Saudi Hollandi Bank البنك السعودي الهولندي

BASEL II – PILLAR 3 ANNUAL DISCLOSURES

YEAR-2011

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1. Scope of Application

a) Scope

The Basel II disclosures contained herein relate to Saudi Hollandi Bank and its subsidiaries Saudi Hollandi Capital (SHC) and Saudi Hollandi Real Estate Company (SHREC), hereinafter collectively referred to as 'the Group' for the period ended December 31, 2011. These are compiled in accordance with 'the Saudi Arabian Monetary Agency (the 'SAMA') regulations on Implementation of New Capital Adequacy Framework'

Pillar 1 – Minimum capital requirements

Basel II requires risk-weighted assets (RWAs) to be calculated for credit, market and operational risk with various approaches available to banks, with differing levels of sophistication.

Minimum capital requirements are calculated as 8% of RWAs.

The Group applies the standardized approach for calculating RWAs.

The capital charge for market risk, is based on a "building-block" approach. The capital charge for each risk category is determined separately. Within the interest rate and equity position risk categories, separate capital charges for specific risk and the general market risk arising from debt and equity positions are calculated.

The Group is also required to calculate a capital charge to cover operational risk, which is calculated by applying a beta by activity to the average income that was achieved in the previous three years by the Group.

Pillar 2 – Supervisory review process

Pillar 2 requires banks to undertake a comprehensive assessment of their risks and to determine the appropriate amounts of capital to be held against these risks where other suitable mitigants are not available. This risk and capital assessment is commonly referred to as the Internal Capital Adequacy Assessment Plan (ICAAP). The range of risks that are covered by the ICAAP is much broader than Pillar 1, which covers only credit, market and operational risk. The risks such as liquidity, concentration, strategic, reputational etc., are covered under Pillar 2.

The Group has developed an ICAAP framework which closely integrates the risk and capital assessment processes, and ensures that adequate levels of capital are maintained to support the Group under stressed conditions.

The Group has formed various committees to oversee the various risks it is exposed to:

The Asset and Liability Committee (ALCO), is responsible for the establishment of, and compliance with, policies relating to balance sheet management, the risks and ensure capital is well aligned.

Credit risk responsibility is vested with the Board and Executive Committee (EC), delegated to the Head Office Credit Committee (HOCC). Treasury Risk Control Services (TRCS) is responsible for controlling Treasury's market and credit risk within approved market and counterparty limits. Operational Risk Management (ORM) is a unit within the risk function, which is responsible for identifying, assessing, monitoring and controlling/mitigating of operational risk throughout the Bank in conjunction with all business units of the Bank.

The ICAAP framework has been designed to be applied consistently across the organisation to meet the Pillar 1 and Pillar 2 requirements of the regulator.

The ICAAP is followed by in-depth discussions between the Group and SAMA on the appropriate capital levels (this second stage is called the Supervisory Review and Evaluation Process or SREP).

Pillar 3 – Market discipline

Pillar 3 aims to provide a consistent and comprehensive disclosure framework that enhances comparability between banks and further promotes improvements in risk practices. The information provided here has been reviewed and validated by senior management and is in accordance with the rules in force at the time of publication, covering both the qualitative and quantitative items.

In accordance with SAMA regulation, the Group publishes the Pillar 3 quantitative disclosures on a semi-annual basis and both qualitative & quantitative disclosures on an annual basis in its website www.shb.com.sa as soon as is practical after the Group announces its annual results.

b) Basis of consolidation

The consolidated financial statements are prepared in accordance with Accounting Standards for Financial Institutions promulgated by SAMA and International Financial Reporting Standards (IFRS) issued by International Accounting Standards Board (IASB). The Group prepares its consolidated financial statements to comply with the Banking Control Law, the provisions of Regulations for Companies in the Kingdom of Saudi Arabia and the Bank's Articles of Association.

The basis of consolidation for accounting purposes is described in note 3(a) to the Notes to the consolidated financial statements of the Annual accounts 2011.

c) Capital transferability between legal entities

Statutory restriction

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

Regulatory prescription

SAMA has prescribed a minimum of 8% Capital adequacy ratio which is in line with Basel II requirements.

2. Capital structure

The Group is well capitalised with a Tier 1 capital ratio of 13.2 per cent (2010:12.7 per cent) and a total capital ratio of 16.6 per cent (2010: 16.4 per cent).

For regulatory purposes, capital is categorised into two main categories. These are Tier 1 and Tier 2, which are described below

Tier 1 capital

Tier 1 capital consists of ordinary share capital, statutory reserves, general reserves, retained earnings and Fair Value reserves.

The ordinary share capital is the authorized, issued and fully paid up share capital of the bank, which consists of 330.75 million shares of SAR 10 each (2010: 330.75 million shares of SAR 10 each). The ownership of the Group's share capital has remained unchanged during 2011. It is as follows:

Saudi Shareholders	60%
ABN Amro Bank N.V	40%

Tier 2 capital

Tier 2 capital should not exceed Tier 1 capital and it comprises the following:

a) **Reserves** included under Tier 2 comprise balances that are available to meet unidentified impairments. These reserves are considered as Tier 2 capital up to a maximum of 1.25 per cent of the total risk-weighted assets as on December 31, 2011.

The Reserves also includes the staff share plan reserve elaborated in note 38 to the annual financial statements for the year ended 31 Dec 2011.

b) **Subordinated debt** includes the following debt securities:

(i) On 30 December 2009, the Group issued SAR 725 million unsecured subordinated Mudaraba Certificates (the Certificates), due in 2019, through public offer. The Group may at its option, but subject to the prior written approval of SAMA redeem the Certificates at their redemption amount at the end of 2014 or at the end of each calendar year thereafter until 2018, or in the event of certain changes affecting taxation and regulatory capital treatment of these Mudaraba Certificates.

(ii) On 29 December 2008, the Group issued SAR 775 million unsecured subordinated Mudaraba Certificates (the Certificates), due in 2018. The Group may at its option, but subject to the prior written approval of SAMA redeem the Certificates at their redemption amount at the end of 2013 or at the end of each calendar year thereafter until 2017, or in the event of certain changes affecting taxation and regulatory capital treatment of these Mudaraba Certificates.

These borrowings are of initial maturity of not less than 5 years and are progressively discounted as per the SAMA guidelines, based on their residual maturity. The total amount of subordinated debts that can be considered for tier 2 cannot exceed 50% of tier 1.

Regulatory deductions

SAMA requires deductions and prudential filters to be applied in calculating capital for regulatory purposes.

Investments in ‘material holdings’ – Insurance organisations: The Group has a 20 percent holding in Wataniya Insurance company. Since it exceeds the threshold limit of 10% stipulated by SAMA, the investment amount of SAR 20 million less the impairment amount of SAR 2.25 million is deducted from Core Tier 1 and Tier 2 capital in equal proportions.

The table below summarises the consolidated capital position of the Group.

Capital Structure (Table 2, (b) to (e)) (Figures in SAR 000's)	
Components of Capital	**Amount**
Core capital - Tier 1:	
Eligible paid-up share capital	3,307,500
Eligible reserves	2,522,480
Retained earnings	1,217,578
Other reserves	(20,240)
Deductions from Tier 1:	
Significant minority investments at 10% and above - Insurance organizations	(8,875)
Total Core Tier 1 capital	**7,018,443**

Supplementary capital - Tier 2:	
Staff share plan reserve	3,950
Subordinated loan capital	1,500,000
Qualifying general provisions	296,771
Deductions from Tier 2:	
Significant minority investments at 10% and above - Insurance organizations	(8,875)
Total Tier 2 capital	1,791,846
Total capital base	**8,810,289**

3. Capital adequacy

SHB determines an adequate level of capital to cover the risks it is exposed to and to support its current and forecast growth. Within SHB, capital adequacy is assessed in the ICAAP. The ICAAP is required as part of the Basel II Pillar II capital adequacy regime. It aligns capital levels to all risks (Pillar 1 & Pillar 2) that the Group is exposed to, and outlines processes by which the Group identifies, measures, monitors and manages risks, thereby ensuring that the Group's capitalization is appropriate.

Capital Planning and Targets

The ICAAP describes the Group's business strategy, its forecasts for assets, its appetite and its assessment of the specific risks it is exposed to, how it intends to mitigate those risks and the capital it allocates to these risks. As such, the ICAAP is a crucial element of the Group's strategic decision making, and its strategy is continuously aligned with the ICAAP.

The ICAAP contains, in detail the following elements:

a) The risks the Group is exposed to and how it measures, monitors and manages those risks;
b) A calculation of internal capital requirements (including Pillar 1 and Pillar 2 risks) in light of the business plans and the risks the Group is exposed to;
c) A calculation of the capital generated internally or externally and the assessment of the adequacy of the Group's capital and buffers vis-à-vis the capital requirements; and
d) A stress test of the Group's capital buffer.

In addition to the annual ICAAP review, the bank has a capital management plan forecasted monthly and monitors closely.

The following sections cover the Pillar 1 risks, which the Group is exposed to and the capital requirements for the same.

a) Risk Exposure and Risk Assessment under Pillar 1

The following table details the types of exposures in each asset class.

Basel Asset Class	**Typical Types of Exposure**
Corporate	Individually rated and managed exposures not covered under other categories - mainly lending and off-balance sheet facilities provided to larger companies, partnerships and other bodies
Sovereign	Exposures to sovereigns and central banks. Includes direct exposures e.g. bond holdings
Bank	Exposures to non-Group bank counterparties. Includes bond holdings and deposits with other banks, trade finance exposures, guarantees provided by other banks and derivatives
Residential Mortgage	Retail exposures secured by residential properties - mainly home loans
Qualifying Revolving Retail	Retail managed consumer credit card exposures
Other Retail	Retail managed exposures other than mortgage and qualifying revolving - includes personal loans, consumer and small business leasing, retail small business lending
Equity	Holdings of third party equities where not consolidated or deducted from capital
Other Assets	Mainly fixed assets and prepayments

The Risk assessment process is elaborated under disclosure 4.

The Group applies the standardised approach for calculation of credit risk under Pillar 1. SAMA has prescribed a minimum of 8% Capital adequacy ratio which is in line with Basel II requirements.

The following table shows the amount of Risk weighted exposures by portfolios and the capital requirements for the same.

Amount of Exposures Subject To Standardized Approach of Credit Risk and related Capital Requirements (Table 3, (b)) (Figures in SAR 000's)		
Portfolio	**Amount of exposures**	**Capital requirements**
Sovereigns and central banks:	**14,063,517**	**420**
SAMA and Saudi Government	13,437,709	-
Others	625,808	420
Multilateral Development Banks (MDBs)	134,431	-
Public Sector Entities (PSEs)	-	-
Banks and securities firms	5,545,250	178,139
Corporates	41,677,441	3,278,507
Retail non-mortgages	**5,564,114**	**317,245**
Small Business Facilities Enterprises (SBFE's)	*637,529*	*38,252*
Mortgages	**229,611**	**18,369**
Residential	229,611	18,369
Commercial	-	-
Securitized assets	-	-
Equity	67,702	5,416
Others	2,450,006	101,166
Total	**69,732,072**	**3,899,262**

The Group applies the Standardised approach to calculate the capital charge to cover market risk, which uses a "building-block" approach. The capital charge for each risk category is determined separately. Within the interest rate and equity position risk categories, separate capital charges for specific risk and the general market risk arising from debt and equity positions are calculated. The following table shows the capital requirements for various risks.

Capital Requirements For Market Risk (Table 3, (d)) (Figures in SAR 000's)					
	Interest rate risk	**Equity position risk**	**Foreign exchange risk**	**Commodity risk**	**Total capital requirements**
Standardised approach	13,137	-	35,044	-	48,181

The Standardised Approach for operational risk capital calculation applies a beta to the average income that was achieved in the previous three years by the Group. The following table shows the capital requirements for operational risks.

Capital Requirements for Operational Risk (Table 3, (e)) (Figures in SAR 000's)	
Particulars	**Capital requirements**
Standardised approach	296,952
Total	**296,952**

Capital Adequacy Ratios (TABLE 3, (f))		
Particulars	**Total capital ratio**	**Tier 1 capital ratio**
	%	
Top consolidated level	16.6%	13.2%

4. Credit Risk

Credit risk is the risk of financial loss from the failure of a customer to fully honour the terms of its contract with the Bank. Losses can arise from:

- Funded lending: i.e. providing loans, overdrafts, credit cards;
- Non-funded: contingent products such as Trade Finance facilities and FX products. Non-funded risk can also give rise to settlement risk which can occur from any transaction which requires assured payment of funds on a given date.

Two variants of credit risk are settlement risk and loan syndication risk.

Credit risk responsibility is vested with the Board and EC, delegated to the HOCC, an approval authority per obligor up to SAR300 million.

The granting of credit to customers is a core business of SHB and accounts for a major portion of the Bank's balance sheet and profitability and hence the major contributor to the Bank's risk assets.

Credit policies

The Credit Policy and Procedures Manual is subject to annual review, endorsed by HOCC and approved by the Board or Executive Committee (EC) at the Board's discretion. Any interim new policy additions or amendments are circulated to business units by 'Credit Policy Amendment Circulars'. Other risk policy manuals are subject to periodic review, and approved by HOCC or ALCO as needed by changing circumstances. The CRM analyst population is encouraged to make suggestions to improve policy.

Concentration risk

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 the diversification of lending activities to ensure that there is no undue concentration of risks with individuals or groups of customers in specific locations or businesses. It also takes security when appropriate.

Credit monitoring

Credit limits are monitored by the business and control functions with at least weekly meetings with senior management to resolve any identified excesses. In addition, regular credit portfolio reports are prepared and presented to HOCC and EC covering the corporate, retail and financial institutions portfolios.

All corporate banking counterparties are rated with internal rating known as the Uniform Counterparty Rating (UCR) scale, based on the Moody's Risk Advisor platform.

The move towards greater risk-aligned pricing was enhanced during 2010 with the introduction of the Risk-Adjusted Return on Regulatory Capital calculator (RARORC). Using a customer's UCR, new business propositions, increases and renewals can be measured against the required internal hurdle rate of 15%.

In addition to monitoring credit limits, the Bank manages the credit exposure relating to its derivative trading activities by entering into master netting agreements and collateral arrangements with counterparties in appropriate circumstances, and by limiting the duration of exposure. The Bank assesses its credit risk relating to derivatives as the potential cost to replace a derivative contract if counterparty fails to fulfill its obligations under the contract. To control the level of credit risk taken, the Bank sets limits for these products and assesses counterparties' creditworthiness using the same techniques as for its lending activities.

Credit risk exposures

The following tables detail the Group's standardised credit risks by exposure class, geographic area, industry sector and residual maturity band.

Credit Risk Exposure (Table 4, (b)) (Figures in SAR 000's)		
Portfolios	**Total gross credit risk exposure**	**Average gross credit risk exposure over the period***
Sovereigns and central banks:	14,063,517	13,636,918
SAMA and Saudi Government	*13,437,709*	*13,095,208*
Others	*625,808*	*541,710*
Multilateral Development Banks (MDBs)	134,431	163,146
Public Sector Entities (PSEs)	-	-
Banks and securities firms	5,545,250	4,647,415
Corporates	41,677,441	39,363,360
Retail non-mortgages	5,564,114	5,437,119
Small Business Facilities Enterprises (SBFE's)	*637,529*	*584,488*
Mortgages	229,611	123,721
Residential	229,611	123,721
Commercial	-	-
Securitized assets	-	-
Equity	67,702	42,192
Others	2,450,006	2,527,092
Total	**69,732,072**	**65,940,961**

* Quarterly averages for the year 2011.

Geographic Breakdown (Table 4, (c)) (Figures in SAR 000's)							
Portfolios	**Geographic area**						
	Saudi Arabia	**Other GCC & Middle East**	**Europe**	**North America**	**South East Asia**	**Others countries**	**Total**
Sovereigns and central banks:	13,437,709	625,808	-	-	-	-	14,063,517
SAMA and Saudi Govt.	13,437,709	-	-	-	-	-	13,437,709
Others	-	625,808	-	-	-	-	625,808
Multilateral Development Banks (MDBs)	-	181	134,250	-	-	-	134,431
Public Sector Entities (PSEs)	-	-	-	-	-	-	-
Banks and securities firms	1,488,616	656,229	835,818	545,778	1,463	2,017,347	5,545,250
Corporates	40,633,458	1,015,282	5,900	-	-	22,802	41,677,441
Retail non-mortgages	5,564,114	-	-	-	-	-	5,564,114
Small Business Facilities Enterprises (SBFE's)	*637,529*	-	-	-	-	-	*637,529*
Mortgages	229,611	-	-	-	-	-	229,611
Residential	*229,611*	-	-	-	-	-	229,611
Commercial	-	-	-	-	-	-	-
Securitized assets	-	-	-	-	-	-	-
Equity	67,702	-	-	-	-	-	67,702
Others	2,450,006	-	-	-	-	-	2,450,006
Total	**63,871,215**	**2,297,499**	**975,968**	**545,778**	**1,463**	**2,040,149**	**69,732,072**

Industry Sector Breakdown (Table 4, (d)) (Figures in SAR 000's)													
Portfolios	Industry sector												
	Govt and quasi govt.	Banks and other financial institutions	Agriculture and fishing	Manufactu-ring	Mining and quarrying	Electricity, water, gas and health services	Building and construction	Commerce	Transportation and communication	Services	Consumer loans and credit cards	Others	Total
Sovereigns and central banks:	14,063,517	-	-	-	-	-	-	-	-	-	-	-	14,063,517
SAMA & Saudi Government	13,437,709	-	-	-	-	-	-	-	-	-	-	-	13,437,709
Others	625,808	-	-	-	-	-	-	-	-	-	-	-	625,808
Multilateral Development Banks (MDBs)	-	134,431	-	-	-	-	-	-	-	-	-	-	134,431
Public Sector Entities (PSEs)	-	-	-	-	-	-	-	-	-	-	-	-	-
Banks and sec firms	-	5,545,250	-	-	-	-	-	-	-	-	-	-	5,545,250
Corporates	1,088,450	1,740,898	585,946	9,361,800	247,828	2,015,417	10,649,536	10,411,534	766,892	2,826,689	-	1,982,449	41,677,441
Retail non-mortgages	-	-	375	63,319	-	-	99,659	89,568	7,654	98,387	4,926,585	278,567	5,564,114
Small Business Facilities Ent.	-	-	375	63,319	-	-	99,659	89,568	7,654	98,387	-	278,567	637,529
Mortgages	-	-	-	-	-	-	-	-	-	-	229,611	-	229,611
Residential	-	-	-	-	-	-	-	-	-	-	229,611	-	229,611
Commercial	-	-	-	-	-	-	-	-	-	-	-	-	-
Securitized assets	-	-	-	-	-	-	-	-	-	-	-	-	-
Equity	-	-	-	-	-	-	-	-	-	-	-	67,702	67,702
Others	-	-	-	-	-	-	-	-	-	-	-	2,450,006	2,450,006
Total	**15,151,967**	**7,420,579**	**586,321**	**9,425,119**	**247,828**	**2,015,417**	**10,749,195**	**10,501,102**	**774,546**	**2,925,076**	**5,156,195**	**4,778,724**	**69,732,072**

Residual Contractual Maturity Breakdown (Table 4, (e)) (Figures in SAR 000's)									
Portfolios	**Maturity breakdown**								
	Less than 8 days	**8-30 days**	**30-90 days**	**90-180 days**	**180-360 days**	**1-3 years**	**3-5 years**	**Over 5 years**	**Total**
Sovereigns and central banks:	5,331,646	-	-	-	65,700	8,047,602	473,821	144,747	14,063,517
SAMA and Saudi Govt.	5,331,646	-	-	-	65,700	8,009,872	-	30,491	13,437,709
Others	-	-	-	-	-	37,731	473,821	114,256	625,808
Multilateral Development Banks (MDBs)	-	-	-	-	-	-	134,431	-	134,431
Public Sector Entities (PSEs)	-	-	-	-	-	-	-	-	-
Banks and securities firms	856,923	820,072	1,065,156	492,958	1,008,924	813,638	148,632	338,946	5,545,250
Corporates	5,270,847	8,619,503	3,971,108	7,706,714	4,766,113	3,644,190	6,344,593	1,354,373	41,677,441
Retail non-mortgages	1,107,321	49,247	209,211	339,480	2,772,360	835,784	189,947	60,764	5,564,114
Small Business Facilities Enterprises (SBFE's)	225,738	37,338	34,477	231,329	37,382	57,516	12,416	1,333	637,529
Mortgages	92	316	-	-	-	-	9,126	220,077	229,611
Residential	92	316	-	-	-	-	9,126	220,077	229,611
Commercial	-	-	-	-	-	-	-	-	-
Securitized assets	-	-	-	-	-	-	-	-	-
Equity	67,702	-	-	-	-	-	-	-	67,702
Others	637,131	-	-	-	115,305	-	-	1,697,571	2,450,006
Total	**13,271,661**	**9,489,138**	**5,245,475**	**8,539,152**	**8,728,401**	**13,341,214**	**7,300,551**	**3,816,478**	**69,732,072**

Impairment assessment methodology

In determining whether an impairment loss should be recorded, the Bank makes judgements as to any collateral held and whether there is any observable data indicating that there is a measurable decrease in the estimated future cash flows.

This evidence may include observable data indicating there has been an adverse change in the payment status of borrowers in a group. Management uses estimates based on historical loss experience for loans 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 the future cash flows are reviewed regularly to reduce any differences between loss estimates and actual loss experience.

The following tables sets out the details of impaired and defaulted loans and the provisions the Group is carrying as at the reporting date 31 Dec 2011.

Impaired Loans, Past Due Loans and Allowances (Table 4, (f)) (Figures in SAR 000's)											
Industry sector	Impaired loans	Defaulted	Ageing of Past Due Loans (days)				Specific allowances				General allowances
			Less than 90	90-180	180-360	Over 360	Balance at the beginning of the period	Charges during the period	Charge-offs during the period	Balance at the end of the period	
Government and quasi government	-	-	-	-	-	-	-	-	-	-	-
Banks and other financial institutions	-	-	-	-	-	-	-	-	-	-	-
Agriculture and fishing	23,170	-	-	-	-	-	23,231	-	79	23,310	-
Manufacturing	64,102	3,158	3,158	-	-	-	111,241	45,261	(38,685)	117,817	-
Mining and quarrying	-	1,910	1,910	-	-	-	-	-	-	-	-
Electricity, water, gas and health services	8,251	2,194	2,194	-	-	-	14,867	-	(6,500)	8,367	-
Building and construction	37,987	13,873	7,054	6,818	-	-	52,827	65,374	(2,987)	115,214	-
Commerce	439,105	307,405	22,803	4,275	-	280,327	507,306	30,282	(123,193)	414,395	-
Transportation and communication	173	-	-	-	-	-	28	-	150	178	-
Services	105,166	3,363	3,363	-	-	-	96,391	-	(67,995)	28,396	-
Consumer loans and credit cards	39,879	42,675	42,675	-	-	-	-	98,613	(70,278)	28,335	21,710
Others	17,577	26,241	2,415	23,827	-	-	16,644	-	20,221	36,865	275,060
Total	**735,410**	**400,819**	**85,572**	**34,920**	**-**	**280,327**	**822,535**	**239,531**	**(289,189)**	**772,877**	**296,771**

The geographical distribution of impaired loans, past due loans and allowances as at 31 Dec 2011 are provided hereunder:

Impaired Loans, Past Due Loans And Allowances (Table 4, (g)) (Figures in SAR 000's)							
Geographic area	Impaired loans	Aging of Past Due Loans (days)				Specific allowances	General allowances
		Less than 90	90-180	180-360	Over 360		
Saudi Arabia	735,410	85,572	34,920	-	280,327	772,877	296,771
Total	**735,410**	**85,572**	**34,920**	**-**	**280,327**	**772,877**	**296,771**

The following table sets out the movements in the Group's total individual and portfolio impairment provisions against loans and advances.

Reconciliation Of Changes In The Allowances For Loan Impairment (Table 4, (h)) (Figures in SAR 000's)		
Particulars	**Specific allowances**	**General allowances**
Balance, beginning of the year	822,535	335,443
Charge-offs taken against the allowances during the period	(327,861)	-
Amounts set aside (or reversed) during the period	239,531	-
Transfers between allowances	38,672	(38,672)
Balance, end of the year	**772,877**	**296,771**

5. Standardized approach and supervisory risk weights

Qualitative disclosures

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

Ratings for banks have been sourced from Standard and Poor's Ratings Group and the Fitch Group and Moody's.

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.

Where the obligors have not yet obtained such a rating, the exposure is taken as unrated and appropriate risk weights applied. The Group has not adopted any of the IRB approaches.

The alignment of alphanumeric scales of each agency to risk buckets:

Alphanumeric scales:

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-
	Ca	CC
	C	C
	WR	D
		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

SAMA requires banks operating in Saudi Arabia to use Option 2 for risk-weighting claims on banks and securities firms; accordingly SHB uses the Option 2.

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

A 0% risk weight has been applied for the MDB’s approved by SAMA

Claims on public sector entities (PSEs)

As per Option 2

Claims included in the regulatory non-mortgage retail portfolios

A 75% risk weight to be assigned to such exposures.

Claims on corporate

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

Claims secured by Residential Mortgages

A 100% risk weight to be applied to such claims

Claims secured by Commercial Real Estate

A 100% risk weight to be applied to such claims

Past due loans

The unsecured portion of any loan that is past due for more than 90 days or rescheduled, net of specific provisions (including partial write-offs), have been risk weighted as follows:

Level of Provisioning	Risk weight%
Upto 20%	150
above 20%	100

Other assets

The standard risk weight for all other assets will be 100% except cash & cash equivalents which are risk weighted at 0%. Other assets include various transmission accounts, accrued receivables, cash and cash equivalents and fixed assets.

The allocation of credit risk exposures on the basis of risk buckets are provided hereunder:

Allocation Of Exposures To Risk Buckets (Table 5, (b)) (Figures in SAR 000's)

Particulars	Risk buckets										Deducted
	0%	20%	35%	50%	75%	100%	150%	Other risk weights	Unrated	TOTAL	
Sovereigns and central banks:	14,037,266	26,251	-	-	-	-	-			**14,063,517**	
SAMA and Saudi Government	*13,437,709*	-	-	-	-	-	-			***13,437,709***	
Others	*599,557*	*26,251*	-	-	-	-	-			***625,808***	
Multilateral Development Banks (MDBs)	134,431	-	-	-	-	-	-			**134,431**	
Public Sector Entities (PSEs)	-	-	-	-	-	-	-			-	
Banks and securities firms	-	2,969,008	-	1,886,617	-	689,626	-	-	-	**5,545,250**	
Corporates	-	426,687	-	709,516	-	40,506,318	34,919	-	-	**41,677,441**	
Retail non-mortgages	-	-	-	-	5,564,114	-	-			**5,564,114**	
Small Business Facilities Enterprises (SBFE's)	-	-	-	-	*637,529*	-	-			*637,529*	
Mortgages	-	-	-	-	-	229,611	-	-	-	**229,611**	
Residential	-	-	-	-	-	*229,611*	-			*229,611*	
Commercial	-	-	-	-	-	-	-			-	
Securitized assets	-	-	-	-	-	-	-			-	
Equity	-	-	-	-	-	67,702	-			**67,702**	
Others	406,200	-	-	-	-	2,043,806	-			**2,450,006**	
TOTAL	**14,577,897**	**3,421,946**	-	**2,596,133**	**5,564,114**	**43,537,063**	**34,919**	-	-	**69,732,072**	

6. Credit Risk: Disclosures for portfolios subject to IRB approaches

Not Applicable

7. Credit Risk Mitigation

The Main Types of Collateral Taken by SHB

Collateral is used to mitigate credit risk, as an alternative source of repayment in the event the counterparty cannot meet its contractual obligations through its operating cash flow or by refinancing.

Types of collateral typically accepted by SHB include, but are not limited to:

- Cash and lien over deposits;
- Real estate security over residential, commercial, industrial or rural property;
- Security over specific plant and equipment;
- Charges over listed shares, bonds and securities; and
- Guarantees and pledges.

In some cases, such as where the customer risk profile is considered very sound (or by the nature of the product, for instance small limit products such as credit cards), a transaction may not be collateralized.

Credit policy sets out the acceptable types of collateral, and also has a process by which additional instruments and/or asset types can be considered for approval.

Besides tangible security and guarantee support as described above, credit risk is further mitigated by prudent transaction structuring and documentation. For example, in some transactions risk can be mitigated by lending covenants, or political risk insurance.

Policies and Processes for Collateral Valuation and Management

SHB has established policies and processes around collateral valuation and management. The concepts of legal enforceability, certainty and accurate valuation are central to collateral management. In order to achieve legal enforceability and certainty, SHB has standard collateral instruments, and where possible, security interests are registered. The use of collateral management systems also provides certainty that the collateral has been properly taken, registered and stored.

In order to rely on the valuation of collateral assets, SHB has developed comprehensive rules around acceptable types of valuations (including who may value an asset), the frequency of revaluations and standard loan to value ratios for typical asset types. Upon receipt of a new valuation, the information is used to reassess the adequacy of the collateral. In the case of impaired assets, collateral valuations are considered when setting and reviewing provisions.

Credit Risk Exposure Covered By CRM (Table 7, (b) and (c)) (Figures in SAR 000's)		
Portfolios	Covered by	
	Eligible financial collateral	Guarantees / credit derivatives
Corporates	449,132	-
Total	**449,132**	**-**

8. General disclosure for exposure related to counter-party credit risk

Counterparty credit risk (CCR) is the risk that the Group's counterparty in a foreign exchange, interest rate, commodity, equity or credit derivative contract defaults prior to maturity date of the contract and that the Group at the time has a claim on the counterparty.

The Group calculates its counterparty credit risk under both trading and banking book exposures by assigning risk weights to exposure types, which are as follows:

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

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

9. Securitisation

The Group is not involved in any securitisation deals, hence the qualitative and quantitative disclosures does not arise.

10. Market Risk: Disclosure for Banks using standardized approaches

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 commission rates, foreign exchange rates, and equity prices. The Bank classifies exposures to market risk into either trading or non-trading or banking-book.

TRCS is responsible for controlling Treasury's market risk within approved market and counter party limits. The Head of TRCS reports directly to CRO.

10.1 Risk identification

Since January 1, 2008, SHB, like all banks in the Kingdom, is Basel II Standardised Approach compliant with respect to market risk reporting and calculation of capital.

10.2 Risk measurement

On a regulatory basis, Market Risk is measured and reported to SAMA in the Q14 and Q17 reports, based on the standardised approach.

The following table shows the capital requirements for various market risks as at 31 Dec 2011, based on the standardised approach.

Level Of Market Risks In Terms Of Capital Requirements (Table 10, (b)) (Figures in SAR 000's)					
	Interest rate risk	**Equity position risk**	**Foreign exchange risk**	**Commodity risk**	**Total**
Capital requirements	13,137	-	35,044	-	48,181

Internally, the core of SHB's market risk measurement is the Value At Risk (VaR) methodology. SHB uses an internally developed, externally verified model for VaR calculation. In addition, non-VaR measures are applied including PV01 and Open Currency Position (OCP) limits.

The method adopted by the Bank is Historical Simulation (HS). The essence of the method is that trading portfolios are re-assessed, using changes in the market rates/prices observed in the specified period in the past, to create a distribution of the portfolio returns. From this distribution the VaR for the portfolio is derived. An important aspect of this methodology is the analysis of the relevant market prices and rates (risk factors) over the specified historical period.

The Bank has chosen to apply an historical period of 400 days for its HS VaR. The historical data for the simulation of the portfolio returns is collected daily. An exponentially decaying weight factor is used which puts more weight on recent observations. The VaR is inferred from the distribution of daily profits and losses using the following parameters and methods:

VaR parameters:

- Method: Historical Simulation
- Holding period: 1 day
- Confidence interval: One-tailed 99 %
- Decay factor: 0.995
- Data set: 400 observations

As a result of the model-based approach, SHB has to perform back-testing to validate the accuracy of its Value-at-Risk (VaR) model. SHB back-tests its VaR model by checking whether the hypothetical daily returns and actual returns are consistent with the corresponding daily VaR produced by the model, at the chosen confidence level. Hence, given the confidence level of 99%, the loss values of the daily returns should exceed the predicted VaR number on one out of every 100 business days, on average. During 2011 Hypothetical P&L exceeded VaR as follows:

Book	**Days VaR Exceeded**
FX Trading	4
IR Trading	2
SAR Forwards	2
International Forwards	3
Money Market	2
Total Treasury IR	2

11. Market Risk: Disclosure for banks using internal models approach (IMA) for trading portfolios

Not applicable

12. Operational Risk

Operational risk is the risk of direct or indirect loss due to an event or action resulting from inadequate or failed internal processes, people and systems, or from external events. SHB's approach has been to adopt the Standardized Approach requirements for Operational Risk as defined by the Basel II framework.

Objective

Operational risks are inherent to all business activities. It is the Group's objective to minimize exposure to such risks, subject to cost tradeoffs. This objective is met through a framework of policies and procedures that ensure risk identification, assessment, control and monitoring.

Governance Structure

Operational Risk Management (ORM) is a unit within the risk function that is managed by the Head of Operational Risk Management who reports directly to the CRO. ORM is guided and directed by the ORM Committee, at the request of SHB's Board of Directors.

During 2011 the Operational Risk management team was restructured with a newly appointed Head of Operational Risk & Risk Projects and enhanced with additional senior management staff.

Roles and Responsibilities

ORM is responsible for identifying, assessing, monitoring and controlling/mitigating of operational risk throughout the Bank in conjunction with all business units of the Bank.

Risk identification

SHB follows the accepted 'best practice' methodology of risk assessments and control evaluations for the identification of inherent operational risks. ORM manages operational risk for new or changed initiatives/products through the Operational Risk Assessment Procedure (ORAP) and the policy for this is set out in the ORAP Policy Manual. All operating losses and issues are recorded in the Bank's Operational Loss Database by the relevant business units following verification. Operational risks are identified and assessed using the Risk and Control Self-Assessment (RCSA) and Key Risk Indicator (KRI) tools.

Risk Measurement

Measurement of operational risk is managed primarily through a Bank Operational Loss Database (BOLD). The following classifications were introduced into BOLD during 2009 to enable better monitoring, control and to focus resources where process improvements are required:

- Business Disruption and System Failures
- Clients, Products and Business Practices
- Execution, Delivery and Process Management
- External Fraud
- Internal Fraud

The associated internal financial recording and treatment is also being enhanced to reflect the changes in BOLD.

13. Equities: Disclosures for banking book positions

All Equity investments are classified as "Available for sale"

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 recognized 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.

The following tables shows the equities investment in banking book as at 31 December 2011

Value Of Investments (Table 13, (b)) Figures in SAR 000's					
	Un-quoted investments		Quoted investments		
	Value disclosed in Financial Statements	Fair value	Value disclosed in Financial Statements	Fair value	Publicly quoted share values (if materially different from fair value)
Investments	4,236	4,236	63,466	63,466	-

Types And Nature of Investments (Table 13, (c)) (Figures in SAR 000's)		
Investments	**Publicly traded**	**Privately held**
Banks and other financial institutions	63,466	1,250
Manufacturing	-	48
Services	-	2,938
Total	**63,466**	**4,236**

Gains / Losses Etc. (Table 13, (d) and (e)) (Figures in SAR 000's)	
Particulars	**Amount**
Unrealized gains (losses) included in Capital	(14,380)
Total unrealized gains (losses)	**(14,380)**

Capital Requirements (Table 13, (f)) (Figures in SAR 000's)	
Equity grouping	**Capital requirements**
Banks and other financial institutions	5,177
Manufacturing	4
Services	235
Total	**5,416**

14. Commission rate risk in the Banking book

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 table shown under Note 32 b (i) to the financial statements 2011, depicts the sensitivity to a reasonable possible change in commission rates, with other variables held constant, on the Bank's statement of income or equity. The sensitivity of the income is the effect of the assumed changes in commission rates on the net commission income for one year, based on the floating rate non-trading financial assets and financial liabilities held as at December 31, 2011 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 December 31, 2011 for the effect of assumed changes in commission rates. The sensitivity of equity is analyzed by maturity of the asset or the hedging instrument.

Abbreviations used:

- ALCO: Assets and Liabilities Committee
- CRM: Corporate Risk Management
- CCR: Counterparty Credit Risk
- CCRM: Consumer Credit Risk Management
- CRO: Chief Risk Officer
- EC: Executive Committee
- HOCC: Head Office Credit Committee
- HS: Historical Simulation
- IASB: International Accounting Standards Board
- ICAAP: Internal Capital Adequacy Assessment Plan
- IFRS: International Financial Reporting Standards
- KRI: Key Risk Indicators
- OCP: Open Currency Position
- ORAP: Operational Risk Assessment Procedure
- ORM: Operational Risk Management
- RARORC: Risk Adjusted Return on Regulatory Capital
- RWA: Risk Weighted Assets
- SAMA: Saudi Arabian Monetary Agency
- SHB: Saudi Hollandi Bank
- SHC: Saudi Hollandi Capital
- SHREC: Saudi Hollandi Real Estate Company
- The Bank: Saudi Hollandi Bank
- TRCS: Treasury Risk Control Services
- UCR: Uniform Counterparty Rating
- VaR: Value at risk