THE SAUDI BRITISH BANK

BASEL II – PILLAR 3 ANNUAL DISCLOSURES

31 December 2009

Cautionary statement regarding forward looking statements

These Capital and Risk Management Pillar 3 Disclosures as at 31 December 2009 contain certain forward looking statements with respect to the financial condition, results of operations and business of SABB. These forward looking statements represent SABB expectations or beliefs concerning future events and involve known and unknown risks and uncertainty that could cause actual results, performance or events to differ materially from those expressed or implied in such statements.

Forward-looking statements involve inherent risks and uncertainties. Readers are cautioned that a number of factors could cause actual results to differ, in some instances materially, from those anticipated or implied in any forward-looking statement. Forward-looking statements speak only as of the date they are made, and it should not be assumed that they have been reviewed or updated in the light of new information or future events.

Table 1
SCOPE OF APPLICATION

a) Scope

These qualitative disclosures set out The Saudi British Bank (SABB) approach to capital assessment and complement the minimum capital requirements and the supervisory review process.

b) Basis of consolidation

The basis of consolidation for accounting purposes is described on page 8 of the Annual Report and Accounts 2009.

The basis of consolidation for regulatory purposes differs from that used for the financial consolidation in that holdings in insurance and financial entities are excluded if they qualify as significant minority investments i.e exceed 20% upto 50% of the investee company’s paid up capital.

SABB uses regulatory capital as the basis for assessing its capital adequacy. Risk weighted assets driving regulatory capital requirements are forecast and monitored at customer group level or at a lower sub-unit level, as appropriate.

Entities that are fully consolidated:

SABB Securities Limited is a wholly owned subsidiary of SABB and its financial statements are consolidated with SABB. The Bank has 98% direct and 2% indirect ownership interest in its subsidiary.

SABB Insurance Company Limited is a wholly owned subsidiary of SABB and its financial statements are consolidated with SABB. The Bank has 98% direct and 2% indirect ownership interest in its subsidiary.

Significant Minority Investments:

Following significant minority investments are deducted from the capital:

- The Bank owns 40% of the equity shares of HSBC Saudi Arabia Limited, which is involved in Investment Banking services in the Kingdom of Saudi Arabia.
- The Bank owns 32.5% of the equity shares of SABB Takaful. It carries out Shariah-compliant insurance activities and offers Family and General Takaful products.

Equity Investments which are risk weighted

Equity investments are risk weighted at 100% where percentage of shareholding is less than 20%.

c) Capital transferability between legal entities

Restrictions by Memorandum and Articles of Association

Through Article 10 of Memorandum & Articles of Association SABB has restricted the transfer of shares held by Saudi Nationals to non Saudi Nationals and has empowered its Board of directors the right to either approve or refuse the transfer of shares.

Apart from the above, no other restrictions have been imposed by the management on transfer of shares.

Statutory restriction

SABB is required to transfer at least 25% of its net profit to statutory reserves before declaration of dividend until the amount of statutory reserves is equal to the paid up capital of the bank.

Regulatory restriction

SAMA has imposed a restriction of at least 8% of capital adequacy ratio which is in line with Basel II requirements.

The significant minority investments namely HSBC Saudi Arabia Limited and SABB Takaful's Articles of Association restrict the reduction in paid up capital below the current levels.

Table 2
CAPITAL STRUCTURE

The authorized, issued and fully paid share capital of the Bank consists of 750 million shares of SAR 10 each (2008: 600 million shares of SAR 10 each). The ownership of the Bank's share capital is as follows:

	2009	***2008***
Saudi shareholders	*60%*	*60%*
HSBC Holdings BV	*40%*	*40%*
(a wholly owned subsidiary of HSBC Holdings plc)		

The composition of shareholders' equity is available in the annual financial statements.

There are four different "types" of capital which SABB must manage. The distinctions between the different notions / definitions of capital, and the capital management principles which arise, are outlined below:

Category	**Definition / meaning / significance**	**Implications for SABB capital management**
Regulatory Capital	Proxy for Risk Capital, particularly under Basel II.	Requirements must be met on a SAMA regulatory rules basis at all times.
Accounting Capital	The capital recognised by accounting standards	Requirements must be met to achieve audited accounts
Invested Capital (Legal capital)	The equity capital invested in SABB by its shareholders for which SABB is accountable.	SABB must earn a return on its invested capital which is in excess of its cost of capital
Economic Capital	Capital actually held by SABB to bear risk, support growth etc. and upon which an 'economic' return is required.	Allocated to businesses in proportion to risks run, and acts as basis to set economic profit targets and inform e.g. pricing decisions.

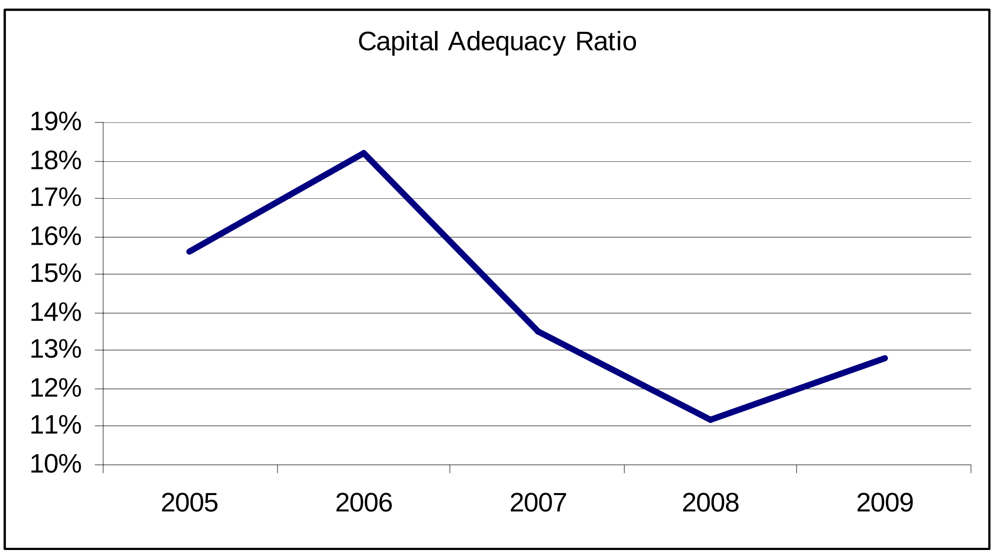
Along with these capital measures, SABB wishes to effectively manage its capital in order to support and improve its own external rating as calculated by risk rating agencies.

Table 3
CAPITAL ADEQUACY

SABB's approach in assessing adequacy of its capital to support current and future activities envisages around the following principles:

- It has a process for assessing its overall capital adequacy in relation to its risk profile and a strategy for maintaining capital levels
- A review of SABB's ICAAP and capital strategies are undertaken by its management, as well as monitoring and ensuring compliance to SAMA regulations, with appropriate actions being taken when required
- It is operating above the minimum regulatory capital ratios, with the ability to hold capital in excess of the minimum
- The ability to intervene at an early stage to prevent capital from falling below the minimum levels as required according to it's risk profile

SABB Capital Adequacy Ratio in the last 5 years has been as follows:



2005-2007: Capital Adequacy Ratio's are on Basel I basis
2008-2009: Capital Adequacy Ratio's are on Basel II basis

TABLE 3
Risk Exposure and Assessment
GENERAL QUALITATIVE DISCLOSURE REQUIREMENTS

Credit Risk

Credit risk is the risk of financial loss through the failure of a customer or counterparty to honour their commitments as they fall due. Credit risk arises principally in corporate and personal lending, trade finance, treasury and syndication underwriting. But credit risk also arises from off balance sheet products such as guarantees and derivatives or from SABB’s holdings of debt securities.

A culture of prudent and responsible lending is supported by a strong risk policy and control framework which is managed by an independent credit function who both partner and challenge business proposals in line with the Board approved risk appetite levels

SABB's credit culture is dedicated to achieving sustainable profitability through maintaining high quality risk assets. This is attained through effective control and management of risk, seeking to minimize credit losses while enhancing risk-adjusted returns, thus contributing to the overall success of the Bank.

A strong risk governance framework has been established under the oversight of the Board designated committee the Risk Management Meeting. A number of sub committees have been established to focus on retail and corporate credit risk, Treasury market risk, Operational risk, security and fraud risk, reputational risk, capital planning, and stress testing.

Credit risk management functions have an appropriate degree of independence and responsibility for key aspects of rating systems, including selection, implementation, performance, and oversight. Approval processes observe high standards of governance, efficiency and facilitate timely decision-making through the use of delegated approval limits.

Credit discipline encompasses an attitude towards risk and risk management instilled in credit officers through experience and training as evidenced for example in:

- Being proactive rather than reactive;
- Knowing the customer;
- Recognizing strengths, weaknesses and competitive advantages;
- Understanding and employing constructively all appropriate techniques for the measurement and management of risk

Automated systems are a prerequisite for efficient credit application processes, for the proper recording, control and reporting of risk limits and exposures and for the calculation of internal risk scores and ratings as well as regulatory and economic capital.

SABB's association to the HSBC Group promotes the use of standard systems and methodologies for these purposes and employs common measurements of risk throughout the organisation. At SABB, consumer lending decisions are based on credit risk score models developed using internal data and embedded into an automated decision process. Corporate customers are evaluated using internal rating models which apply a 22 point rating scale and which are complimented by expert judgment from the credit approval teams.

In the event of customers facing difficulties with repayment, SABB operates dedicated collection and recoveries teams to manage non performing loans and maximise recovery rates.

In order to support and evaluate credit decisions SABB maintains an analytics capability to develop policy and systems, generate performance and management information and undertake stress testing and scenario analysis across SABB’s various risk asset portfolios. The outcomes of any analysis are subject to a thorough management challenge to ensure any changes are fit for purpose.

Credit risk consumes the largest proportion of SABB's minimum capital requirement. Within the established principles and parameters SABB ensures that strict capital discipline is maintained through correct pricing and management of credit risks in relation to the regulatory and economic capital requirements.

Information on counterparty credit risk is provided in the table 8 commentary below.

Market Risk

Market Risk is the risk that movements in market risk factors, including foreign exchange rates, commodity prices, interest rates, credit spreads and equity prices will reduce SABB's income or the value of its portfolios.

Further information on market risk is provided in the table 10 commentary below.

Operational Risk

Operational Risk is the risk of loss arising through fraud, unauthorized activities, error, omission, inefficiency, system failure or from external events. These risks are inherent in every business and cover a wide range of issues including process failures, systems failures and human error.

Further information on operational risk capital is provided in the table 12 commentary below.

Investment Risk

Investment risk is the risk of an adverse impact on P&L and capital due to an unexpected loss in value of the investment position held by SABB on a long term (non-trading basis). This can arise out of SABB’s investment, private equity or equity investment portfolios.

As a general policy SABB seeks to focus investments around establishing a diversified portfolio of high quality and highly liquid securities. Less liquid or structured investments account for less than 2% of the portfolio.

SABB will continue to review its investment policy in line with market developments and opportunities as they arise. The risk mandate will however always maintain a focus on high quality, liquid investments with a preference for domestically issued debt and securities.

Whilst SABB does hold a nominal position in private equity investments it does not hold any diect equity investments. Further information on equities risk is provided in the table 13 commentary below.

Interest Rate Risk

Interest rate risk in the banking book is defined as the exposure of the non-trading products of the Bank to interest rates. Interest rate risk arises principally from mismatches between the future yield on assets and their funding costs, as a result of changes in interest rates.

Further information on interest risk is provided in the table 14 commentary below.

Foreign Exchange Risk

Currency or foreign exchange risk (FX) arises from an open position, either overbought (long) or oversold (short), in a foreign currency, creating exposure to a change in the relevant exchange rate.

SABB categorises foreign exchange risk as follows:

- **Trading Book FX risk** - arises from proprietary currency trading i.e. spot, forwards, futures, swaps and options. Trading exposures are controlled through assigning limits to each currency and aggregate exposure levels as well as through VAR and stress testing measures.
- **Banking Book FX risk** - arises from a currency mismatch / revaluation between assets and liabilities, including accrued interest and accrued expenses. The mismatch is transferred to Treasury and managed on daily basis through the trading book.
- **Structural FX risk**- arises due to two reasons a) relates to net investments in subsidiaries, branches or associated capital undertakings. b) Relates to the non-SAR denominated assets. The currencies where structural FX rise arises are those other than the designated reporting currency of the SABB, which is the Saudi Riyal (SAR).

Liquidity Risk

Liquidity risk is the risk that SABB does not have sufficient financial resources to meet its obligations when they fall due, or will have to do so at excessive cost. This risk can arise from mismatches in the timing of cash flows. Funding risk (a particular form of liquidity risk) arises when the necessary liquidity to fund illiquid asset positions cannot be obtained at the expected terms and when required.

As a general policy SABB seeks to be self-sufficient with regards to funding its own operations through the use of a range of diverse funding sources.

The approach taken by SABB to managing liquidity risk has been aligned with the 17 principles issued by the BIS in their note titled ‘Principles for Sound Liquidity Risk Management and Supervision’ issued in September 2008.

SABB assesses and manages liquidity risk through clearly defined liquidity policies which form part of a boarder Liquidity and Funding framework and funding plan which is reviewed and approved by ALCO and EXCOM. There is a designated Liquidity Management Committee, which monitors the bank's current and projected liquidity position and proposes changes to ALCO on SABB’s liquidity ratio limits, funding strategy and liquidity stress testing scenarios.

SABB manages and reports balance sheet liquidity against a range of internal and regulatory ratios which cover the proportion of net liquid assets to customer liabilities, the adequacy of assets to deposits, the proportion of customer deposits held in liquid assets and that Amanah liabilities are only invested in Amanah assets and any excess needs to be invested in Shariah compliant assets.

The Financial Control Department prepares a bank-wide liquidity report, which is monitored daily against approved limits and regulatory requirements by Senior Management, along with a 1-year rolling forecast balance sheet on a quarterly basis showing expected loan and deposit growth including major currency breakdowns.

SABB seeks to maintain a cushion of unencumbered, high quality, liquid assets that can be liquidated or repoed in times of stressed liquidity. The asset tolerance limit is defined and monitored by ALCO on a monthly basis.

Operational Cashflow Projections are used to stress the liquidity position across a range of maturity bands and through the application of bank specific and market wide scenarios.

Current accounts and savings deposits payable on demand or at short notice form a significant part of SABB's funding and there is considerable focus on maintaining the stability of such deposits. SABB manages and monitors depositor and debt security concentration in order to avoid undue reliance on large individual depositors and ensuring a satisfactory overall funding mix and maturity profile of deposit and debt securities.

A comprehensive Liquidity Contingency Plan is in place and tested on an annual basis. The plan identifies early indicators of stress conditions and describes actions to be taken in the event of difficulties arising from systemic or other crises.

SABB has continued to expand its investor relations programme to ensure that it keeps investors advised of developments and kept itself aware of their changing requirements in readiness for any potential debt or equity issuances.

Concentration Risk

Concentration in credit portfolios has been a cause for bank and banking system distress in the past. As a result, concentration risk forms an integral part of SABB's supervisory review and internal risk assessment process. There can also be benefits where a Banks portfolio can evidence diversification across asset classes, customer groups, industry sectors, business lines and geographic locations.

Concentration risk can manifest itself in three main forms where there is an imperfect diversification of credit risk.

- Single name concentration (Idiosyncratic risk)
- Sector concentration (Systematic risk)
- Contagion (Systemic failure)

It is the Bank's policy to avoid undesired concentration of exposure in any single dimension of the entire credit portfolio (asset class, industry sector, geography, etc.). We aim to ensure that the Bank's exposure is well diversified across a broad mix of business sectors. SABB has established exposure policies and lending risk tolerance limits for individual counterparties, industry sectors, country cross border risk, specific products or advance purposes and portfolio level controls.

SABB retains capital against the granularity of its lending portfolio and reviews the level of concentration within portfolios on a monthly basis through the senior risk management meeting (RMM) and Excom.

Reputational Risk

Reputational risk is the potential negative but unquantifiable current and future impact on profits and capital, which might arise from a changed and adverse perception of SABB's reputation among its various stakeholders in the various facets of its operations.

The safeguarding of SABB’s reputation is of paramount importance and critical to its success. SABB’s policies and procedures are regularly reviewed to ensure reputational factors covering environmental, social and governance risks are continually updated in light of relevant developments. All new products are reviewed by the reputational risk committee, which reviews key activities that give rise to material reputational risk sensitivities.

Actions by employees can have an impact on the reputation of the bank and they are provided with awareness sessions to educate people on reputational risk and their personal responsibilities in upholding and enhancing the image and brand of SABB.

The range of stakeholders whose perception of SABB may give rise to a reputational impact include investors, customers, suppliers, employees, regulators, politicians, the media, non-governmental organizations, and the communities and societies in which SABB operates. The facets of SABB's activities that may influence a changed and adverse perception of its reputation include product quality and cost, corporate governance, employee relations, customer service, intellectual capital, financial performance, compliance or regulatory breaches, involvement in the financing of terrorist or major money laundering incidents, and the handling of environmental and social issues.

Sustainability risk sensitivities are also of high importance in managing reputational risk and SABB seeks to uphold the highest sustainability risk standards, including the equator principles for project finance lending, sector based sustainability guidelines covering sectors with high environmental, ethical or social impacts.

The unique structure of Islamic financial products (Shariah Compliant Products) is quite distinct and places increased requirements on the Bank to ensure that not only do they meet customer suitability standard but that the internal Shariah compliance process if robust. The impact of Shariah compliance failures would impact SABB’s reputation and as a result SABB operates a dedicated Amanah banking team who control Islamic product develop and monitor ongoing compliance with Shariah requirements.

Macro Economic and Business Cycle Risk

SABB assesses and manages macroeconomic and business cycle risk through clearly defined policies and procedures. Macroeconomic and Business Cycle Risks are seen as the potential negative impacts on profits and capital as a result of SABB not meeting its goals and objectives caused by unforeseen changes in the business and regulatory environment, exposure to economic cycles and technological changes.

As an intrinsic part of the process, SABB's Risk Management Meeting (RMM) regularly monitors local key macroeconomic indicators, such as:

- Price of oil per barrel in the world market
- Any significant reduction in public finances expenditure
- The TASI index
- Decline in rental yields
- Annual real GDP growth
- Inflation rate
- Currency uncertainty that may be caused by USD weakness and real appreciation of the SAR

Strategic Risk

Strategic Risk is the risk that the business will fail to identify and react appropriately to opportunities and/or threats arising from changes in the market, some of which may emerge over a number of years such as changing economic and political circumstances, customer requirements, demographic trends, regulatory developments or competitor action. Risk may be mitigated by consideration of the potential opportunities and challenges through the strategic planning process.

Strategic and Operating Plans are established against clearly defined guidelines and via a rigorous process that considers the wider business, regulatory and economic environment when preparing the plans. Plans are monitored on an ongoing basis to ensure that targets are being achieved and to proactively consider risks, which might arise to non-achievement of goals.

The strategic risks are monitored by the strategic planning function on a regular basis and variations, if any are reported to the Risk Management Meeting. Where necessary the Board holds strategic review meetings to refine the bank's strategy in light of market developments.

Compliance Risk

Compliance Risk is the risk leading to statutory, legal sanctions, material financial loss, or damage to the reputation of SABB that may be suffered as a result of the failure to comply with all applicable laws, rules and regulations. The aim of compliance is to protect the reputation and credibility of SABB and protect the interest of shareholders and depositors, and safeguard the institution against legal consequences.

Compliance risk is managed by adhering to industry best practice and local regulator requirements for the management of Compliance in banks. A dedicated compliance manual, responsibilities assigned to business compliance officers, periodic risk based compliance risk assessments and quarterly meetings are methods used to manage compliance risk. Annual Compliance Risk Assessments (CRA) are required by every business and Business control heat maps monitor and report progress. In 2009 a Compliance Committee was formed based on the guidelines of the SAMA Compliance Manual issued during the year.

Wrong Way Risk

Wrong-way risk occurs when there is an adverse correlation between the counterparty's probability of default and the mark-to-market value of the underlying transaction. Wrong way risks arising from customer activity is managed under defined guidelines and limits on a regular basis. The following control infrastructure is in place and reported to senior management on monthly basis.

- Business referral process where Wrong-Way Risk transactions are passed for separate approval prior to execution.
- A wrong way risk exposure report is tabled in the senior Risk Management Meeting.
- Total exposure at counterparty level is maintained under predefined credit approved limits.

Other Risks

SABB continues identifying risks that will adversely impact on the present and future operations of the Bank. The process flows in an interactive fashion among the bank's Board of Directors, executive committee and senior managers. This aims to address issues in a proactive manner with respect to risk assessment and management and to ensure continued compliance with HSBC Group and consistent with local regulatory requirements. Economic and regulatory capital issues, if any, shall be promptly addressed through the policies and procedures in place.

Table 4
CREDIT RISK: GENERAL DISCLOSURES FOR ALL BANKS

Past due loans:

A loan is considered past due if it is not repaid on the payment due date or maturity date.

Impaired loan:

Individual Impairment Provisions:

The Bank reviews its non-performing loans and advances at each reporting date to assess whether a specific provision for credit losses should be recorded in the consolidated statement of income. In particular, judgment by management is required in the estimation of the amount and timing of future cash flows when determining the level of provision required. Such estimates are based on assumptions about a number of factors and actual results may differ, resulting in future changes to the specific provision.

Collective Impairment Provisions:

The Bank reviews its loan portfolios to assess an additional portfolio provision on each reporting date. In determining whether an impairment loss should be recorded, the Bank makes judgments as to whether there is any observable data indicating that there is a measurable decrease in the estimated future cash flows from a portfolio of loans. This evidence may include observable data indicating that there has been an adverse change in the payment status of borrowers in a group, or national or local economic conditions that correlate with defaults on assets in the group. Management uses estimates based on historical loss experience for assets with credit risk characteristics and objective evidence of impairment similar to those in the portfolio when estimating its cash flows. The methodology and assumptions used for estimating both the amount and the timing of future cash flows are reviewed regularly to reduce any differences between loss estimates and actual loss experience.

Credit Risk:

Standardised Approach

Overall, SABB currently calculates its models and assessments based on the Basel II Standardised Approach, in line with the approval granted by SAMA. Specifically, SABB is segmenting its asset portfolio and generating associated RWAs and capital support data in accordance with SAMA guidelines and uses the Standardised approach to calculate the minimum capital requirements.

Advanced IRB Approach

SABB is developing its processes, in line with SAMA guidance notes, to enable it to move to the advanced approaches of Basel II for credit risk.

SABB has a set of independently validated corporate scorecards to calculate the PD for each exposure. Along with this, specific LGD & EAD engines are being developed to calculate the respective LGD & EAD for each client. The output from these engines, combined with additional appropriate data such as maturity, allow SABB to calculate RWA based on the IRB-A approach. It is important to note that each distinct portfolio has a dedicated PD scorecard to determine the appropriate credit risk rating. These scorecards are reviewed at least annually and approved by the RMM.

For retail portfolios SABB uses a wide range of application and behavioural models and has completed a risk segmentation process as well as having developed a full range of Basle II IRB-A compliant scorecards to calculate expected and unexpected losses for each retail portfolio. SABB is currently in the process of embedding these models into its capital generation system.

Table 5

STANDARDIZED APPROACH AND SUPERVISORY RISK WEIGHTS IN THE IRB APPROACHES

For portfolios under the standardized approach, External Credit Assessment Institutions risk assessments are used by SABB as part of the determination of risk weightings:

- SABB has nominated three SAMA recognized External Credit Assessment Institutions for this purpose – Moody's Investors Service, Standard and Poor's Ratings Group and the Fitch Group.
- Credit ratings of all exposures are individually determined from the above credit rating agencies and mapped to the exposures assigning a risk weight according to the supervisory tables.

The alignment of alphanumeric scales of each agency to risk buckets is as follows:

Moody's	Standard and Poor's	Fitch
Aaa	AAA	AAA
Aa1	AA+	AA+
Aa2	AA	AA
Aa3	AA-	AA-
A1	A+	A+
A2	A	A
A3	A-	A-
Baa1	BBB+	BBB+
Baa2	BBB	BBB
Baa3	BBB-	BBB-
Ba1	BB+	BB+
Ba2	BB	BB
Ba3	BB-	BB-
B1	B+	B+
B2	B	B
B3	B-	B-
Caa1	CCC+	CCC+
Caa2	CCC	CCC
Caa3	CCC-	CCC-
Ca	CC	CC
C	C	C
WR	D	D
	NR	NR

Claims on sovereigns and their central banks

Credit Assessment	AAA to AA-	A+ to A-	BBB+ to BBB-	BB+ to B-	Below B-	Unrated
Risk Weight	0%	20%	50%	100%	150%	100%

Claims on Banks and Securities Firms (Under Option 2 as required by SAMA)

Credit Assessment	AAA to AA-	A+ to A-	BBB+ to BBB-	BB+ to B-	Below B-	Unrated
Risk Weight under option 2	20%	50%	50%	100%	150%	50%
Risk weight for short-term claims under Option - 2	20%	20%	20%	50%	150%	20%

Multilateral Development Banks

0% risk weight for qualifying MDB's as per SAMA and in general risk weights to be determined on the basis of individual MDB rating as for option# 2 for banks.

Claims on public sector entities (PSEs)

As per Option – 2

Claims on corporates

Credit Assessment	AAA to AA-	A+ to A-	BBB+ to BB-	Below BB-	Unrated
Risk Weight	20%	50%	100%	150%	100%

Claims included in the regulatory non-mortgage retail portfolios

A 75% risk weight to be assigned to such exposures

Claims secured by residential mortgages

A 100% retail risk weight to be applied to such claims.

Claims secured by commercial real estate

A 100% retail risk weight to be applied to such claims.

Past due loans

Risk weight%	**Level of Provisioning**
150	Upto 20%
100	20% to 50%
100	50% and above

Other assets

The standard risk weight for all other assets will be 100% except gold to be treated equivalent to cash and risk weighted at 0%.

When calculating the risk weighted value of any exposure under the standardized approach, look up function is applied to the central data base maintained in Excel and assigns to each individual exposures.

Table 6
CREDIT RISK: DISCLOSURES FOR PORTFOLIOS SUBJECT TO IRB APPROACHES

Not Applicable

Table 7
CREDIT RISK MITIGATION: DISCLOSURES FOR STANDARDISED AND IRB APPROACHES

The mitigation of credit risk is an important aspect of its effective management and takes many forms.

SABB grants facilities based on the borrower's ability to repay, rather than placing its reliance on credit risk mitigation. SABB nevertheless does hold a range of security to reduce the risk of loss and maximise the probability of facilities being repaid. A number of these risk mitigants have been applied under the Standardised approach in Pillar I, and there are other securities that cannot be assigned a value such as shares, land and local property.

The main types of collateral taken by the bank are as follows:

- Savings and Time deposits
- Listed Shares
- Bank Guarantees
- Title deeds of property
- Government Bonds
- Mutual Funds Units
- Corporate / Individual Guarantees
- Assignment of salary or contract proceeds

International and Local Banks Guarantees are referred to Institutional Banking for counterparty and cross border country risk approval

The granting of facilities and taking of collateral as risk mitigants is governed by defined policies and procedures, as well as the use of bank standard documentation that cater for the offset of credit balances against facilities granted, the control over the integrity and valuation of collateral, and the rights required to enforce and realize security. SABB monitors the concentration of risk mitigants and does not have any material concentrations in the risk mitigants currently held.

Table 8
GENERAL DISCLOSURE FOR EXPOSURE RELATED TO COUNTERPARTY CREDIT RISK

Counterparty credit risk is the risk that a counterparty to a transaction may default before completing the satisfactory settlement of the transaction.

The Bank calculates its counterparty credit risk for both trading and banking book exposures by assigning risk weights to exposure types:

- Securities financing transactions (e.g reverse repos) - trading and banking book
- Over the counter (OTC) derivatives – trading and banking book

The capital requirement is determined on above exposures based on same methodology as credit risk and is reported separately for risk assessment.

Table 9
SECURITIZATION

Currently there are no securitisation deals involving SABB. There is a prescribed process in SABB for managing securitisation transactions. This risk assessment and reporting process will be observed when the need to apply the same arises.

Table 10
MARKET RISK: DISCLOSURE FOR BANKS USING STANDARDIZED APPROACHES

Market risk is identified by businesses and transferred into SABB Treasury who has the necessary expertise to manage the positions using risk limits approved by the executive committee of the Board (EXCOM). Exposures are separated into trading (market-making, proprietary trading, and mark to market positions) and non-trading (interest rate management, and financial investments either held to maturity or available for sale) portfolios.

The monitoring and control of market risk is handled by an independent market risk team which is responsible for ensuring market risk exposures are measured in accordance with defined policies and reported daily against prescribed control limits.

SABB uses a range of control measures to manage market risk ranging from specific stop loss control limits, to sensitivity analysis limits including the present value of a basis point movement of interest rates, as well as VAR loss limits designed to estimate the potential loss from market movements across a specified time horizon and for a given level of confidence using a historical simulation approach. SABB recognizes the limitations of VAR and compliments its analysis with scenario stress testing to evaluate the impact of more extreme but plausible events or movements in market variables.

Stress testing is performed at a portfolio level covering the impacts of movements in any single risk factor, technical scenarios looking at the largest observed movements, hypothetical scenarios looking at potential macro-economic events and historical scenarios which incorporate observed market movements from periods not captured in the VAR. These scenarios are governed by an oversight committee and the results are reported to senior management together with an assessment of the impact such events would have on SABB together with proposals for mitigating actions.

The risk of credit spread movements or specific issuer risk which arises from the change in value of a bond due to perceived changes in the credit quality of an issuer is managed through credit VAR and stress testing limits and tolerance levels.

Whilst SABB uses both VAR and standard rules to manage market risk, capital requirements are assessed for all positions using the standard rules approaches prescribed by SAMA.

Table 11
MARKET RISK: DISCLOSURE FOR BANKS USING INTERNAL MODELS APPROACH (IMA) FOR TRADING PORTFOLIOS

Not Applicable

Table 12
OPERATIONAL RISK

SABB manages operational risk by tracking actual and near miss operational losses. Historical loss experiences have been seen in the areas of fraudulent activities, breakdown in processes due to misjudgment or human error and systems failures.

Whilst operational risk is the responsibility of individual employees and businesses it is organized as an independent risk discipline within SABB. The operational risk function seeks to manage and control risk in a cost efficient manner within agreed risk tolerance levels. A formal governance structure is in place to provide oversight over the management of risk within which designated business coordinators feed into a committee structure and ultimately to the Risk Management Meeting and Board.

Operational risk policies and procedures explain the requirements for identifying, assessing, monitoring reporting and controlling risk as well as providing guidance on the mitigation action to be taken when weaknesses are identified. Businesses are responsible for undertaking a self assessment, designing controls and reporting defined key risk indicators all of which are subject to an independent challenge and review process. Systems and centralised databases are in place to track and record actual as well as near miss loss events for collation, analysis and reporting to senior management.

Capital requirements are assessed using the standardised approach, which applies one of three fixed percentages to an average of the last three financial years gross revenues allocated across eight defined business lines.

Table 13
EQUITIES: DISCLOSURES FOR BANKING BOOK POSITIONS

Equity Investments are either classified as “Available for sale” or as “Investments in Associate”.

Available-for-sale investments are those intended to be held for an unspecified period of time, which may be sold in response to needs for liquidity or changes in interest rates, exchange rates or equity prices.

Investments, which are 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 “Other reserves” under Shareholders’ equity. On derecognition, any cumulative gain or loss previously recognized in shareholders’ equity 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.

Investment in associate is accounted for using the equity method in accordance with International Accounting Standard 28 – Investment in Associates. An associate is an entity in which the Bank has significant influence and which is neither a subsidiary nor a joint venture.

Under the equity method, investment in associate is carried in the balance sheet at cost plus post investment changes in the Bank's share of net assets of the associate. The investments in associates are carried in balance sheet at the lower of equity accounted or recoverable amount.

The reporting dates of the associate and the Bank are identical and the associate's 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 are eliminated to the extent of the Bank's interest in the associate.

Table 14
INTEREST RATE RISK IN THE BANKING BOOK (IRRBB)

The analysis of Interest Rate risk is complicated by having to make assumptions on embedded optionality in products such as loan prepayments, and from behavioural assumptions regarding the economic duration of liabilities, which are contractually repayable on demand. Product reviews are undertaken annually to review and validate any behavioural assumptions.

In order to manage interest rate risk, the risk is transferred to Treasury by a series of internal deals between Treasury and the various business units. Treasury then evaluates the relative risk on the basis of applying Present Value Basis Point (PVBP) and VAR approaches and managing the resultant risk within approved limits assigned by Excom. Where practical, Risk monitoring takes place on a daily basis.

Stress testing and sensitivity analysis is also carried out and results reported to ALCO on a monthly basis.

SABB Treasury seeks to manage the impact of interest rate risk on net interest income in so far as such hedging is possible and cost effective to undertake.