**a) Forwards and futures**

Forwards and futures are contractual agreements to either buy or sell a specified currency, commodity or financial instrument at a specified price and date in the future. Forwards are customised contracts transacted in the over-the-counter market. Foreign currency and special commission rate futures are transacted in standardised amounts on regulated exchanges, and changes in futures contract values are settled daily.

**b) Options**

Options are contractual agreements under which the seller (writer) grants the purchaser (holder) the right, but not the obligation, to either buy or sell at a fixed future date or at any time during a specified period, a specified amount of a currency, commodity or financial instrument at a predetermined price.

**c) Swaps**

Swaps are commitments to exchange one set of cash flows for another. For special commission rate swaps, counterparties generally exchange fixed and floating rate special commission payments in a single currency without exchanging principal. For currency swaps, fixed special commission payments and principal are exchanged in different currencies. For cross currency special commission rate swaps, principal, fixed and floating special commission payments are exchanged in different currencies.

**d) Forward rate agreements**

Forward rate agreements are over-the-counter negotiated special commission rate contracts that call for a cash settlement for the difference between a contracted special commission rate and the market rate on a specified future date, based on a notional principal for an agreed period of time.

***Risk-related adjustments***

*Bid-offer:*

IFRS 13 requires use of the price within the bid-offer spread that is most representative of fair value. Valuation models will typically generate mid-market values. The bid-offer adjustment reflects the extent to which bid-offer cost would be incurred if substantially all residual net portfolio market risks were closed using available hedging instruments or by disposing of or unwinding the position.

*Credit valuation adjustment ('CVA'):*

The credit valuation adjustment is an adjustment to the valuation of OTC derivative contracts to reflect within fair value the possibility that the counterparty may default and that SABB may not receive the full market value of the transactions.

*Debit valuation adjustment ('DVA'):*

The debit valuation adjustment is an adjustment to the valuation of OTC derivative contracts to reflect within fair value the possibility that SABB may default, and that SABB may not pay the full market value of the transactions.

*Credit valuation adjustment/debit valuation adjustment methodology:*

SABB calculates a separate CVA and DVA for each counterparty to which the entity has exposure. SABB calculates the CVA by applying the probability of default ('PD') of the counterparty conditional on the non default of SABB to the expected positive exposure to the counterparty and multiplying the result by the loss expected in the event of default. Conversely, SABB calculates the DVA by applying the PD of SABB, conditional on the non default of the counterparty, to the expected positive exposure of the counterparty to SABB and multiplying by the loss expected in the event of default. Both calculations are performed over the life of the potential exposure.

***Derivatives held for trading purposes***

Most of the Bank's derivative trading activities relate to sales, positioning and arbitrage. Sales activities involve offering products to customers in order, inter alia, to enable them to transfer, modify or reduce current and future risks. Positioning involves managing market risk positions with the expectation of profiting from favourable movements in prices, rates or indices. Arbitrage involves identifying, with the expectation of profiting from price differentials between markets or products.

***Derivatives held for hedging purposes***

The Bank has adopted a comprehensive system for the measurement and management of risk (see note 29 - credit risk, note 30- market risk and note 31 - liquidity risk). Part of the risk management process involves managing the Bank's exposure to fluctuations in foreign exchange and special commission rates to reduce its exposure to currency and special commission rate risks to acceptable levels, as determined by the Board of Directors within the guidelines issued by SAMA. The Board of Directors has established the levels of currency risk by setting limits on currency position exposures. Positions are monitored on a daily basis and hedging strategies are used to ensure that positions are maintained within the established limits. The Board of Directors has also established the levels of special commission rate risk by setting limits on special commission rate gaps for stipulated periods. Asset and liability special commission rate gaps are reviewed on a periodic basis and hedging strategies are used to maintain special commission rate gaps within the established limits.

As part of its asset and liability management process, the Bank uses derivatives for hedging purposes in order to adjust its exposure to currency and special commission rate risks. This is generally achieved by hedging specific transactions as well as by strategic hedging against overall statement of financial position exposures. Strategic hedging other than portfolio hedging does not qualify for hedge accounting and the related derivatives are accounted for as held for trading.

The Bank uses forward foreign exchange contracts and currency swaps to hedge against specifically identified currency risks. In addition, the Bank uses special commission rate swaps to hedge against the special commission rate risk arising from specifically identified fixed special commission rate exposures. The Bank also uses special commission rate swaps to hedge against the cash flow risk arising on certain floating rate exposures. In all such cases, the hedging relationship and objective, including the details of the hedged items and hedging instruments, are formally documented and the transactions are accounted for as fair value or cash flow hedges.

***Hedge effectiveness testing***

To qualify for hedge accounting, SABB requires that at the inception of the hedge and throughout its life, each hedge must be expected to be highly effective both prospectively and retrospectively, on an ongoing basis.

The documentation of each hedging relationship sets out how the effectiveness of the hedge is assessed and the method adopted by an entity to assess hedge effectiveness will depend on its risk management strategy. For prospective effectiveness, the hedging instrument must be expected to be highly effective in offsetting changes in fair value or cash flows attributable to the hedged risk during the period for which the hedge is designated, with the effectiveness range being defined as 80% to 125%. Hedge ineffectiveness is recognised in the consolidated statement of income 'Net trading income'.

***Cash flow hedges***

The Bank is exposed to variability in future special commission cash flows on non-trading assets and liabilities which bear special commission income at a variable rate. The Bank uses commission rate swaps as cash flow hedges of these special commission rate risks. Below is the schedule indicating as at 31 December, the periods when the hedged cash flows are expected to occur and when they are expected to affect profit or loss:

| | | | | SAR' 000 |
|---|---|---|---|---|
| **2016** | **Within 1 year** | **1-3 years** | **3-5 years** | **Over 5 years** |
| Cash inflows (assets) | **33,816** | **76,126** | **60,243** | **68,604** |
| Cash out flows (liabilities) | **(3,358)** | **(10,203)** | **(2,941)** | **-** |
| Net cash outflow | **30,458** | **65,923** | **57,302** | **68,604** |
| 2015 | Within 1 year | 1-3 years | 3-5 years | Over 5 years |
| Cash inflows (assets) | **5,963** | **48,771** | **129.322** | **199,969** |
| Cash out flows (liabilities) | - | - | - | - |
| Net cash inflow | **5,963** | **48,771** | **129,322** | **199,969** |

The schedule reflects special commission income cash flows expected to arise on the hedged items in cash flow hedges based on the repricing profile of the hedged assets and liabilities.

The tables below show the positive and negative fair values of derivative financial instruments held, together with their notional amounts as at 31 December, analysed by the term to maturity. The notional amounts, which provide an indication of the volumes of the transactions outstanding at the year end, do not necessarily reflect the amounts of future cash flows involved. These notional amounts, therefore, are neither indicative of the Bank's exposure to market risk nor credit risk, which is generally limited to the positive fair value of the derivatives.

***Notional amounts by term to maturity***

| **2016 SAR'000** | **Positive fair value** | **Negative fair value** | **Notional amount total** | **Within 3 months** | **3-12 months** | **1-5 years** | **Over 5 years** |
|---|---|---|---|---|---|---|---|
| **Derivatives held for trading:** | | | | | | | |
| Special commission rate swaps | **229,698** | **(206,844)** | **36,848,122** | **2,733,963** | **11,883,157** | **20,102,625** | **2,128,377** |
| Special commission rate futures and options | **87,500** | **(87,500)** | **8,815,118** | **-** | **50,000** | **7,365,118** | **1,400,000** |
| Spot and forward foreign exchange contracts | **116,874** | **(49,190)** | **19,420,843** | **14,283,065** | **4,003,297** | **1,134,481** | **-** |
| Currency options | **145,808** | **(148,103)** | **143,436,015** | **35,574,192** | **79,705,017** | **28,156,806** | **-** |
| Currency swaps | **14,028** | **(11,472)** | **1,423,750** | **-** | **-** | **1,423,750** | **-** |
| Others | **425** | **(425)** | **425,786** | **64,950** | **360,836** | | **-** |
| **Derivatives held as fair value hedges:** | | | | | | | |
| Special commission rate swaps | **86,254** | **(54,188)** | **3,904,331** | **-** | **187,500** | **2,254,331** | **1,462,500** |
| **Derivatives held as cash flow hedges:** | | | | | | | |
| Special commission rate swaps | **32,875** | **(34,092)** | **2,465,000** | **-** | **-** | **1,300,000** | **1,165,000** |
| Currency swaps | **8,450** | **(12,979)** | **1,071,317** | **-** | **-** | **1,071,317** | **-** |
| **Total** | **721,912** | **(604,793)** | **217,810,282** | **52,656,170** | **96,189,807** | **62,808,428** | **6,155,877** |

| 2015 SAR'000 | Positive fair value | Negative fair value | Notional amount total | Within 3 months | 3-12 months | 1-5 years | Over 5 years |
|---|---|---|---|---|---|---|---|
| Derivatives held for trading: | | | | | | | |
| Special commission rate swaps | 332,167 | (259,396) | 45,436,530 | 1,510,432 | 5,617,498 | 35,862,449 | 2,446,151 |
| Special commission rate futures and options | 34,088 | (34,088) | 2,858,426 | - | - | 226,250 | 2,632,176 |
| Spot and forward foreign exchange contracts | 56,989 | (52,287) | 12,446,528 | 7,655,619 | 3,963,409 | 827,500 | - |
| Currency options | 364,518 | (380,808) | 290,984,536 | 44,900,089 | 122,574,007 | 123,510,440 | - |
| Currency swaps | 73,874 | (74,049) | 421,414 | - | 421,414 | - | - |
| Others | 8,455 | (8,455) | 435,573 | 3,994 | 5,794 | 425,785 | - |
| Derivatives held as fair value hedges: | | | | | | | |
| Special commission rate swaps | - | (51,608) | 1,452,467 | 3 | 243,750 | 571,214 | 637,500 |
| Derivatives held as cash flow hedges: | | | | | | | |
| Special commission rate swaps | - | (33,474) | 1,100,000 | - | - | 1,100,000 | - |
| Currency swaps | 2,774 | (1,264) | 585,938 | - | - | 585,938 | - |
| Total | 872,865 | (895,429) | 355,721,412 | 54,070,137 | 132,825,872 | 163,109,576 | 5,715,827 |

The Bank enters into structured currency option products with clients which involve one or more derivatives included in the structure. In such instances, the fair value of the individual structured product represents a net valuation of the underlying derivatives. The sum of all option notionals included in each structure as of the reporting date is disclosed in the table above.

The tables below show a summary of the hedged items, the nature of the risk being hedged, the hedging instruments and their fair values.

| **2016 (SAR'000)** **Description of the hedged items:** | **Fair value** | **Hedge inception value** | **Risk** | **Hedging instrument** | **Positive fair value** | **Negative fair value** |
|---|---|---|---|---|---|---|
| Fixed commission rate investments | **3,872,738** | **3,904,682** | Fair value | Special commission rate swap | **86,254** | **(54,188)** |
| Floating commission rate investments | **2,315,251** | **2,465,270** | Cash flow | Special commission rate swap | **32,875** | **(34,092)** |
| Fixed commission rate investments | **883,189** | **883,195** | Cash flow | Currency swap | **8,450** | **(8,575)** |
| Fixed commission rate deposits | **187,500** | **187,500** | Cash flow | Currency swap | **-** | **(4,404)** |

| 2015 (SAR'000) Description of the hedged items: | Fair value | Hedge inception value | Risk | Hedging instrument | Positive fair value | Negative fair value |
|---|---|---|---|---|---|---|
| Fixed commission rate investments | 1,523,484 | 1,470,671 | Fair value | Special commission rate swap | - | (51,608) |
| Fixed commission rate loans | 3 | 3 | Fair value | Special commission rate swap | - | - |
| Floating commission rate investments | 1,055,956 | 1,100,280 | Cash flow | Special commission rate swap | - | (33,474) |
| Floating commission rate investments | 594,434 | 596,759 | Cash flow | Currency swap | 2,774 | (1,264) |

The hedge inception value has been adjusted, where necessary, to reflect book values.

The net gains on the hedging instruments for fair value hedges are SAR 83.6 million (2015: net losses SAR 20.7 million). The net losses on the hedged item attributable to the hedged risk are SAR 84.8 million (2015: net gains SAR 20.6 million).

Approximately 48% (2015: 26%) of the positive fair value of the Bank's derivatives are entered into with financial institutions and out of which 7% (2015: 5%) of the positive fair value contracts are with any individual counterparty at the reporting date.

## 11. Due to banks and other financial institutions

| | **2016 SAR'000** | 2015 SAR'000 |
|---|---|---|
| Current accounts | **2,624,448** | 1,284,625 |
| Money market deposits | **794,726** | 550,281 |
| **Total** | **3,419,174** | 1,834,906 |

Money market deposits also include deposits placed by SAMA amounting to SAR 200.0 million (2015: SAR 288.4 million).

## 12. Customers' deposits

| | 2016 SAR'000 | 2015 SAR'000 |
|---|---|---|
| Demand | **82,345,754** | 87,284,903 |
| Savings | **7,320,350** | 7,545,422 |
| Time | **49,386,046** | 51,794,969 |
| Margin deposits | **1,587,635** | 2,261,884 |
| **Total** | **140,639,785** | 148,887,178 |

Customers' deposits include SAR 79,195.3 million (2015: SAR 84,628.0 million) deposits under Shariah approved product contracts.

The above deposits include the following foreign currency deposits:

| | 2016 SAR'000 | 2015 SAR'000 |
|---|---|---|
| Demand | **10,450,712** | 12,088,428 |
| Savings | **320,548** | 210,935 |
| Time | **8,741,338** | 6,177,145 |
| Margin deposits | **730,550** | 1,147,165 |
| **Total** | **20,243,148** | 19,623,673 |

## 13. Debt securities in issue

| | 2016 SAR'000 | 2015 SAR'000 |
|---|---|---|
| SAR 1,500 million 5 year subordinated Sukuk - 2012 | **1,510,459** | 1,507,835 |
| SAR 1,500 million 7 year subordinated Sukuk - 2013 | **1,502,104** | 1,501,710 |
| SAR 1,500 million 10 year subordinated Sukuk- 2015 | **1,505,073** | 1,503,393 |
| **Total** | **4,517,636** | 4,512,938 |

***SAR 1,500 million 5 year subordinated Sukuk – 2012***

The Sukuk was issued by SABB on 28 March 2012 and matures in March 2017. The Sukuk was issued as a partial commercial exchange from senior to subordinated debt to the extent of SAR 1,000 million. The remaining portion of SAR 500 million was fully subscribed in cash.

The Sukuk carries effective special commission income at three months' SAIBOR plus 120 bps payable quarterly. The Sukuk is unsecured and is listed on the Saudi Stock Exchange (Tadawul).

***SAR 1,500 million 7 year subordinated Sukuk – 2013***

The Sukuk was issued by SABB on 17 December 2013 and matures in December 2020. This is a Basel III compliant issuance and SABB has an option to repay the Sukuk after 5 years, subject to prior approval of SAMA and terms and conditions of the agreement.

The Sukuk carries effective special commission income at six months' SAIBOR plus 140 bps payable semi-annually. The Sukuk is unsecured and is listed on the Saudi Stock Exchange (Tadawul).

***SAR 1,500 million 10 year subordinated Sukuk -2015***

The Sukuk was issued by SABB on 28 May 2015 and matures in May 2025. This is a Basel III compliant issuance and SABB has an option to repay the Sukuk after 5 years, subject to prior approval of SAMA and terms and conditions of the agreement.

The Sukuk carries effective special commission income at six months' SAIBOR plus 130 bps payable semi-annually. The Sukuk is unsecured and is listed on the Saudi Stock Exchange (Tadawul).

## 14. Borrowings

| | **2016 SAR'000** | 2015 SAR'000 |
|---|---|---|
| Borrowing from IFC | **15,663** | 46,988 |
| Syndicated Loan | **1,694,295** | - |
| **Total** | **1,709,958** | 46,988 |

Borrowing from IFC represents a 12 year amortising fixed rate loan that carries special commission at the rate of 5.11% payable semi-annually. The loan was taken on 7 July 2005 and is repayable by 15 June 2017.

Syndicated loan represents a floating rate loan obtained by the Bank on 19 October 2016 amounting to USD 450 million. The loan is unsecured and matures on 19 October 2019.

## 15. Other liabilities

| | **2016 SAR'000** | 2015 SAR'000 |
|---|---|---|
| Accounts payable | **1,122,161** | 592,537 |
| Drawings payable | **496,478** | 839,226 |
| Dividends payable | **331,191** | 199,825 |
| End of service benefits | **414,510** | 382,382 |
| Others | **1,521,280** | 1,384,477 |
| **Total** | **3,885,620** | 3,398,447 |

## 16. Share capital

The authorised, issued and fully paid share capital of SABB consists of 1,500 million shares of SAR 10 each (2015: 1,500 million shares of SAR 10 each). The ownership of the SABB's share capital is as follows:

| | **2016** | 2015 |
|---|---|---|
| Saudi shareholders | **60%** | 60% |
| HSBC Holdings BV<br>(a wholly owned subsidiary of HSBC Holdings plc) | **40%** | 40% |

## 17. Statutory reserve

In accordance with the Banking Control Law of the Kingdom of Saudi Arabia, a minimum of 25% of the net income for the year is required to be transferred to a statutory reserve until this reserve is equal to the paid up capital of SABB. Accordingly, a sum of SAR 973.7 million (2015: SAR 1,082.6 million) was transferred to statutory reserve. The statutory reserve is not currently available for distribution.

## 18. Other reserves

***Cash flow and available for sale investments***

| **2016 SAR'000** | **Cash flow hedges** | **Available for sale investments** | **Total** |
|---|---|---|---|
| Balance at beginning of the year | **(30,890)** | **(302,695)** | **(333,585)** |
| Net change in fair value | **11,326** | **405,301** | **416,627** |
| Transfer to consolidated statement of income | **(6,080)** | **(26,297)** | **(32,377)** |
| Net movement during the year | **5,246** | **379,004** | **384,250** |
| **Sub total** | **(25,644)** | **76,309** | **50,665** |
| | | | |
| Treasury shares | | | **(44,149)** |
| Employee share plan reserve | | | **17,536** |
| **Sub total** | | | **(26,613)** |
| **Balance at end of the year** | | | **24,052** |

| 2015 SAR'000 | Cash flow Hedges | Available for sale investments | Total |
|---|---|---|---|
| Balance at beginning of the year | 1,865 | 59,749 | 61,614 |
| Net change in fair value | (31,964) | (295,809) | (327,773) |
| Transfer to consolidated statement of income | (791) | (66,635) | (67,426) |
| Net movement during the year | (32,755) | (362,444) | (395,199) |
| Sub total | (30,890) | (302,695) | (333,585) |
| | | | |
| Treasury shares | | | (25,792) |
| Employee share plan reserve | | | 18,769 |
| Sub total | | | (7,023) |
| Balance at end of the year | | | (340,608) |

The discontinuation of hedge accounting during prior years resulted in reclassification of the associated cumulative gains of SAR 6.1 million (2015: SAR 0.8 million) from equity to the consolidated statement of income included in the above numbers under cash flow hedges.

## 19. Commitments and contingencies

**a) Legal proceedings**

As at 31 December 2016, there are legal proceedings outstanding against the Bank. No material provision has been made as professional advice indicates that it is not probable that any significant loss will eventuate.

**b) Capital commitments**

As at 31 December 2016, the Bank has capital commitments of SAR 241.43 million (2015: SAR 193.8 million) in respect of land, buildings and equipment purchases.

**c) Credit related commitments and contingencies**

Credit related commitments and contingencies mainly comprise guarantees, letters of credit, acceptances and commitments to extend credit. Guarantees and standby letters of credit, which represent irrevocable assurances that the Bank will make payments in the event that a customer cannot meet its obligations to third parties, carry the same credit risk as loans and advances. Documentary letters of credit, which are written undertakings by the Bank on behalf of a customer authorising a third party to draw drafts on the Bank up to a stipulated amount under specific terms and conditions, are generally collateralised by the underlying shipments of goods to which they relate and therefore have significantly less risk. Acceptances comprise undertakings by the Bank to pay bills of exchange drawn on customers. The cash requirement under these instruments is considerably less than the amount of the related commitment because the Bank generally expects the customers to fulfil their primary obligation.

Commitments to extend credit represent the unutilised portion of authorisations to extend credit, principally in the form of loans and advances, guarantees and letters of credit. With respect to credit risk on commitments to extend credit, the Bank is potentially exposed to a loss in an amount equal to the total unutilised commitments. However, the likely amount of loss, which cannot readily be quantified, is expected to be considerably less than the total unutilised commitment as most commitments to extend credit are contingent upon customers maintaining specific credit standards. The total outstanding commitments to extend credit do not necessarily represent future cash requirements, as many of the commitments could expire or be terminated without being funded.

**d)** The contractual maturity structure of the Bank’s credit related commitments and contingencies is as follows:

| **2016 SAR’000** | **Within 3 months** | **3-12 months** | **1-5 years** | **Over 5 years** | **Total** |
|---|---|---|---|---|---|
| Letters of credit | **4,835,710** | **3,693,984** | **1,574,616** | **1,115,000** | **11,219,310** |
| Guarantees | **10,239,017** | **21,815,831** | **14,994,739** | **7,948,197** | **54,997,784** |
| Acceptances | **1,682,585** | **1,456,144** | **938** | **-** | **3,139,667** |
| Irrevocable commitments to extend credit | **130,000** | **1,000,000** | **292,502** | **941,092** | **2,363,594** |
| **Total** | **16,887,312** | **27,965,959** | **16,862,795** | **10,004,289** | **71,720,355** |

| 2015 SAR’000 | Within 3 months | 3-12 months | 1-5 years | Over 5 years | Total |
|---|---|---|---|---|---|
| Letters of credit | 8,158,313 | 3,692,441 | 380,103 | 1,122,511 | 13,353,368 |
| Guarantees | 10,138,625 | 22,721,667 | 24,265,160 | 6,345,628 | 63,471,080 |
| Acceptances | 2,403,501 | 1,194,445 | 15,158 | - | 3,613,104 |
| Irrevocable commitments to extend credit | - | 1,130,000 | 829,373 | 2,136,335 | 4,095,708 |
| **Total** | 20,700,439 | 28,738,553 | 25,489,794 | 9,604,474 | 84,533,260 |

The outstanding unutilised portion of non-firm commitments, which can be revoked unilaterally at any time by the Bank, is SAR 51,739 million (2015: SAR 75,252 million).

**e)** The analysis of credit related commitments and contingencies by counterparty is as follows:

| | **2016 SAR’000** | 2015 SAR’000 |
|---|---|---|
| Government and quasi government | **2,669,792** | 2,532,751 |
| Corporate | **56,085,585** | 67,466,296 |
| Banks and other financial institutions | **12,883,545** | 14,462,283 |
| Other | **81,433** | 71,930 |
| **Total** | **71,720,355** | 84,533,260 |

**f) Operating lease commitments**

The future minimum lease payments under non-cancellable operating leases where the Bank is the lessee are as follows:

| | **2016 SAR'000** | 2015 SAR'000 |
|---|---|---|
| Less than 1 year | **16,035** | 3,216 |
| 1 to 5 years | **213,868** | 196,195 |
| Over 5 years | **129,637** | 128,877 |
| **Total** | **359,540** | 328,288 |

## 20. Net special commission income

| | **2016 SAR'000** | 2015 SAR'000 |
|---|---|---|
| **Special commission income** | | |
| Investments | | |
| – available for sale investments | **419,022** | 509,648 |
| – held at amortised cost | **113,613** | 19,771 |
| | **532,635** | 529,419 |
| Due from banks and other financial institutions | **97,009** | 10,932 |
| Loans and advances | **5,445,458** | 4,273,070 |
| **Total** | **6,075,102** | 4,813,421 |
| **Special commission expense** | | |
| Due to banks and other financial institutions | **125,911** | 27,080 |
| Customers' deposits | **1,073,562** | 397,832 |
| Debt securities in issue | **109,965** | 131,065 |
| Borrowings | **8,749** | 3,566 |
| **Total** | **1,318,187** | 559,543 |
| **Net special commission income** | **4,756,915** | 4,253,878 |

## 21. Fees and commission income, net

| | **2016 SAR'000** | 2015 SAR'000 |
|---|---|---|
| **Fee and commission income:** | | |
| - Fund management fees | **12,410** | 44,467 |
| - Trade finance | **695,328** | 822,807 |
| - Corporate finance and advisory | **144,793** | 199,872 |
| - Cards | **395,580** | 387,828 |
| - Other banking services | **409,021** | 386,228 |
| **Total fee and commission income** | **1,657,132** | 1,841,202 |

| | 2016 | 2015 |
|---|---|---|
| **Fee and commission expense:** | | |
| - Cards | **(197,145)** | (182,688) |
| - Custodial services | **(590)** | (942) |
| - Other banking services | **(118,554)** | (107,301) |
| **Total fee and commission expense** | **(316,289)** | (290,931) |
| **Fees and commission income, net** | **1,340,843** | 1,550,271 |

## 22. Trading income, net

| | 2016 SAR'000 | 2015 SAR'000 |
|---|---|---|
| Foreign exchange income, net | **195,310** | 186,040 |
| Derivatives | **66,448** | 66,679 |
| Debt securities | **(267)** | (232) |
| Others | **157** | (105) |
| **Total** | **261,648** | 252,382 |

## 23. Gains on non-trading investments, net

| | 2016 SAR'000 | 2015 SAR'000 |
|---|---|---|
| Available for sale investments | **26,297** | 66,634 |

## 24. Salaries and employee related expenses

| | 2016 SAR'000 | 2015 SAR'000 |
|---|---|---|
| Salaries and allowance | **739,351** | 717,890 |
| Housing allowance | **123,332** | 120,313 |
| End of service benefits | **53,464** | 66,390 |
| Others | **312,811** | 348,132 |
| **Total** | **1,228,958** | 1,252,725 |

### a) Quantitative Disclosure

The following table summarizes the Bank's employee categories defined in accordance with SAMA's rules on compensation practices and includes the total amounts of fixed and variable compensation paid to employees during the year ended 31 December 2016 and 31 December 2015, and the forms of such payments.

| **2016** | | **Fixed** | **Variable compensation paid in 2016** | | |
|---|---|---|---|---|---|
| **Category** | **Number of Employees** | **compensation SAR'000** | **Cash SAR'000** | **Shares SAR'000** | **Total SAR'000** |
| Senior executives requiring SAMA no objection | **20** | **32,061** | **24,224** | **10,227** | **34,451** |
| Employees engaged in risk taking activities | **554** | **176,745** | **60,388** | **7,070** | **67,458** |
| Employees engaged in control functions | **296** | **99,839** | **21,836** | **1,535** | **23,371** |
| Other employees | **2,716** | **480,039** | **72,166** | **1,718** | **73,884** |
| Outsourced employees | **493** | **39,731** | **5,566** | **-** | **5,566** |
| **Total** | **4,079** | **828,415** | **184,180** | **20,550** | **204,730** |

| | |
|---|---|
| Variable compensation accrued in 2016 | **197,836** |
| Other employee related benefits | **202,707** |
| Total salaries and employee related expenses | **1,228,958** |

| 2015 | | Fixed | Variable compensation paid in 2015 | | |
|---|---|---|---|---|---|
| Category | Number of employees | compensation SAR'000 | Cash SAR'000 | Shares SAR'000 | Total SAR'000 |
| Senior executives requiring SAMA no objection | 16 | 26,155 | 14,561 | 6,685 | 21,246 |
| Employees engaged in risk taking activities | 547 | 176,207 | 59,980 | 4,872 | 64,852 |
| Employees engaged in control functions | 272 | 93,986 | 22,492 | 1,490 | 23,982 |
| Other employees | 2,616 | 474,502 | 82,587 | 300 | 82,887 |
| Outsourced employees | 404 | 29,998 | 8,364 | - | 8,364 |
| Total | 3,855 | 800,848 | 187,984 | 13,347 | 201,331 |

| | |
|---|---|
| Variable compensation accrued in 2015 | 213,719 |
| Other employee related benefits | 238,158 |
| Total salaries and employee related expenses | 1,252,725 |

***Senior executives (requiring SAMA no objection):***
This comprises senior management having responsibility and authority for formulating strategies, directing and controlling the activities of the Bank whose appointment requires no objection from SAMA. This covers the Managing Director and other executives directly reporting to him.

***Employees engaged in risk taking activities:***
This comprises of management staff within the business lines (Corporate, Trade Services, Private Banking and Treasury employees), who are responsible for executing and implementing the business strategy on behalf of the Bank. This also includes those involved in recommending and evaluating credit limits and credit worthiness, pricing of loans, undertaking and executing business proposals and treasury dealing activities.

***Employees engaged in control functions:***
This refers to employees working in divisions that are not involved in risk taking activities but engaged in review functions (Risk Management, Compliance, Internal Audit, Treasury Operation, Amanah Islamic Banking Services, Finance and Accounting). These functions are fully independent from risk taking units.
***Other employees:***
This includes all other employees of the Bank, excluding those already reported under categories mentioned above.

***Outsourced employees:***
This includes staff employed by various agencies who supply services to the Bank on a full-time basis in non-critical roles. None of these roles require risk undertaking or control.

**b) Qualitative Disclosure**

***Compensation disclosure for the Annual Financial Statements***
SAMA being the Banking industry regulator for the Kingdom of Saudi Arabia has issued its Rules on compensation practices. In compliance with the SAMA Rules on compensation practices, a compensation policy endorsed by Nomination and Remuneration Committee and approved by the Board of Directors has been formulated and implemented.

***SABB Compensation Policy***

*i. Policy Objectives*
The policy sets the guidelines as to how both fixed and variable pay will be managed at SABB. The scope of policy covers the following: all categories of employees; its subsidiaries; all compensation elements; key determinants of compensation; approval process; reporting processes; bonus deferral process; share retention and relevant stakeholder's roles and responsibilities.

The objectives of the policy are to: align the reward practices with the Bank's strategy & values so as to support the successful execution of the strategy in a risk compliant manner; offer an attractive employee value proposition to attract, retain and motivate competent and committed people; and ensure the financial sustainability of SABB.

*ii. Compensation Structure*
SABB's compensation operates on a Total Package basis that is benchmarked to market data from peers in the appropriate industry. Total Package comprises of the following blend of fixed and variable compensation elements: salaries, allowances; benefits; annual bonuses; short-term incentives; and long-term incentives.

*iii. Performance Management System*
The performance of all employees is evaluated against agreed targets using a Performance Scorecard methodology, financial, customer, process and people. A calibration process is applied to ensure fair and equitable performance evaluation. The performance management methodology at SABB focuses on the differentiation of individual performance and drives the variable reward strategy which encourages high performance within a risk compliant manner.

*iv. Risk-adjustment for Variable Pay schemes*
The Bank has reviewed all its variable pay schemes, with the assistance of external remuneration consultants, to ensure that any bonus pay pools have taken into account all relevant risks. The determination of bonus pools is based on appropriate performance factors adjusted for risk. The bonus pool for the Control functions have been ring fenced from short term profits in alignment with SAMA regulations.

*v. Bonus Deferral*
Bonus deferral in the form of equity applies to all employees who are either subject to SAMA "No Objection" and /or undertake or control significant risk undertaking by the Bank. Bonuses of all these employees will be subject to deferral over a three year vesting period. The vesting will be subject to malus conditions.

*vi. Nomination and Remuneration Committee*
The Nomination and Remuneration Committee has oversight of the remuneration structures and policies for all employees to ensure that: all performance based bonuses are adjusted for risk, compensation structures are regulatory compliant, and effective in achieving its stated objectives.

**c) Share based bonus payments**

The Bank has Share Based Equity settled Bonus payment plans outstanding at the end of the year. Under the terms of these plans, eligible employees of the Bank are offered shares at a predetermined price for a fixed period of time. At the vesting dates determined under the terms of the plan, the Bank delivers the underlying allotted shares to the employees, subject to the satisfactory completion of the vesting conditions. The cost of the plans is recognized over the period in which the service condition is fulfilled, ending on the date on which the relevant employees become fully entitled to the shares ('the vesting date'). The cumulative expense recognized for these plans at each reporting date until the vesting date, reflects the extent to which the vesting period has expired and the Bank's best estimate of the number of equity instruments that will ultimately vest.

The movement in in the number of shares under Share Based Equity settled Bonus payment plans is as follows:

| | **Number of shares** | |
|---|---|---|
| | **2016** | 2015 |
| Beginning of the year | **648,351** | 566,575 |
| Forfeited | **(37,132)** | (25,314) |
| Exercised/Expired | **(310,882)** | (354,890) |
| Granted during the year | **618,765** | 461,980 |
| End of the year | **919,102** | 648,351 |

The weighted average price of shares granted during the year was SAR 21.41 (2015: SAR 29.86).

## 25. Basic and diluted earnings per share

Basic and diluted earnings per share for the year ended 31 December 2016 and 2015 is calculated by dividing the net income for the year attributable to the equity holders by the weighted average number of issued shares.

## 26. Gross dividend, Zakat and income tax

The Board of Directors has proposed a gross final dividend of SAR 570.0 million for the year 2016 (2015: SAR 570.0 million). During 2016, an interim dividend of SAR 585.0 million (2015: SAR 675.0 million) was also proposed and paid. Dividends will be paid to the Saudi and non-Saudi shareholders after deduction of Zakat and income tax respectively as follows:

***Saudi shareholders:***
Zakat attributable to the Saudi shareholders for the year amounted to approximately SAR 60.3 million (2015: SAR 64.8 million) which will be deducted from their share of dividend, resulting in a net dividend to Saudi Shareholders of SAR 0.70 per share (2015: SAR 0.75 per share).

***Non Saudi shareholders***
Income tax attributable to the foreign shareholder on its current year's share of income is approximately SAR 313.7 million (2015: SAR 340.4 million).

The share of dividend of HSBC Holdings BV will be paid after deducting the related taxes due.

***Status of Zakat and Income Tax assessments***
The Bank has filed its Zakat and Income Tax returns with the General Authority of Zakat and Tax (GAZT) and paid Zakat and Income Tax for financial years up to and including the year 2015 and has received the assessments for the years up to 2009 in which the GAZT raised additional demands aggregating to SAR 487 million for the years 2005 to 2009. This liability has further reduced to SR 433 million based on the favourable decision rendered by Preliminary Appeal Committee for Zakat and Tax Matters (PAC) on certain items contested by Bank. These additional demands include SAR 413 million on account of "disallowance of long-term investments and the addition of long term financing to the Zakat base by the GAZT". The basis for the additional Zakat liability is being contested by the Bank before the Higher Appeal Committee for Zakat and Tax Matters (HAC). Management is confident of a favourable outcome on the aforementioned appeals and have therefore not made any provisions in respect of the above.

The assessments for the years 2010 to 2015 are yet to be raised by the GAZT. However, if long-term investments are disallowed and long-term financing is added to the Zakat base, in line with the assessments finalized by GAZT for the years referred to above, it would result in significant additional zakat exposure to the Bank which remains an industry wide issue and disclosure of which might affect the Bank's position in this matter.

## 27. Cash and cash equivalents

Cash and cash equivalents included in the consolidated statement of cash flows comprise the following:

| | **2016 SAR'000** | 2015 SAR'000 |
|---|---|---|
| Cash and balances with SAMA excluding the statutory deposit amounting to SAR 8,853 million (2015: SAR 9,056 million) (note 3) | **15,268,906** | 1,885,901 |
| Due from banks and other financial institutions with an original maturity of three months or less from date of the acquisition | **7,689,871** | 11,452,326 |
| **Total** | **22,958,777** | 13,338,227 |

## 28. Operating segments

The Bank's primary business is conducted in Saudi Arabia.

Transactions between the operating segments are on normal commercial terms and conditions. Segment assets and liabilities comprise operating assets and liabilities, being the majority of the balance.

### a) The Bank's reportable segments are as follows:

**Retail Banking** –caters mainly to the banking requirements of personal and private banking customers.

**Corporate Banking** –caters mainly to the banking requirements of commercial and corporate banking customers.

**Treasury** –manages the Bank's liquidity, currency and special commission rate risks. It is also responsible for funding the Bank's operations and managing the Bank's investment portfolio and liquidity position.

**Others –** includes activities of investment in a joint venture and an associate.

Transactions between the operating segments are reported as recorded by the Bank's transfer pricing system. The Bank's total assets and liabilities as at 31 December 2016 and 2015, its total operating income and expenses, and the results for the years then ended, by operating segment, are as follows:

| **2016 SAR'000** | **Retail Banking** | **Corporate Banking** | **Treasury** | **Others** | **Total** |
|---|---|---|---|---|---|
| Total assets | **31,751,274** | **93,094,359** | **60,567,964** | **642,297** | **186,055,894** |
| Total liabilities | **62,549,688** | **69,843,491** | **22,383,787** | **-** | **154,776,966** |
| Investment in a joint venture and an associate | **-** | **-** | **-** | **642,297** | **642,297** |
| Total operating income | **2,364,546** | **3,167,932** | **1,376,126** | **-** | **6,908,604** |
| Total operating expenses | **1,623,389** | **1,296,922** | **157,339** | **-** | **3,077,650** |
| Share in earnings of joint venture and associate | **-** | **-** | **-** | **63,777** | **63,777** |
| Net income for the year | **741,157** | **1,871,010** | **1,218,787** | **63,777** | **3,894,731** |
| Net special commission income | **1,865,335** | **2,027,300** | **864,280** | **-** | **4,756,915** |
| Fees and commission income, net | **374,440** | **961,060** | **5,343** | **-** | **1,340,843** |
| Trading income, net | **-** | **23,782** | **237,866** | **-** | **261,648** |
| Credit losses and impairment provision, net | **407,593** | **582,866** | **3,641** | **-** | **994,100** |

| 2015<br>SAR'000 | Retail Banking | Corporate Banking | Treasury | Others | Total |
|---|---|---|---|---|---|
| Total assets | 33,000,077 | 96,850,258 | 57,206,853 | 693,235 | 187,750,423 |
| Total liabilities | 61,345,170 | 75,311,894 | 22,918,822 | - | 159,575,886 |
| Investment in a joint venture and an associate | - | - | - | 693,235 | 693,235 |
| Total operating income | 2,311,689 | 2,970,362 | 1,348,576 | - | 6,630,627 |
| Total operating expenses | 1,465,074 | 829,361 | 135,990 | - | 2,430,425 |
| Share in earnings of joint venture and associate | - | - | - | 130,345 | 130,345 |
| Net income for the year | 846,615 | 2,141,001 | 1,212,586 | 130,345 | 4,330,547 |
| Net special commission income | 1,638,171 | 1,797,451 | 818,256 | - | 4,253,878 |
| Fees and commission income, net | 411,090 | 1,140,138 | (957) | - | 1,550,271 |
| Trading income, net | - | 30,337 | 222,045 | - | 252,382 |
| Credit losses and impairment provision, net | 269,144 | 160,572 | (9,631) | - | 420,085 |

**b) Total operating income by operating segments**

| **31 December 2016 SAR'000 (Unaudited)** | **Retail Banking** | **Corporate Banking** | **Treasury** | **Total** |
|---|---|---|---|---|
| **External** | **2,224,226** | **4,240,478** | **443,900** | **6,908,604** |
| **Internal** | **140,320** | **(1,072,546)** | **932,226** | **-** |
| **Total operating income** | **2,364,546** | **3,167,932** | **1,376,126** | **6,908,604** |

| 31 December 2015 SAR'000 (Unaudited) | Retail Banking | Corporate Banking | Treasury | Total |
|---|---|---|---|---|
| External | 2,390,998 | 3,680,958 | 558,671 | 6,630,627 |
| Internal | (79,309) | (710,596) | 789,905 | - |
| Total operating income | 2,311,689 | 2,970,362 | 1,348,576 | 6,630,627 |

**c) The Bank's credit exposure by operating segment is as follows:**

| **2016 SAR'000** | **Retail Banking** | **Corporate Banking** | **Treasury** | **Total** |
|---|---|---|---|---|
| Assets | **29,326,780** | **91,638,035** | **59,110,084** | **180,074,899** |
| Commitments and contingencies | **71,948** | **33,653,270** | **-** | **33,725,218** |
| Derivatives | **-** | **-** | **1,832,448** | **1,832,448** |
| **Total** | **29,398,728** | **125,291,305** | **60,942,532** | **215,632,565** |

| 2015 SAR'000 | Retail Banking | Corporate Banking | Treasury | Total |
|---|---|---|---|---|
| Assets | 30,319,292 | 95,627,344 | 55,370,125 | 181,316,761 |
| Commitments and contingencies | 85,321 | 39,642,851 | - | 39,728,172 |
| Derivatives | - | - | 2,303,539 | 2,303,539 |
| Total | 30,404,613 | 135,270,195 | 57,673,664 | 223,348,472 |

Credit exposure comprises the carrying value of assets excluding cash, property and equipment, other assets, investment in joint venture and associate and equity investments, and the credit equivalent value for commitments, contingencies and derivatives based on the credit conversion factor as prescribed by the SAMA.

## 29. Credit risk

The Board of Directors is responsible for the overall risk management approach within SABB and for reviewing its effectiveness.

The Board's designated committee for risk matters is the Board Risk Committee which approves and provides oversight for the Bank's risk framework, plans and performance targets, which include the establishment of risk appetite statements, risk management strategies, the appointment of senior officers, the delegation of authorities for credit and other risks and the establishment of effective control procedures.

The Bank manages exposure to credit risk, which is the risk that one party to a financial instrument will fail to discharge an obligation and cause the other party to incur a financial loss. Credit exposures arise principally in lending activities that lead to loans and advances, and investment activities. There is also credit risk on credit related commitments and contingencies and derivatives.

The Bank assesses the probability of default of counterparties using internal rating tools. Also the Bank uses external ratings, of major rating agencies, where available.

The Bank attempts to control credit risk by monitoring credit exposures, limiting transactions with specific counterparties, and continually assessing the creditworthiness of counterparties. The Bank's risk management policies are designed to identify and to set appropriate risk limits and to monitor the risks and adherence to limits. Actual exposures against limits are monitored daily. In addition to monitoring credit limits, the Bank manages the credit exposure relating to its trading activities by entering into master netting agreements and collateral arrangements with counterparties in appropriate circumstances, and limiting the duration of exposure. In certain cases the Bank may also close out transactions to mitigate credit risk. The Bank's credit risk for derivatives, represents the potential cost to replace the derivative contracts if counterparties fail to fulfil their obligation. To control the level of credit risk taken, the Bank assesses counterparties using the same techniques as for its lending activities.

Concentrations of credit risk arise when a number of counterparties are engaged in similar business activities, or activities in the same geographic region, or have similar economic features that would cause their ability to meet contractual obligations to be similarly affected by changes in economic, political or other conditions.

Concentrations of credit risk indicate the relative sensitivity of the Bank's performance to developments affecting a particular industry or geographical location.

The Bank seeks to manage its credit risk exposure through diversification of lending activities to ensure that there is no undue concentration of risks with individuals or groups of customers in specific locations or business. It also takes security when appropriate. The Bank also seeks additional collateral from the counterparty as soon as impairment indicators are noticed for the relevant individual loans and advances.

Management monitors the market value of collateral and requests additional collateral in accordance with the underlying agreements. It also monitors the market value of collateral obtained during its review of the adequacy of the provision for credit losses.

The Bank regularly reviews its risk management policies and systems to reflect changes in market's products and emerging best practice.

The debt securities included in the investment portfolio are mainly sovereign risk. Analysis of investments by counter-party is provided in note 5. For details of the composition of loans and advances refer to note 6. Information on credit risk relating to derivative instruments is provided in note 10 and for commitments and contingencies in note 19. The information on Bank's maximum credit exposure by operating segment is given in note 28.

**a) Geographical concentration of assets, liabilities, commitments and contingencies, and credit exposure**

| 2016 SAR'000 | Kingdom of Saudi Arabia | GCC and Middle East | Europe | North America | Other Countries | Total |
|---|---|---|---|---|---|---|
| **Assets** | | | | | | |
| Cash and balances with SAMA | | | | | | |
| Cash in hand | 1,444,680 | - | - | - | - | 1,444,680 |
| Balances with SAMA | 22,398,068 | - | - | - | - | 22,398,068 |
| Other balances | 279,073 | - | - | - | - | 279,073 |
| Due from banks and other financial institutions | | | | | | |
| Current accounts | 2,035 | 86,174 | 1,488,611 | 4,861,975 | 66,076 | 6,504,871 |
| Money market placements | 520,890 | 1,034,216 | 157,769 | - | - | 1,712,875 |
| Investments, net | | | | | | |
| Available for sale | 15,793,949 | 3,203,490 | 602,050 | 2,422,827 | 985,495 | 23,007,811 |
| Amortised Cost | 6,265,244 | - | - | - | - | 6,265,244 |
| Positive fair value of derivatives | | | | | | |
| Held for trading | 358,426 | 32,228 | 203,675 | - | 4 | 594,333 |
| Held as fair value hedges | - | 649 | 85,605 | - | - | 86,254 |
| Held as cash flow hedges | 5,050 | 19,563 | 16,712 | - | - | 41,325 |
| Loans and advances, net | | | | | | |
| Credit Cards | 2,210,011 | - | - | - | - | 2,210,011 |
| Consumer Loans | 24,145,266 | - | - | - | - | 24,145,266 |
| Commercial Loans | 94,056,828 | 214,571 | 328,125 | 10,014 | - | 94,609,538 |
| Investment in a joint venture and associate | 642,297 | - | - | - | - | 642,297 |
| Property and equipment, net | 1,038,352 | - | - | - | - | 1,038,352 |
| Other assets | 1,075,896 | - | - | - | - | 1,075,896 |
| **Total** | 170,236,065 | 4,590,891 | 2,882,547 | 7,294,816 | 1,051,575 | 186,055,894 |
| **Liabilities** | | | | | | |
| Due to banks and other financial institutions | | | | | | |
| Current accounts | 194,601 | 247,086 | 594,692 | 1,570,193 | 17,876 | 2,624,448 |
| Money market deposits | 202,092 | 592,634 | - | - | - | 794,726 |
| Customer deposits | | | | | | |
| Demand | 81,680,986 | 4,117 | 620,945 | 8,775 | 30,931 | 82,345,754 |
| Saving | 7,318,311 | 2,039 | - | - | - | 7,320,350 |
| Time | 48,379,359 | - | 926,935 | 18,792 | 60,960 | 49,386,046 |
| Margin Deposits | 1,587,635 | - | - | - | | 1,587,635 |
| Debt securities in issue | 4,517,636 | | | | | 4,517,636 |
| Borrowings | - | - | 1,709,958 | - | - | 1,709,958 |
| Negative fair value of derivatives | | | | | | |
| Held for trading | 144,433 | 69,779 | 289,322 | - | - | 503,534 |
| Held as fair value hedges | - | - | 54,188 | - | - | 54,188 |
| Held as cash flow hedges | - | 10,977 | 36,094 | - | - | 47,071 |
| Other liabilities | 3,885,620 | - | - | - | - | 3,885,620 |
| **Total** | 147,910,673 | 926,632 | 4,232,134 | 1,597,760 | 109,767 | 154,776,966 |
| **Commitments and contingencies** | 60,327,209 | 983,785 | 4,161,724 | 1,272,506 | 4,975,131 | 71,720,355 |

| **Credit exposure (stated at credit equivalent amounts)** | | | | | | |
|---|---|---|---|---|---|---|
| Assets | **164,599,518** | **4,539,570** | **4,238,843** | **5,648,738** | **1,048,230** | **180,074,899** |
| Commitments and contingencies | **28,239,980** | **481,883** | **2,065,426** | **500,988** | **2,436,941** | **33,725,218** |
| Derivatives | **763,978** | **205,834** | **845,683** | **-** | **16,953** | **1,832,448** |
| **Total credit exposure** | **193,603,476** | **5,227,287** | **7,149,952** | **6,149,726** | **3,502,124** | **215,632,565** |

| 2015<br>SAR'000 | Kingdom of Saudi Arabia | GCC and Middle East | Europe | North America | Other Countries | Total |
|---|---|---|---|---|---|---|
| Assets | | | | | | |
| Cash and balances with SAMA | | | | | | |
| Cash in hand | 1,520,252 | - | - | - | - | 1,520,252 |
| Balances with SAMA | 9,207,361 | - | - | - | - | 9,207,361 |
| Other balances | 214,655 | - | - | - | - | 214,655 |
| Due from banks and other financial institutions | | | | | | |
| Current accounts | - | 90,939 | 1,938,547 | 5,592,991 | 54,628 | 7,677,105 |
| Money market placements | 2,450,652 | 1,325,221 | - | - | - | 3,775,873 |
| Investments, net | | | | | | |
| Available for sale | 25,311,302 | 5,675,113 | 468,003 | 43,440 | 359,545 | 31,857,403 |
| Amortised Cost | 3,669,642 | - | - | - | - | 3,669,642 |
| Positive fair value of derivatives | | | | | | |
| Held for trading | 699,691 | 22,682 | 147,717 | - | - | 870,090 |
| Held as fair value hedges | - | - | - | - | - | - |
| Held as cash flow hedges | - | 2,752 | 23 | - | - | 2,775 |
| Loans and advances, net | | | | | | |
| Credit Cards | 2,084,543 | - | - | - | - | 2,084,543 |
| Consumer Loans | 25,262,809 | - | - | - | - | 25,262,809 |
| Commercial Loans | 97,884,986 | 375,000 | 318,750 | 20,548 | - | 98,599,284 |
| Investment in a joint venture and associate | 693,235 | - | - | - | - | 693,235 |
| Property and equipment, net | 991,455 | - | - | - | - | 991,455 |
| Other assets | 1,323,941 | - | - | - | - | 1,323,941 |
| Total | 171,314,524 | 7,491,707 | 2,873,040 | 5,656,979 | 414,173 | 187,750,423 |
| Liabilities | | | | | | |
| Due to banks and other financial institutions | | | | | | |
| Current accounts | - | 519,393 | 578,749 | 161,905 | 24,578 | 1,284,625 |
| Money market deposits | 296,514 | 253,767 | - | - | - | 550,281 |
| Customer deposits | | | | | | |
| Demand | 87,050,947 | 4,477 | 187,165 | 9,358 | 32,956 | 87,284,903 |
| Saving | 7,545,320 | 102 | - | - | - | 7,545,422 |
| Time | 50,984,296 | 1,639 | 738,531 | 15,447 | 55,056 | 51,794,969 |
| Margin Deposits | 2,261,884 | - | - | - | - | 2,261,884 |
| Debt securities in issue | 4,512,938 | - | - | - | - | 4,512,938 |
| Borrowings | - | - | 46,988 | - | - | 46,988 |
| Negative fair value of derivatives | | | | | | |

| | | | | | | |
|---|---|---|---|---|---|---|
| Held for trading | 123,483 | 104,981 | 508,272 | 295 | 72,054 | 809,085 |
| Held as fair value hedges | - | - | 51,608 | - | - | 51,608 |
| Held as cash flow hedges | - | - | 34,736 | - | - | 34,736 |
| Other liabilities | 3,398,447 | - | - | - | - | 3,398,447 |
| Total | 156,173,829 | 884,359 | 2,146,049 | 187,005 | 184,644 | 159,575,886 |
| Commitments and contingencies | 71,464,891 | 1,361,117 | 4,703,690 | 1,510,942 | 5,492,620 | 84,533,260 |
| Credit exposure (stated at credit equivalent amounts) | | | | | | |
| Assets | 164,847,467 | 7,405,968 | 2,723,972 | 5,656,856 | 682,498 | 181,316,761 |
| Commitments and contingencies | 29,813,723 | 660,126 | 2,321,538 | 500,320 | 2,689,290 | 35,984,997 |
| Derivatives | 1,641,852 | 136,423 | 514,748 | - | 10,516 | 2,303,539 |
| Total credit exposure | 196,303,042 | 8,202,517 | 5,560,258 | 6,157,176 | 3,382,304 | 219,605,297 |

**b) The distributions by geographical concentration of impaired loans and advances and provision for credit losses are as follows:**

| **2016 SAR'000** | **Saudi Arabia** | **GCC and Middle East** | **Europe** | **North America** | **Other Countries** | **Total** |
|---|---|---|---|---|---|---|
| **Non-performing loans, net** | **1,655,479** | **-** | **-** | **-** | **-** | **1,655,479** |
| **Provision for credit loss** | **2,889,711** | **-** | **-** | **-** | **-** | **2,889,711** |

| 2015 SAR'000 | Saudi Arabia | GCC and Middle East | Europe | North America | Other Countries | Total |
|---|---|---|---|---|---|---|
| Non-performing loans, net | 1,517,272 | - | - | - | - | 1,517,272 |
| Provision for credit loss | 2,486,546 | - | - | - | - | 2,486,546 |

## 30. Market risk

Market Risk is the risk that the fair value or future cash flows of financial instruments will fluctuate due to changes in market variables such as special commission rates, foreign exchange rates, and equity prices. The Bank classifies exposures to market risk into either trading and non-trading or banking-book.

Market Risk exposures in the trading book are restricted to derivatives classified as held for trading as disclosed in these financial statements. Market Risk exposures in the non-trading or banking book arise on special commission rate risk and equity price risk as disclosed in part b) of this disclosure.

The market risk for the trading book is managed and monitored using Value at Risk (VAR) methodology. Market risk for non-trading book is managed and monitored using a combination of VAR, stress testing and sensitivity analysis.

### a) Market risk-trading book

The Board has set limits for the acceptable level of risks in managing the trading book. The Bank applies a VAR methodology to assess the market risk positions held and to estimate the potential economic loss based upon a number of parameters and assumptions for change in market conditions.

A VAR methodology estimates the potential negative change in market value of a portfolio at a given confidence level and over a specified time horizon. The Bank uses simulation models to assess the possible changes in the market value of the trading book based on historical data. VAR models are usually designed to measure the market risk in a normal market environment and therefore the use of VAR has limitations because it is based on historical correlations and volatilities in market prices and assumes that the future movements will follow a statistical distribution.

The VAR that the Bank measures is an estimate, using a confidence level of 99% of the potential loss that is not expected to be exceeded if the current market positions were to be held unchanged for one day. The use of 99% confidence level depicts that within a one-day horizon, losses exceeding VAR figure should occur, on average, not more than once every hundred days.

The VAR represents the risk of portfolios at the close of a business day, and it does not account for any losses that may occur beyond the defined confidence interval. The actual trading results however, may differ from the VAR calculations and, in particular, the calculation does not provide a meaningful indication of profits and losses in stressed market conditions.

To overcome the VAR limitations mentioned above, the Bank also carries out stress tests of its portfolio to simulate conditions outside normal confidence intervals. The potential losses occurring under stress test conditions are reported regularly to the Bank's ALCO committee for their review.

The Bank's VAR related information is as under.

| | | | **SAR'000** |
|---|---|---|---|
| **2016** | **Foreign exchange** | **Special commission rate** | **Overall risk** |
| VAR as at 31December 2016 | **1,492** | **6,693** | **7,084** |
| Average VAR for 2016 | **568** | **4,210** | **4,268** |
| Minimum VAR for 2016 | **13** | **508** | **562** |
| Maximum VAR for 2016 | **2,326** | **11,374** | **11,398** |

| | | | SAR'000 |
|---|---|---|---|
| 2015 | Foreign exchange | Special commission rate | Overall risk |
| VAR as at 31December 2015 | 474 | 562 | 650 |
| Average VAR for 2015 | 300 | 444 | 608 |
| Minimum VAR for 2015 | 11 | 51 | 115 |
| Maximum VAR for 2015 | 1,966 | 1,062 | 2,437 |

**b) Market risk – non trading or banking book**

Market risk on non-trading or banking positions mainly arises from the special commission rate, foreign currency exposures and equity price changes.

***i) Special commission rate risk***

Special commission rate risk arises from the possibility that the changes in commission rates will affect either the fair values or the future cash flows of the financial instruments. The Board has established commission rate gap limits for stipulated periods. The Bank monitors positions daily and uses hedging strategies to ensure maintenance of positions within the established gap limits.

The following table depicts the sensitivity to a reasonably possible change in commission rates, with other variables held constant, on the Bank's consolidated statement of income or equity. The sensitivity of the income is the effect of the assumed changes in commission rates on the net special commission income for one year, based on the floating rate non-trading financial assets and financial liabilities repricing as at 31 December 2016, including the effect of hedging instruments. The sensitivity of equity is calculated by revaluing the fixed rate available for sale financial assets; including the effect of any associated hedges as at 31 December 2016 for the effect of assumed changes in commission rates. The sensitivity of equity is analysed by maturity period of the asset or swap and represent only those exposures that directly impact OCI of the Bank.

**2016** **SAR' 000**

| **Currency** | **Increase in basis points** | **Sensitivity of Special Commission Income** | **Sensitivity of Equity** | | | | |
|---|---|---|---|---|---|---|---|
| | | | **6months or less** | **1 year or less** | **1-5 years or less** | **Over 5 years** | **Total** |
| **SAR** | **+ 100** | **39,050** | **(3,724)** | **(6,598)** | **(32,153)** | **(23,716)** | **(66,191)** |
| **USD** | **+ 100** | **20,323** | **(2,954)** | **(1,142)** | **(172,664)** | **(94,914)** | **(271,674)** |
| **EUR** | **+ 100** | **1,024** | **(5)** | **(75)** | **(10,117)** | **97** | **(10,100)** |
| **Others** | **+ 100** | **1** | **(106)** | **-** | **-** | **-** | **(106)** |

**2016** **SAR '000**

| **Currency** | **Decrease in basis points** | **Sensitivity of Special Commission Income** | **Sensitivity of Equity** | | | | |
|---|---|---|---|---|---|---|---|
| | | | **6months or less** | **1 year or less** | **1-5 years or less** | **Over 5 years** | **Total** |
| **SAR** | **- 100** | **(39,050)** | **3,724** | **6,598** | **32,153** | **23,716** | **66,191** |
| **USD** | **- 100** | **(20,323)** | **2,954** | **1,142** | **172,664** | **94,914** | **271,674** |
| **EUR** | **- 100** | **(1,024)** | **5** | **75** | **10,117** | **(97)** | **10,100** |
| **Others** | **- 100** | **(1)** | **106** | **-** | **-** | **-** | **106** |

2015 SAR' 000

| Currency | Increase in basis points | Sensitivity of Special Commission Income | Sensitivity of Equity | | | | |
|---|---|---|---|---|---|---|---|
| | | | 6months or less | 1 year or less | 1-5 years or less | Over 5 years | Total |
| SAR | + 100 | (49,847) | (38,820) | (5,492) | (28,846) | - | (73,158) |
| USD | + 100 | 13,783 | (22,550) | (26,310) | (69,503) | (2,361) | (120,724) |
| EUR | + 100 | 1,069 | (1,815) | (1,659) | (11,613) | (416) | (15,503) |
| Others | + 100 | 17 | - | - | - | - | - |

| 2015 | | | | | | | SAR '000 |
|---|---|---|---|---|---|---|---|
| Currency | Decrease in basis points | Sensitivity of Special Commission Income | Sensitivity of Equity | | | | |
| | | | 6months or less | 1 year or less | 1-5 years or less | Over 5 years | Total |
| SAR | - 100 | 49,847 | 38,820 | 5,492 | 28,846 | - | 73,158 |
| USD | - 100 | (13,783) | 22,550 | 26,310 | 69,503 | 2,361 | 120,724 |
| EUR | - 100 | (1,069) | 1,815 | 1,659 | 11,613 | 416 | 15,503 |
| Others | - 100 | (17) | - | - | - | - | - |

The Bank is exposed to risks associated with fluctuations in the levels of market special commission rates. The table below summarises the Bank's exposure to special commission rate risks. Included in the table are the Bank's assets and liabilities at carrying amounts, categorised by the earlier of the contractual repricing or the maturity dates. The Bank is exposed to special commission rate risks as a result of mismatches or gaps in the amounts of assets and liabilities and derivative financial instruments that reprice or mature in a given period. The Bank manages this risk by matching the repricing of assets and liabilities through risk management strategies.

| **2016 SAR'000** | **Within 3 months** | **3-12 months** | **1-5 years** | **Over 5 years** | **Non special commission bearing** | **Total** |
|---|---|---|---|---|---|---|
| **Assets** | | | | | | |
| Cash and balances with SAMA | | | | | | |
| Cash in hand | - | - | - | - | **1,444,680** | **1,444,680** |
| Balances with SAMA | **13,545,153** | - | - | - | **8,852,915** | **22,398,068** |
| Other balances | - | - | - | - | **279,073** | **279,073** |
| Due from banks and other financial institutions | | | | | | |
| Current accounts | - | - | - | - | **6,504,871** | **6,504,871** |
| Money market placements | **1,712,875** | - | - | - | - | **1,712,875** |
| Investments, net | | | | | | |
| Available for sale | **12,155,818** | **3,259,574** | **4,684,769** | **1,849,793** | **1,057,857** | **23,007,811** |
| Amortised cost | **2,615,440** | - | **3,149,838** | **499,966** | - | **6,265,244** |
| Positive fair value of derivatives | | | | | | |
| Held for trading | - | - | - | - | **594,333** | **594,333** |
| Held as fair value hedges | - | - | - | - | **86,254** | **86,254** |
| Held as cash flow hedges | - | - | - | - | **41,325** | **41,325** |
| Loans and advances, net | | | | | | |
| Credit cards | **2,210,011** | - | - | - | - | **2,210,011** |
| Consumer loans | **50,608** | **313,238** | **13,774,452** | **10,006,968** | - | **24,145,266** |
| Commercial loans | **63,885,759** | **23,955,833** | **6,234,667** | **533,279** | - | **94,609,538** |
| Investment in a joint venture and associate | - | - | - | - | **642,297** | **642,297** |
| Property and equipment, net | - | - | - | - | **1,038,352** | **1,038,352** |
| Other assets | - | - | - | - | **1,075,896** | **1,075,896** |
| **Total assets** | **96,175,664** | **27,528,645** | **27,843,726** | **12,890,006** | **21,617,853** | **186,055,894** |

| | | | | | | |
|---|---|---|---|---|---|---|
| **Liabilities and shareholders' equity** | | | | | | |
| Due to banks and other financial institutions | | | | | | |
| Current accounts | - | - | - | - | 2,624,448 | 2,624,448 |
| Money market deposits | 794,726 | - | - | - | - | 794,726 |
| Customer deposits | | | | | | |
| Demand | - | - | - | - | 82,345,754 | 82,345,754 |
| Saving | 7,320,350 | - | - | - | - | 7,320,350 |
| Time | 34,325,175 | 9,729,761 | 5,331,110 | - | - | 49,386,046 |
| Margin | - | - | - | - | 1,587,635 | 1,587,635 |
| Debt securities in issue | 1,517,636 | 3,000,000 | - | - | - | 4,517,636 |
| Borrowings | 6,795 | 15,663 | 1,687,500 | - | - | 1,709,958 |
| Negative fair value of derivatives | | | | | | |
| Held for trading | - | - | - | - | 503,534 | 503,534 |
| Held as fair value hedges | - | - | - | - | 54,188 | 54,188 |
| Held as cash flow hedges | - | - | - | - | 47,071 | 47,071 |
| Other liabilities | - | - | - | - | 3,885,620 | 3,885,620 |
| Shareholders' equity | - | - | - | - | 31,278,928 | 31,278,928 |
| **Total liabilities and shareholders' equity** | 43,964,682 | 12,745,424 | 7,018,610 | - | 122,327,178 | 186,055,894 |
| **Commission rate sensitivity on assets and liabilities** | 52,210,982 | 14,783,221 | 20,825,116 | 12,890,006 | (100,709,325) | |
| **Commission rate sensitivity on derivative financial instruments** | 1,659,331 | (220,000) | (1,141,831) | (297,500) | - | |
| **Total special commission rate sensitivity gap** | 53,870,313 | 14,563,221 | 19,683,285 | 12,592,506 | (100,709,325) | |
| **Cumulative special commission rate sensitivity gap** | 53,870,313 | 68,433,534 | 88,116,819 | 100,709,325 | - | |

| 2015 SAR'000 | Within 3 months | 3-12 months | 1-5 years | Over 5 years | Non special commission bearing | Total |
|---|---|---|---|---|---|---|
| Assets | | | | | | |
| Cash and balances with SAMA | | | | | | |
| Cash in hand | - | - | - | - | 1,520,252 | 1,520,252 |
| Balances with SAMA | 150,994 | - | - | - | 9,056,367 | 9,207,361 |
| Other balances | - | - | - | - | 214,655 | 214,655 |
| Due from banks and other financial institutions | | | | | | |
| Current accounts | - | - | - | - | 7,677,105 | 7,677,105 |
| Money market placements | 3,775,873 | - | - | - | - | 3,775,873 |
| Positive fair value of derivatives | | | | | | |
| Held for trading | - | - | - | - | 870,091 | 870,091 |
| Held as fair value hedges | - | - | - | - | - | - |
| Held as cash flow hedges | - | - | - | - | 2,774 | 2,774 |
| Investments, net | | | | | | |
| Available for sale | 12,138,923 | 8,782,236 | 6,064,606 | 3,839,226 | 1,032,412 | 31,857,403 |
| Amortised cost | 19,642 | - | 3,150,000 | 500,000 | - | 3,669,642 |
| Loans and advances, net | | | | | | |
| Credit Cards | 2,084,543 | - | - | - | - | 2,084,543 |
| Consumer loans | 36,893 | 319,748 | 13,341,684 | 11,564,484 | - | 25,262,809 |
| Commercial loans | 72,418,698 | 20,052,356 | 6,065,779 | 62,451 | - | 98,599,284 |
| Investment in a joint venture and associate | - | - | - | - | 693,235 | 693,235 |
| Property and equipment, net | - | - | - | - | 991,455 | 991,455 |
| Other assets | - | - | - | - | 1,323,941 | 1,323,941 |
| Total assets | 90,625,566 | 29,154,340 | 28,622,069 | 15,966,161 | 23,382,287 | 187,750,423 |
| Liabilities and shareholders' equity | | | | | | |
| Due to banks and other financial institutions | | | | | | |
| Current accounts | - | - | - | - | 1,284,625 | 1,284,625 |
| Money market deposits | 261,875 | 288,406 | - | - | - | 550,281 |
| Customer deposits | | | | | | |
| Demand | - | - | - | - | 87,284,903 | 87,284,903 |
| Saving | 7,545,422 | - | - | - | - | 7,545,422 |
| Time | 37,441,026 | 9,542,828 | 4,811,115 | - | - | 51,794,969 |
| Margin | - | - | - | - | 2,261,884 | 2,261,884 |
| Debt securities in issue | 1,512,938 | 3,000,000 | - | - | - | 4,512,938 |
| Borrowings | 113 | 46,875 | - | - | - | 46,988 |
| Negative fair value of derivatives | | | | | | |
| Held for trading | - | - | - | - | 809,083 | 809,083 |
| Held as fair value hedges | - | - | - | - | 51,608 | 51,608 |
| Held as cash flow hedges | - | - | - | - | 34,738 | 34,738 |
| Other liabilities | - | - | - | - | 3,398,447 | 3,398,447 |
| Shareholders' equity | - | - | - | - | 28,174,537 | 28,174,537 |
| Total liabilities and shareholders' equity | 46,761,374 | 12,878,109 | 4,811,115 | - | 123,299,825 | 187,750,423 |
| Commission rate sensitivity on assets and liabilities | 43,864,192 | 16,276,231 | 23,810,954 | 15,966,161 | (99,917,538) | |
| Commission rate sensitivity on derivative financial instruments | 1,158,402 | (463,750) | (57,152) | (637,500) | - | |
| Total special commission rate sensitivity gap | 45,022,594 | 15,812,481 | 23,753,802 | 15,328,661 | (99,917,538) | |
| Cumulative special commission rate sensitivity gap | 45,022,594 | 60,835,075 | 84,588,877 | 99,917,538 | - | |

The net gap between derivative financial instruments represents the net notional amounts of derivative financial instruments, which are used to manage the special commission rate risk.

***ii) Currency risk***

Currency risk represents the risk of change in the value of financial instruments due to changes in foreign exchange rates. The Bank does not maintain material non trading open currency positions. Foreign currency exposures that arise in the non trading book are transferred to the trading book and are managed as part of the trading portfolio. The foreign exchange risk VAR disclosed in note 31(a) reflects the Bank's total exposure to currency risk.

The Bank is exposed to fluctuations in foreign currency exchange rates. The Board of Directors sets limits on the level of exposure by currency, and in total for both overnight and intraday positions, which are monitored daily. At the end of the year, the Bank had the following significant net exposures denominated in foreign currencies:

| | **2016 SAR'000 Long (short)** | 2015 SAR'000 Long (short) |
|---|---|---|
| US Dollar | **1,989,574** | 1,785,761 |
| Euro | **(293)** | (8,933) |
| Sterling Pounds | **(840)** | (1,264) |
| Other | **1,099** | (12,612) |

***iii) Equity price risk***

Equity price risk is the risk that the fair value of equities decreases as the result of changes in the level of equity indices and individual stocks. The non trading equity price risk exposure arises from equity securities classified as available for sale. A 10 per cent increase or decrease in the value of the bank's available for sale equities at 31 December 2016 would have correspondingly increase or decrease equity by SAR 105.8 million (2015: SAR 103.2 million).

## 31. Liquidity risk

Liquidity risk is the risk that the Bank will be unable to meet its payment obligations when they fall due under normal and stress circumstances. Liquidity risk can be caused by market disruptions or credit downgrades, which may cause certain sources of funding to be less readily available. To mitigate this risk, management has diversified funding sources in addition to its core deposit base, manages assets with liquidity in mind, maintaining an appropriate balance of cash, cash equivalents and readily marketable securities and monitors future cash flows and liquidity on a daily basis. The Bank also has committed lines of credit that it can access to meet liquidity needs.

In accordance with the Banking Control Law and the regulations issued by SAMA, the Bank maintains a statutory deposit with SAMA of 7% of total demand deposits and 4% of savings and time deposits. In addition to the statutory deposit, the Bank also maintains liquid reserves of not less than 20% of the deposit liabilities, in the form of cash, Saudi Government Development Bonds or assets, which can be converted into cash within a period not exceeding 30 days. The Bank has the ability to raise additional funds through repo facilities available with SAMA against Saudi Government Development securities.

The table below summarises the maturity profile of the Bank's financial liabilities. The contractual maturities of liabilities have been determined on the basis of the remaining period at the reporting date to the contractual maturity date and does not take account of effective maturities as indicated by the Bank's deposit retention history. The amounts disclosed in the table are the contractual undiscounted cash flows, whereas the Bank manages the inherent liquidity risk based on expected undiscounted cash inflows. All derivatives used for hedging purposes are shown by maturity based on their contractual, undiscounted repayment obligations. As the major portion of the derivatives trading book comprises of back to back transactions and consequently the open derivatives trading exposures are small, the management believes that the inclusion of trading derivatives in the contractual maturity table is not relevant for an understanding of the timing of cash flows and hence these have been excluded.

Management monitors the maturity profile to ensure that adequate liquidity is maintained.  The weekly liquidity position is monitored and regular liquidity stress testing is conducted under a variety of scenarios covering both normal and more severe market conditions. All liquidity policies and procedures are subject to review and approval by ALCO. A summary report, covering the bank and operating subsidiaries, including any exceptions and remedial action taken, is submitted monthly to ALCO.

**a) Analysis of financial liabilities by remaining contractual maturities :**

The table below sets out Bank's contractual undiscounted financial liabilities.

| **2016 SAR'000** | **Within 3 Months** | **3-12 months** | **1-5 years** | **Over 5 years** | **No fixed maturity** | **Total** |
|---|---|---|---|---|---|---|
| **Financial liabilities** | | | | | | |
| Due to banks and other financial institutions | | | | | | |
| Current accounts | **2,624,448** | **-** | **-** | **-** | **-** | **2,624,448** |
| Money market deposits | **795,411** | **-** | **-** | **-** | **-** | **795,411** |
| Customer deposits | | | | | | |
| Demand | **-** | **-** | **-** | **-** | **82,345,754** | **82,345,754** |
| Saving | **7,320,350** | **-** | **-** | **-** | **-** | **7,320,350** |
| Time | **34,685,674** | **10,426,340** | **5,261,382** | **-** | **-** | **50,373,396** |
| Margin | **188,163** | **649,271** | **616,763** | **133,438** | **-** | **1,587,635** |
| Debt securities in issue | **1,516,773** | **108,704** | **1,880,127** | **1,689,047** | **-** | **5,194,651** |
| Borrowings | **9,193** | **43,609** | **1,761,046** | **-** | **-** | **1,813,848** |
| Derivatives : | | | | | | |
| - Special commission contractual amounts payable (receivable) | **(64,242)** | **18,930** | **(45,660)** | **(26,147)** | **-** | **(117,119)** |
| **Total undiscounted financial liabilities** | **47,075,770** | **11,246,854** | **9,473,658** | **1,796,338** | **82,345,754** | **151,938,374** |

| 2015 SAR'000 | Within 3 Months | 3-12 months | 1-5 years | Over 5 years | No fixed maturity | Total |
|---|---|---|---|---|---|---|
| Financial liabilities | | | | | | |
| Due to banks and other financial institutions | | | | | | |
| Current accounts | 1,284,625 | - | - | - | - | 1,284,625 |
| Money market deposits | 261,889 | 290,589 | - | - | - | 552,478 |
| Customer deposits | | | | | | |
| Demand | - | - | - | - | 87,284,903 | 87,284,903 |
| Saving | 7,545,422 | - | - | - | | 7,545,422 |
| Time | 31,882,024 | 14,776,470 | 5,320,431 | 108,093 | | 52,087,018 |
| Margin | 544,904 | 751,123 | 772,647 | 193,210 | | 2,261,884 |
| Debt securities in issue | 21,137 | 104,205 | 3,326,632 | 1,668,407 | - | 5,120,381 |
| Borrowings | 113 | 33,279 | 16,029 | - | - | 49,421 |
| Derivatives : | | | | | | |
| - Special commission contractual amounts payable (receivable) | (525) | 2,793 | (81,673) | (59,262) | - | (138,667) |
| Total undiscounted financial liabilities | 41,539,589 | 15,958,459 | 9,354,066 | 1,910,448 | 87,284,903 | 156,047,465 |

**b) Maturity analysis of assets and liabilities :**

The table below shows an analysis of assets and liabilities analysed according to when they are expected to be recovered or settled.

| 2016<br>SAR'000 | Within 3 months | 3-12 Months | 1-5 Years | Over 5 years | No fixed maturity | Total |
|---|---|---|---|---|---|---|
| **Assets** | | | | | | |
| Cash and balances with SAMA | | | | | | |
| Cash in hand | 1,444,680 | - | - | - | - | 1,444,680 |
| Balances with SAMA | 13,545,153 | - | - | - | 8,852,915 | 22,398,068 |
| Other balances | 279,073 | - | - | - | - | 279,073 |
| Due from banks and other financial institutions | | | | | | |
| Current accounts | 6,504,871 | - | - | - | - | 6,504,871 |
| Money market placements | 1,222,925 | 50,000 | 439,950 | - | - | 1,712,875 |
| Investments, net | | | | | | |
| Available for sale | 8,589,884 | 1,916,493 | 6,861,768 | 4,581,808 | 1,057,858 | 23,007,811 |
| Amortised Cost | 25,211 | - | 3,300,028 | 2,940,005 | - | 6,265,244 |
| Positive fair value of derivatives | | | | | | |
| Held for trading | 594,333 | - | - | - | - | 594,333 |
| Held as fair value hedges | 86,254 | - | - | - | - | 86,254 |
| Held as cash flow hedges | 41,325 | - | - | - | - | 41,325 |
| Loans and advances, net | | | | | | |
| Credit Cards | 2,210,011 | - | - | - | - | 2,210,011 |
| Consumer Loans | 50,608 | 313,238 | 13,774,452 | 10,006,968 | - | 24,145,266 |
| Commercial Loans | 46,981,561 | 16,934,896 | 13,436,553 | 17,256,528 | - | 94,609,538 |
| Investment in a joint venture and associate | - | - | - | - | 642,297 | 642,297 |
| Property and equipment, net | - | - | - | - | 1,038,352 | 1,038,352 |
| Other assets | 134,450 | 640,307 | - | - | 301,139 | 1,075,896 |
| **Total assets** | 81,710,339 | 19,854,934 | 37,812,751 | 34,785,309 | 11,892,561 | 186,055,894 |

| 2016<br>SAR'000 | Within 3 months | 3-12 Months | 1-5 Years | Over 5 years | No fixed maturity | Total |
|---|---|---|---|---|---|---|
| **Liabilities and shareholders' equity** | | | | | | |
| Due to banks and other financial institutions | | | | | | |
| Current accounts | 2,624,448 | - | - | - | - | 2,624,448 |
| Money market deposits | 794,726 | - | - | - | - | 794,726 |
| Customer deposits | | | | | | |
| Demand | - | - | - | - | 82,345,754 | 82,345,754 |
| Saving | 7,320,350 | - | - | - | - | 7,320,350 |
| Time | 34,325,174 | 9,729,762 | 5,331,110 | - | - | 49,386,046 |
| Margin Deposits | 188,163 | 649,271 | 616,763 | 133,438 | - | 1,587,635 |
| Debt securities in issue | 1,517,636 | - | 1,500,000 | 1,500,000 | - | 4,517,636 |
| Borrowings | 6,795 | 15,663 | 1,687,500 | - | - | 1,709,958 |
| Negative fair value of derivatives | | | | | | |
| Held for trading | 503,534 | - | - | - | - | 503,534 |
| Held as fair value hedges | 54,188 | - | - | - | - | 54,188 |
| Held as cash flow hedges | 47,071 | - | - | - | - | 47,071 |
| Other liabilities | 564,801 | 91,469 | 137,204 | 15,245 | 3,076,901 | 3,885,620 |
| Shareholders' equity | - | - | - | - | 31,278,928 | 31,278,928 |
| **Total liabilities and shareholders' equity** | 47,946,886 | 10,486,165 | 9,272,577 | 1,648,683 | 116,701,583 | 186,055,894 |

| 2015<br>SAR'000 | Within 3 months | 3-12 Months | 1-5 Years | Over 5 years | No fixed maturity | Total |
|---|---|---|---|---|---|---|
| Assets | | | | | | |
| Cash and balances with SAMA | | | | | | |
| Cash in hand | 1,520,252 | - | - | - | - | 1,520,252 |
| Balances with SAMA | 150,994 | - | - | - | 9,056,367 | 9,207,361 |
| Other balances | 214,655 | - | - | - | - | 214,655 |
| Due from banks and other financial institutions | | | | | | |
| Current accounts | 7,677,105 | - | - | - | - | 7,677,105 |
| Money market placements | 3,775,873 | - | - | - | - | 3,775,873 |
| Investments, net | | | | | | |
| Available for sale | 12,159,090 | 7,177,779 | 8,707,463 | 2,781,158 | 1,031,913 | 31,857,403 |
| Amortised Cost | 19,642 | - | 3,150,000 | 500,000 | - | 3,669,642 |
| Positive fair value of derivatives | | | | | | |
| Held for trading | 870,091 | - | - | - | - | 870,091 |
| Held as fair value hedges | - | - | - | - | - | - |
| Held as cash flow hedges | 2,774 | - | - | - | - | 2,774 |
| Loans and advances, net | | | | | | |
| Credit Cards | - | - | - | - | 2,084,543 | 2,084,543 |
| Consumer Loans | 36,893 | 319,748 | 13,341,684 | 11,564,484 | - | 25,262,809 |
| Commercial Loans | 50,265,382 | 23,817,544 | 12,400,544 | 12,115,814 | - | 98,599,284 |
| Investment in a joint venture and associate | - | - | - | - | 693,235 | 693,235 |
| Property and equipment, net | - | - | - | - | 991,455 | 991,455 |
| Other assets | 44,216 | 433,354 | - | - | 846,371 | 1,323,941 |
| Total assets | 76,736,967 | 31,748,425 | 37,599,691 | 26,961,456 | 14,703,884 | 187,750,423 |

| 2015 SAR'000 | Within 3 months | 3-12 Months | 1-5 Years | Over 5 years | No fixed maturity | Total |
|---|---|---|---|---|---|---|
| Due to banks and other financial institutions | | | | | | |
| Current accounts | 1,284,625 | - | - | - | - | 1,284,625 |
| Money market deposits | 261,875 | 288,406 | - | - | - | 550,281 |
| Customer deposits | | | | | | |
| Demand | - | - | - | - | 87,284,903 | 87,284,903 |
| Saving | 7,545,422 | - | - | - | - | 7,545,422 |
| Time | 37,441,026 | 9,542,828 | 4,811,115 | - | - | 51,794,969 |
| Margin Deposits | 544,904 | 751,123 | 772,647 | 193,210 | - | 2,261,884 |
| Debt securities in issue | 12,938 | - | 3,000,000 | 1,500,000 | - | 4,512,938 |
| Borrowings | 113 | - | 46,875 | - | - | 46,988 |
| Negative fair value of derivatives | | | | | | |
| Held for trading | 809,083 | - | - | - | - | 809,083 |
| Held as fair value hedges | 51,608 | - | - | - | - | 51,608 |
| Held as cash flow hedges | 34,738 | - | - | - | - | 34,738 |
| Other liabilities | 902,102 | 91,871 | 137,806 | 15,312 | 2,251,356 | 3,398,447 |
| Shareholders' equity | - | - | - | - | 28,174,537 | 28,174,537 |
| Total liabilities and shareholders' equity | 48,888,434 | 10,674,228 | 8,768,443 | 1,708,522 | 117,710,796 | 187,750,423 |

Assets available to meet all of the liabilities and to cover outstanding loan commitments include cash, balances with SAMA, items in the course of collection; loans and advances to banks; and loans and advances to customers. The maturities of commitments and contingencies are given in note 19(d) of the consolidated financial statements.

## 32. Offsetting of financial assets and financial liabilities

Financial assets subject to offsetting, enforceable master netting arrangements and similar agreements:

| | | | | **Amount not set off in the statement of financial position** | | |
|---|---|---|---|---|---|---|
| **SAR'000** | **Gross amount of recognised financial assets** | **Gross amounts offset in the statement of financial position** | **Amounts presented in the statement of financial position** | **Financial instruments** | **Cash collateral received** | **Net amount** |
| **At 31 December 2016** | | | | | | |
| Due from banks and other financial institutions | **10,852,629** | **(2,634,883)** | **8,217,746** | **-** | **-** | **8,217,746** |
| At 31 December 2015 | | | | | | |
| Due from banks and other financial institutions | 12,921,685 | (1,468,707) | 11,452,978 | - | - | 11,452,978 |

Financial liabilities subject to offsetting, enforceable master netting arrangements and similar agreements

| SAR'000 | Gross amount of recognised financial liabilities | Gross amounts offset in the statement of financial position | Amounts presented in the statement of financial position | Amount not set off in the statement of financial position: Financial instruments | Cash collateral pledged | Net amount |
|---|---|---|---|---|---|---|
| **At 31 December 2016** | | | | | | |
| Derivatives | **604,793** | **-** | **604,793** | **-** | **(268,301)** | **336,492** |
| Sale and repurchase arrangements | **-** | **-** | **-** | **-** | **-** | **-** |
| At 31 December 2015 | | | | | | |
| Derivatives | 895,429 | - | 895,429 | - | (814,500) | 80,929 |
| Sale and repurchase arrangements | - | - | - | - | - | - |

Financial assets and financial liabilities are offset and the net amount is reported in the statement of financial position when there is a currently legally enforceable right to offset the recognised amounts and there is an intention to settle on a net basis, or realise the asset and settle the liability simultaneously.

## 33. Fair values of financial instruments

Fair value is the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction in the principal (or the most advantageous) market between market participants at the measurement date under current market conditions regardless of whether that price is directly observable or estimated using another valuation technique. Consequently, differences can arise between the carrying values and fair value estimates.

The fair values of recognised financial instruments are not materially different from their carrying values.

***Determination of fair value and fair value hierarchy***

The Bank uses the following hierarchy for determining and disclosing the fair value of financial instruments:

**Level 1:** quoted prices in active markets for the same instrument (i.e., without modification or repacking):

**Level 2:** quoted prices in active markets for similar assets and liabilities or other valuation techniques for which all significant inputs are based on observable market data: and

**Level 3:** valuation techniques for which any significant input is not based on observable market data.

| **31 December 2016 SAR (000's)** | **Level 1** | **Level 2** | **Level 3** | **Total** |
|---|---|---|---|---|
| **Financial assets** | | | | |
| Derivative financial instruments | **-** | **721,912** | **-** | **721,912** |
| Financial investments available for sale | **1,022,685** | **21,949,953** | **35,173** | **23,007,811** |
| Investments held at amortised cost | **-** | **6,269,003** | **-** | **6,269,003** |
| Loans and advances | **-** | **119,380,837** | **-** | **119,380,837** |
| **Financial Liabilities** | | | | |
| Customers deposits | **-** | **140,760,543** | **-** | **140,760,543** |
| Derivative financial instruments | **-** | **604,793** | | **604,793** |
| Debt securities in issue | **-** | **4,517,636** | **-** | **4,517,636** |
| Borrowings | **-** | **1,709,958** | **-** | **1,709,958** |

| 31 December 2015 SAR (000's) | Level 1 | Level 2 | Level 3 | Total |
|---|---|---|---|---|
| Financial assets | | | | |
| Derivative financial instruments | - | 872,865 | - | 872,865 |
| Financial investments available for sale | 979,845 | 30,825,491 | 52,067 | 31,857,403 |
| Investments held at amortised cost | - | 3,669,642 | - | 3,669,642 |
| Loans and advances | - | 124,560,927 | - | 124,560,927 |
| Financial Liabilities | | | | |
| Customers deposits | - | 148,841,203 | - | 148,841,203 |
| Derivative financial instruments | - | 895,429 | - | 895,429 |
| Debt securities in issue | - | 4,512,938 | - | 4,512,938 |
| Borrowings | - | 46,988 | - | 46,988 |

Derivatives classified as Level 2 comprise over the counter special commission rate swaps, currency swaps, special commission rate futures and options, spot and forward foreign exchange contracts, currency options and other derivative financial instruments. These derivatives are fair valued using the bank's proprietary valuation models that are based on discounted cash flow techniques. The data inputs to these models are based on observable market parameters relevant to the markets in which they are traded and are sourced from widely used market data service providers.

Available for sale investments classified as Level 2 include plain vanilla bonds for which market quotes are not available. These are fair valued using simple discounted cash flow techniques that use observable market data inputs for yield curves and credit spreads.

Available for sale investments classified as Level 3 include Private Equity Funds, the fair value of which is determined based on the fund's latest reported net assets value (NAV) as at the reporting date. The movement in Level 3 financial instruments during the year relates to fair value and capital repayment movement only.

There were no transfers between the levels of fair value hierarchies during the year.

The total amount of the changes in fair value recognised in the consolidated statement of income, which was estimated using valuation technique, is positive SAR 61.16 million (2015: SAR 52.6 million).

**34. Related party transactions**

Managerial and specialised expertise is provided under a technical services agreement with HSBC Holdings plc, the parent company of HSBC Holdings BV. This agreement was renewed on 30 September 2012 for a period of five years.

In the ordinary course of its activities, the Bank transacts business with related parties. In the opinion of the management and the Board, the related party transactions are performed on an arm's length basis. The related party transactions are governed by limits set by the Banking Control Law and the regulations issued by SAMA.

The year end balances included in the consolidated financial statements resulting from such transactions are as follows:

| | **2016 SAR'000** | 2015 SAR'000 |
|---|---|---|
| **The HSBC Group:** | | |
| Due from banks and other financial institutions | **5,243,173** | 7,007,693 |
| Investments | **781,379** | 943,556 |
| Other assets | **567,281** | 265,291 |
| Derivatives (at fair value) | **(55,583)** | (99,846) |
| Due to banks and other financial institutions | **1,011,970** | 738,502 |
| Borrowings | **281,250** | - |
| Other liabilities | **154,160** | 8,355 |
| Commitments and contingencies | **2,191,791** | 1,673,929 |

The above investments include investments in a joint venture and associate, amounting to SAR 642.3 million (2015: SAR 693.2 million).

**Directors, audit committee, other major shareholders and their affiliates:**

| | | |
|---|---|---|
| Investments | **100,000** | - |
| Loans and advances | **2,952,344** | 3,009,582 |
| Customers' deposits | **6,332,302** | 8,802,798 |
| Derivatives (at fair value) | **14,536** | 23,474 |
| Commitments and contingencies | **68,594** | 224,345 |

Other major shareholders represent shareholdings (excluding the non-Saudi shareholder) of more than 5% of the Bank's issued share capital.

| | | |
|---|---|---|
| **Related mutual funds:** | | |
| Loans and advances | **-** | 7,068 |
| Customers' deposits | **410,699** | 697,514 |

Income and expense pertaining to transactions with related parties included in the consolidated financial statements are as follows:

| | | |
|---|---|---|
| Special commission income | **138,129** | 94,372 |
| Special commission expense | **(143,076)** | (148,660) |
| Fees and commission income | **20,252** | 47,653 |
| Services charges paid to HSBC group | **38,130** | 39,384 |
| Profit share arrangement relating to investment banking activities | **(653)** | (2,340) |
| Share in earnings of a joint venture and an associate | **63,777** | 130,345 |
| Directors' remuneration | **2,723** | 2,995 |

The total amount of compensation paid to key management personnel during the year is as follows:

| | | |
|---|---|---|
| Short-term employee benefits (salaries and allowances) | **42,226** | 36,749 |
| Employment termination benefits | **2,774** | 687 |

Key management personnel are those persons, including an executive director, having authority and responsibility for planning, directing and controlling the activities of the Bank, directly or indirectly.

The Bank offers share based payment scheme arrangements to certain senior management and employees. There were three such schemes outstanding at 31 December 2016. The details of these schemes have been separately disclosed in note 24 to these consolidated financial statements.

## 35. Capital adequacy

The Bank's objectives when managing capital are, to comply with the capital requirements set by SAMA; to safeguard the Bank's ability to continue as a going concern; and to maintain a strong capital base.

Capital adequacy and the use of regulatory capital are monitored regularly by the Bank's management. SAMA requires the Bank to hold the minimum level of the regulatory capital and to maintain a ratio of total regulatory capital to the risk-weighted assets at or above the agreed minimum of 8%.

The Bank monitors the adequacy of its capital using the methodology and ratios established by SAMA. These ratios measure capital adequacy by comparing the Bank's eligible capital with its assets, commitments and contingencies, and notional amount of derivatives at a weighted amount to reflect their relative risk.

| | **2016 SAR'000** | 2015 SAR'000 |
|---|---|---|
| **Risk Weighted Assets (RWA)** | | |
| Credit Risk RWA | **161,899,067** | 167,661,775 |
| Operational Risk RWA | **13,333,290** | 12,620,144 |
| Market Risk RWA | **2,514,488** | 2,844,213 |
| **Total RWA** | **177,746,845** | 183,126,132 |
| **Tier I Capital** | **31,278,928** | 28,174,537 |
| **Tier II Capital** | **3,600,244** | 4,082,996 |
| **Total I & II Capital** | **34,879,172** | 32,257,533 |
| **Capital Adequacy Ratio %** | | |
| **Tier I ratio** | **17.60%** | 15.39% |
| **Tier I + Tier II ratio** | **19.62%** | 17.61% |

**36. Prospective changes in accounting standards**

The Bank has opted not to early adopt the following new standards which have been issued but not yet effective for the Bank's accounting years beginning on or after 1 January 2017 and is currently assessing their impact.

Following is a brief on the new IFRS and amendments to IFRS, effective for annual periods beginning on or after January 01, 2017:

- IFRS 9 – "Financial instruments", applicable for the annual periods beginning on or after 1 January 2018, and will be applied retrospectively with some exemptions. The new standard presents revised guidance on the classification and measurement of financial assets, including a new expected credit loss model for calculating impairment.

- IFRS 15 -- "Revenue from contracts with customers", applicable for the annual periods beginning on or after 1 January 2017. The new standard presents a five-step model to determine when to recognize revenue, and at what amount. The application of this standard will have a significant impact on how and when you recognize revenue, with new estimates and judgments, and the possibility of revenue recognition being accelerated or deferred.

- Amendments to IAS 7 – "Statement of Cash Flows", applicable for the annual periods beginning on or after 1 January 2017. The amendments require disclosures that enable users of financial statements to evaluate changes in liabilities arising from financing activities, including both changes arising from cash flow and non-cash changes.

- Amendments to IAS 12 - "Income Taxes", applicable for the annual periods beginning on or after 1 January 2017. The amendments clarify that the existence of a deductible temporary difference depends solely on a comparison of the carrying amount of an asset and its tax base at the end of the reporting period, and is not affected by possible future changes in the carrying amount or expected manner of recovery of the asset. Therefore, assuming that the tax base remains at the original cost of the debt instrument, there is a temporary difference.

- Amendments to IFRS 2 -- "Share-based Payment", applicable for the period beginning on or after 1 January 2018. The amendments cover classification and measurement of three accounting areas, first, measurement of cash-settled share-based payments, second, classification of share-based payments settled net of tax withholdings, and third, accounting for a modification of a share-based payment from cash-settled to equity-settled.

- IFRS 16 - "Leases", applicable for the period beginning on or after 1 January 2019. The new standard eliminates the current dual accounting model for lessees under IAS 17, which distinguishes between on-balance sheet finance leases and off-balance sheet operating leases. Instead, IFRS 16 proposes on-balance sheet accounting model.

## 37. IFRS 9

### Introduction

In July 2014, the IASB issued IFRS 9 Financial Instruments, the standard that will replace IAS 39 for annual periods on or after 1 January 2018. In 2015 the Bank set up a project with members from its Risk, Finance and IT teams to prepare for IFRS 9 implementation ('the Project').

The Project is sponsored by the Chief Financial Officer and Chief Risk Officer, with the Chief Financial Officer regularly reporting progress to the Bank's Risk Management Committee and Board Audit Committee. The Project has clear individual work streams for classification and measurement and impairment. The initial gap assessment and impact analysis were completed as at the end of 2016. Both the classification and measurement and impairment work streams are active on the deployment and operationalization of the framework including the corresponding disclosure requirements.

### Classification and measurement

From a classification and measurement perspective, the new standard will require all financial assets, except equity instruments and derivatives, to be assessed based on a combination of the entity's business model for managing the assets and the instruments' contractual cash flow characteristics.

The IAS 39 measurement categories will be replaced by: Fair Value through Profit or Loss (FVPL), Fair Value through Other Comprehensive Income (FVOCI), and amortised cost. IFRS 9 will also allow entities to continue to irrevocably designate instruments that qualify for amortised cost or fair value through OCI instruments as FVPL, if doing so eliminates or significantly reduces a measurement or recognition inconsistency. Equity instruments that are not held for trading may be irrevocably designated as FVOCI, with no subsequent reclassification of gains or losses to the income statement.

The accounting for financial liabilities will largely be the same as the requirements of IAS 39, except for the treatment of gains or losses arising from an entity's own credit risk relating to liabilities designated at FVPL.

Having completed its initial assessment, the Bank has concluded that:

- The majority of loans and advances to banks, loans and advances to customers reverse repo agreements and settlement balances that are classified as loans and receivables under IAS 39 are expected to be measured at amortised cost under IFRS 9.
- The majority of the debt securities classified as available for sale under IAS 39 are expected to be measured at amortised cost or FVOCI. Some securities, however, may be classified as FVPL, either because of their contractual cash flow characteristics or the business model within which they are held.

### Hedge accounting

IFRS 9 allows entities to continue with the hedge accounting under IAS 39 even when other elements of IFRS become mandatory on 1 January 2018. Based on its analysis, the Bank has decided to continue to apply hedge accounting under IAS 39.

### Impairment of financial assets

***Overview***

IFRS 9 will fundamentally change the loan loss impairment methodology applied by the Bank. The standard will replace IAS 39's incurred loss approach with a forward-looking expected credit loss (ECL) approach. The Bank will be required to record an allowance for expected credit losses for all loans and other debt financial assets, together with loan commitments and financial guarantee contracts. The allowance is based on the expected credit losses associated with the probability of default in the next twelve months unless there has been a significant increase in credit risk since origination, in which case, the allowance is based on the probability of default over the life of the asset.

The Bank will establish a framework to perform an assessment at the end of each reporting period of whether credit risk has increased significantly since initial recognition by considering the change in the risk of default occurring over the remaining life of the financial instrument.

To calculate ECL, the Bank will estimate the risk of a default occurring on the financial instrument during its expected life. ECLs are estimated based on the present value of all cash shortfalls over the remaining expected life of the financial asset, i.e., the difference between: the contractual cash flows that are due to the Bank under the contract, and the cash flows that the Bank expects to receive, discounted at the effective interest rate of the loan.

In comparison to IAS 39, the Bank expects the impairment charge under IFRS 9 to be more volatile and to result in an increase in the total level of current impairment allowances.

The Bank will classify its loans and advances into Stage 1, Stage 2 and Stage 3, based on the impairment methodology, as described below|:

- Stage 1 – Performing loans: when loans are first recognised, the Bank recognises an allowance based on 12-month expected credit losses.
- Stage 2 – Underperforming loans: when a loan shows a significant increase in credit risk, the Bank records an allowance for the lifetime expected credit loss.
- Stage 3 – Impaired loans: the Bank recognises the lifetime expected credit losses for these loans.

In addition, in Stage 3 the Bank accrues interest income on the amortised cost of the loan net of allowances.

The Bank will record impairment for debt securities, depending on whether they are classified as Stage 1, 2, or 3, as explained above. However, the expected credit losses will not reduce the carrying amount of these financial assets in the statement of financial position, which will remain at fair value. Instead, an amount equal to the allowance that would arise if the asset were measured at amortised cost will be recognised in OCI as an accumulated impairment amount, with a corresponding charge to profit or loss.

***Forward looking information***
The Bank will incorporate forward-looking information in both the assessment of significant increase in credit risk and the measurement of ECLs.

The forward-looking information would be used to evaluate a range of possible outcomes, the bank intends to formulate three scenarios: a base case, a worse case and a better case.
The base case scenario represents the more likely outcome resulting from the bank's annual financial planning and budgeting process, while the better and worse case scenarios represent more optimistic or pessimistic outcomes. For each scenario, the Bank will derive an ECL and apply a probability weighted approach to determine the impairment allowance.

The Bank will consider internal information, combined with published external information from government and private economic forecasting services. The forward-looking assumptions would be approved through a formal governance forum including representatives from both Risk and Finance before they are applied in the different scenarios.

***Limitation of estimation techniques***
The framework applied by the Bank may not always capture all characteristics of the market at a point in time as they cannot be recalibrated at the same pace as changes in market conditions. Interim adjustments are expected to need to be made until the base framework are updated. Although the Bank will use data that is as current as possible, models used to calculate ECLs will be based on data that is one month in arrears and adjustments will be made for significant events occurring prior to the reporting date. The governance over such adjustments is still in development.

**Capital management**
The Bank is in the process of evaluating how the new ECL model will impact the Bank's ongoing regulatory capital structure and further details will be provided once the assessment is complete. The magnitude of the effect on capital will depend, amongst other things, on how the capital rules will be amended to reflect IFRS 9 or to include transition provisions for the effect of IFRS 9.

## 38. Comparative figures

The Accrued Special Commission Receivable or Payable on Financial Assets or Financial Liabilities, which was previously shown under "Other Assets" or "Other Liabilities" respectively, has now been shown together with the related asset or liability as required by IFRS.

Certain other prior year figures have been reclassified to conform with the current year's presentation.

## 39. Board of Directors' approval

The consolidated financial statements were approved by the Board of Directors on 19 Jumaada Al-Awal 1438H (Corresponding 16 February 2017).