THE SAUDI BRITISH BANK

BASEL – PILLAR 3 ANNUAL DISCLOSURES

31 December 2015

Cautionary statement regarding forward looking statements

These Capital and Risk Management Pillar 3 Disclosures as at 31 December 2015 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 in Note 1 of the Annual Report and Accounts 2015.

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 has 100% (2014:100%) 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% (2014:100%) 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% (2014:100%) 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% 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 main purpose is the registration of real estates.

Significant Minority Investments:

SABB owns 51% (2014:51%) 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% (2014: 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 2015 is SAR 363.4 million (2014: SAR 346.9 million).

Equity Investments which are risk weighted

Equity investments are generally risk weighted at 100%.

Under Basel III, significant minority investments in commercial entities and financial institutions below a defined Basel threshold which under Basel II were deducted 50% from Tier 1 and 50% from Tier 2 will receive the risk weight 1250% and 250% respectively.

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 III 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 1,000 million shares of SAR 10 each (2014: 1,000 million shares of SAR 10 each). The ownership of the Bank's share capital is as follows:

	2015	***2014***
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.	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 required by SABB businesses to bear risk, support growth etc. and upon which an 'economic' return is required.	Allocated to businesses in line with risk appetite given the risks run, and acts as basis to set economic profit targets.

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.

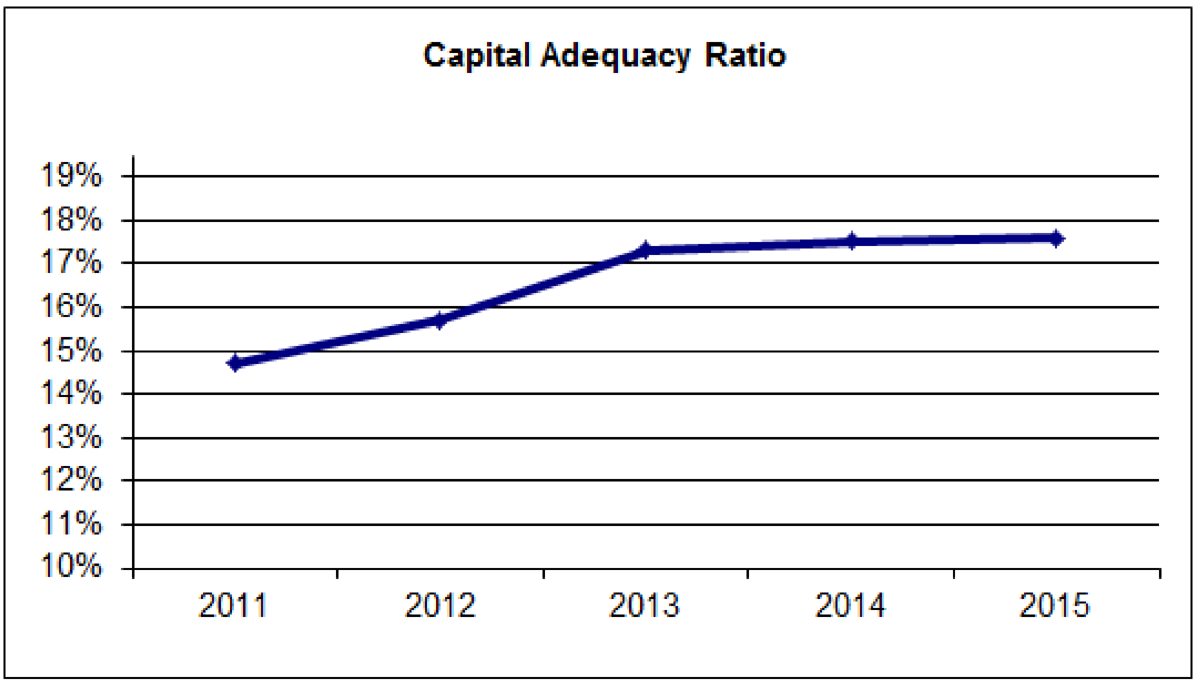
Table 3
CAPITAL ADEQUACY

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 Internal Capital Adequacy Assessment Process (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:



2011-2012: Capital Adequacy Ratio's are on Basel II basis
2013-2015: Capital Adequacy Ratio's are on Basel III 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 strong culture of prudent and responsible lending is a cornerstone of SABB’s risk management philosophy. This is attained through effective control and management of risk, seeking to minimize credit losses while enhancing risk-adjusted returns.

Credit manuals provide clear and consistent lending guidelines, policies, and procedures to manage the corporate and personal banking asset portfolios. These policy manuals are reviewed annually by the Risk Management function and approved by the Chief Risk Officer with material policy changes approved through the Risk Management Committee (RMC). In line with SAMA Rules on Credit Risk Management, the main Credit Policy manual has been reviewed and approved by the Board Risk Committee (BRC) in 2015.

Credit risk assessment is undertaken by the credit approval function which reports directly to the Managing Director through the CRO; hence ensuring that they have an appropriate degree of independence. The teams are responsible for credit approval decisions, as well as key aspects of the risk rating systems, including selection, implementation, performance, and oversight.

The approval process is reviewed annually by the Board Risk Committee with limit delegations named down from the Board. Within SABB, emphasis is placed on the individual's responsibility for making credit decisions and as such there is a series of delegated approval limits agreed by Board.

A key element in the Bank's credit culture is the proactive management of the portfolio through:

- The regular review of facilities by lending and credit officers, at least annually.
- The operation of an independent special asset management function to handle non performing and problem exposures.
- The central monitoring of credit concentration in certain countries, specialized industries / sectors, products, customers and customer groups with monthly reports to the RMC, Asset and Liability Committee (ALCO) and quarterly to BRC.
- The continual development of improved techniques for measuring and evaluating risk, and for optimizing risk-adjusted return on capital.
- The development and adoption of automated application processing and assessment systems, to enable consistency of decisions and an efficient framework for application processing.
- A structured framework of credit training and accreditation to build risk awareness and credit assessment capabilities.

Personal lending decisions are based on credit scoring models and decision strategies, developed using internal data and credit bureau information from SIMAH; with behavioural scoring applied to support credit card processing, authorisation, collections and limit review decisions.

For defaulted customers, impairment provisions (collective and discounted cash flow basis) are maintained in accordance with established IFRS accounting practices.

SABB operates dedicated special assets and recoveries teams to manage companies in financial distress and non-performing loans to maximise recovery rates. For high value and problematic accounts the recovery process includes direct involvement from Legal. For personal banking there is a dedicated collections function undertaking debt counselling and recovery activities at each stage of delinquency including the use of external and overseas recovery agencies

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 defined as the risk of loss resulting from inadequate or failed internal processes, people and systems or from external events, this will include legal risks covering, but not limited to, exposure to fines, penalties, or punitive damages resulting from supervisory actions, as well as private settlements.

Operational risk is relevant to every aspect of SABB’s business and covers a wide spectrum of issues. Losses arising through fraud, unauthorized activities, errors, omission, inefficiency, systems failure or from external events all fall within the operational risk definition.

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.

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 direct 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.

SABB continued to monitor liquidity risk during 2015 based on projected cashflow scenarios referred to as the Operational Cashflow Projection (OCP). Its objective is to better reflect the likely behaviour of different customers and manage liquidity during crisis events or loss in confidence in SABB, resulting in deposit withdrawals by customers. The OCP policy aims to diversify SABB's liability base, and reduce concentration levels to any single customer.

The framework is compliant with BIS guidelines 'Principles for Sound Liquidity Risk Management and Supervision' issued in September 2008 and the 'International Framework for Liquidity Risk, Measurement, Standards and Monitoring' issued in December 2010 and subsequent revisions and updates issued as part of the Basel III framework.

As a general policy, SABB seeks to be self-sufficient with regards to funding its own operations from 'core' deposits. Exceptions are permitted to facilitate the efficient funding of certain short-term treasury requirements and start-up ventures, which do not have access to deposit markets.

SABB uses cashflow stress testing as part of its control processes to assess liquidity risk. The cashflow stress testing process estimates and takes into consideration the potential severe adverse P&L and capital impacts in a liquidity crisis, with a view to assessing the bank's ability to maintain an adequate capital position in such a scenario.

SABB has established Risk Appetite Statements covering liquidity risk that are approved by the Board Risk Committee annually and reviewed monthly through ALCO and RMC with quarterly reports provided to the BRC.

SABB managed and reported balance sheet liquidity during 2015 against the following internal and regulatory ratios:

- ***Operational Cashflow Projection*** – The OCP is a cashflow based model for management of liquidity risks, taking into account the Bank's total cash inflow (assets) and total cash outflow (liabilities) under stress scenario. The objective is to increase the core funds and decrease non-core-funds.
- ***SABB Internal Asset to Deposit Ratio (ADR)*** – Monitors the extent to which customer advances are covered by core deposits.
- ***Asset to Deposit Ratio (ADR*)** – Monitors the extent to which customer advances are covered by customer deposits.
- ***SAMA Liquid Reserve Requirement*** – Minimum 20% of deposit liabilities to be held in liquid assets maturing in less than 1 month, treasury bills and government bonds in accordance with Article 7 of the Banking Control Law.
- ***Liquidity Coverage Ratio (LCR)*** – Minimum requirement of 100% requiring SABB to hold enough liquid assets which can, if needed, be converted easily into cash in private markets to survive a 30 day stress scenario.
- ***Net Stable Funding Ratio (NSFR)* –** Minimum requirement of 100% requiring SABB to hold a minimum amount of stable funding relative to the liquidity profiles of asset activities over one year horizon

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 BRC. 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.

The Finance 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.

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 Contingency Funding 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.

The maturity profile of the Bank's assets and liabilities is monitored to ensure that sufficient liquidity is maintained at all times. The table below shows the analysis of assets and liabilities maturity as at 31 December 2015 as per annual financial statement:

ASSETS & LIABILITIES MATURITY PROFILE *(SAR '000)*	Within 3 months	3 - 12 months	1 - 5 years	Over 5 years	No fixed maturity	Total
ASSETS						
Cash and balances with SAMA	1,885,901	-	-	-	9,056,367	10,942,268
Due from banks and other financial institutions	11,452,326	-	-	-	-	11,452,326
Investments, net	12,077,926	7,177,779	11,857,463	3,281,158	1,031,913	35,426,239
Loans and advances, net	51,864,487	24,137,292	25,742,228	23,680,298	-	125,424,305
Investment in associates	-	-	-	-	693,235	693,235
Property and equipment, net	-	-	-	-	991,455	991,455
Other assets	35,538	140,610	573,835	122,882	1,947,730	2,820,595
Total assets	77,316,178	31,455,681	38,173,526	27,084,338	13,720,700	187,750,423
LIABILITIES						
Due to banks and other financial institutions	1,538,392	288,406	-	-	-	1,826,798
Customers' deposits	132,567,690	10,293,951	5,583,762	193,210	-	148,638,613
Debt securities in issue	-	-	3,000,000	1,500,000	-	4,500,000
Borrowings	-	-	46,875	-	-	46,875
Other liabilities	39,785	142,218	583,769	129,659	3,668,169	4,563,600
Shareholders' equity	-	-	-	-	28,174,537	28,174,537
Total liabilities & shareholders' equity	134,145,867	10,724,575	9,214,406	1,822,869	31,842,706	187,750,423
GAP	(56,829,689)	20,731,106	28,959,120	25,261,469	(18,122,006)	-

SABB also accesses global debt markets in order to source longer term funding for its balance sheet.

SABB would meet unexpected net cash outflows by selling securities and accessing additional funding sources through inter-bank markets.

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 RMC.

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 the SABB's reputation among its various stakeholders in the various facets of its operations. SABB has built a strong image and reputation within the Saudi market.

A focus on Community Service programs resulted in SABB being awarded the “Best Commercial Establishment in Community Service in KSA” by the Ministers of Social Affairs of the GCC Council.

The reputation of SABB is critical to its success. Any financial services organisation stands or falls by its reputation and the confidence it can engender in its customers. The maintenance of customer confidence is a prime objective of management and can be achieved through a strong and healthy financial position and by exhibiting successful risk management, but can be severely damaged by non-compliance with relevant regulations or by inappropriate actions or comments to the media or in the public domain.

SABB Board decided in 2013 to adopt the highest International Standards in every aspect of our business in order to enhance our brand, protect our reputation and achieve competitive advantage. The programme has been branded as the ‘SABB International Standards’ (SIS) and is designed to complement SABB’s core values.

The SABB International Standards focus on three core themes:

1. Treating Customers Fairly
2. Protecting Customer Information
3. Comply with Laws and Regulations

SABB has initiated four programmes to address the International Standards:

- Customer Due Diligence (CDD)
- Transactions Monitoring Workstream
- Information Protection Programme (IPP)
- Treating Customers Fairly Programme (TCF)

These standards are intended to ensure that SABB is upholding the highest International Standards, which in conjunction with its Values will act not only to protect SABB’s reputation in the local market but also build a clear comparative advantage when compared to its competitors.

Macro Economic and Business Cycle Risk

Macroeconomic risk or business cycle risk is the non-diversifiable impact of the domestic and global economic cycles on SABB's businesses. Macroeconomic risk can arise from changes in the regulatory environment, technological advances, or shocks to the economy such as deflation, recession or changes to government spending plans.

In line with international best practices, 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, the management monitors local key macroeconomic indicators, with quarterly reporting to RMC. These indicators include:

- Price of oil per barrel in the world market
- Any significant reduction in public finances expenditure
- TASI Index
- Housing market trends
- Bank lending to private sector
- Annual real GDP growth
- Money supply
- Inflation rate
- Currency uncertainty that may be caused by USD weakness and real appreciation of the SAR.

The BRC also reviews regional indicators, such as the HSBC Group Purchasing Managers Index (PMI) which acts as an indicator of changes in market sentiment. Business Heads use the macroeconomic data as part of their business forecasting and to assess risk impacts. Similarly a review is undertaken on the annual Government expenditure budget to identify strategic policy shifts for SABB and its risk appetite framework.

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 Committee. 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 is a specialised activity with a great degree of complexity managing the risks of financial crime and regulatory compliance capturing Sanctions, Money Laundering, Fraud, Anti-Bribery and Corruption and alike. There have been significant investments in people and compliance infrastructure over the last three years, from a base of 18 staff to over 100 and expanding. In view of the growing focus on financial crime activity in the industry in general, during 2Q14 the compliance function was re-organised to establish two streams of Financial Crime Compliance and Regulatory Compliance. Several additional resources were added to the team in order to better monitor the transactions and customer activity. The function has also added roles to manage the risk of Bribery and Corruption.

SABB ensures full compliance with all directives issued by SAMA, the CMA and other such regulatory bodies in addition to local legal requirements. SABB also seeks to align with broader HSBC best practices to manage, monitor and control compliance risks in respect of international sanctions.

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 RMC.
- 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. Issues are addressed in a proactive manner with respect to risk assessment and management to ensure continued compliance with local regulatory requirements. Economic and regulatory capital issues, if any, are promptly addressed through the relevant policies and procedures.

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 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 for credit risk.

SABB has established a comprehensive framework for the Model Governance of its Internal Risk-Based (IRB) models and methodologies used in credit risk evaluation, which sets out standards for development, monitoring and validation of IRB models and methodologies. It also clearly defines roles and responsibilities in the IRB models' development, monitoring and validation. The Model Governance framework has been approved by the Chief Risk Officer.

SABB Risk Strategy produces a quarterly monitoring report of its IRB models and frameworks which assesses a performance of IRB models. The results of the monitoring report are brought to the attention of SABB senior management.

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 RMC or designated committee.

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 Basel IRB-A compliant scorecards to calculate expected and unexpected losses for each retail portfolio.

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 Board Risk Committee. 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

The operational risk governance framework is made up of a series of operational risk meetings and processes. An operational risk assessment process is undertaken periodically and at least annually by each line of business and support functions with the output challenged through the Operational Risk and Internal Control Committee (ORICC).

The operational risk taxonomy was expanded from the previous 4 major risk categories (people, process, systems, external) to a more granular 16 key Level 1 risk categories which include major areas that are currently a focus of regulatory/national bodies:

- People	- Compliance	- Business continuity	- Tax
- Systems	- Legal	- Accounting	- Shariah
- Operations	- Internal fraud	- Physical	- Political
- Information	- External fraud	- Fiduciary	- Project

A Bank level Operational Risk dashboard is used by Senior Management to highlight the major risks and breaches; loss trends reports are reviewed monthly by ORIC Committees and RMC with a quarterly update provided to the BRC.

Systems established to record risks and losses by Basel business lines, risk and loss event categories enable business units to manage their action plans and request for management information reports. Duties are segregated to ensure integrity of loss and risk data in the system. Data is captured and approved in the system by the business. The central Operational Risk department coordinates the recording process, reconciles to ensure only operational losses are captured and the data meets both SABB and regulatory guidelines in addition to ensuring the quality of the input data.

During 2015, SABB continued the consolidation/strengthening of its Operational Risk Management and Governance processes:

- The Risk Governance Framework was reviewed by the Board Risk Committee.
- Effectiveness reviews continued to be undertaken by the Board Risk Committee with business heads and risk owners to provide an assurance on the effectiveness of internal controls within their business or across their risk area.
- Continued focus to implement the Board approved SABB International Standards programme covering adherence to laws and regulations, Treating Customers Fairly, and Protecting Customer Information.
- SABB continued to fully assess the dependencies and business impact analysis related to the Bank's association with HSBC Group.
- The Three Lines of Defence model was enhanced to underpin our approach to strong risk management. The Three Lines of Defence model defines who is responsible to identify, assess, measure, manage, monitor, and mitigate operational risks, encouraging collaboration and enabling efficient coordination of risk and control activities.
- Risk and Control Assessment (RCA) is a component of the Operational Risk and Internal Control (ORIC) Management Framework implemented across SABB. The RCA process is designed to provide business/function with a forward looking view of operational risk to help them proactively determine whether their key operational risks are controlled within acceptable levels.

- The formalisation of Second Line of Defence Reviews and establishment of an assurance programme within ORIC was established to ensure implementation of the Bank's ORIC framework within the businesses.
- The ongoing implementation of findings from the independent review of the Internal Control Guidelines are tracked using the ORIC system (ORION) to verify timely close of item with updates submitted monthly to RMC and quarterly to the BRC and AUCOM.

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 BRC. 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.