

SAUDI BRITISH BANK

BASEL III - LIQUIDITY COVERAGE RATIO

QUALITATIVE DISCLOSURE

As at 31st December 2016

Liquidity risk is the risk that Saudi British Bank (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 monitored its liquidity risk in 2015 based on the projected cashflow scenarios referred to as the Operational Cashflow Projection (OCP). In Jan 2016, SABB has implemented a new internal liquidity framework based on the SAMA Basel III Liquidity framework, the Liquidity Coverage Ratio (LCR) and the Net Stable Funding Ratio (NSFR) replacing the OCP framework, which took effect from 1 Jan 2016.

The objective of the LCR is to limit the risks of severe cash outflows owing to an over-reliance on volatile funding sources and certain lending commitments. Under the LCR, SABB is required to hold a minimum level of unencumbered high-quality liquid assets (HQLA) to withstand an acute stress scenario lasting 30 days. The LCR is specifically designed to improve the short-term resilience of SABB against liquidity shocks. By contrast, the NSFR is designed to limit the risks emanating from excessive maturity mismatches over the medium to long term. More specifically, the NSFR requires SABB to fund illiquid assets with a minimum amount of stable liabilities over a horizon of one year.

The LCR and NSFR framework defines customer deposits as "stable", "semi- stable", and "non-stable". Stable and semi stable funds are defined as deposits that are less likely to be actively managed by customers and therefore, more likely to remain with the bank during a period of stress. Equally, non-stable funds are defined as those deposits that are more actively managed by customers and more likely to be withdrawn at the early indication of market stress forming part of the LCR calculations.

As a general policy, SABB seeks to be self-sufficient with regards to funding its own operations from 'stable' 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 Asset Liability Management Committee (ALCO) and Risk Management Committee (RMC) with quarterly reports provided to the Board Risk Committee (BRC).

SABB manages and reports balance sheet liquidity against the following key ratios:

- ***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 broader 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.

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.

SABB seeks to maintain a cushion of unencumbered, high quality, liquid assets mainly comprising of deposits with the central bank, cash and unencumbered sovereign debt, that can be liquidated or repoid in times of stressed liquidity. The asset tolerance limit is defined and monitored by ALCO on a monthly basis.

LCR & NSFR 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, while minimising adverse long-term implications for the business.

SABB has at its disposal a wide range of money market and capital sources to cover the funding needs.

SABB continues to diversify its sources of funds through its debt issuances in both local and international markets in order to source longer term funding for its balance sheet.

The mark to market of the Bank's back to back derivative exposures does not have significant impact on liquidity management.

As per SAMA guidelines, a currency is considered as "significant" if the aggregate liabilities denominated in that currency amounts to five per cent or more of the bank's total liabilities. Only SAR and USD are material currencies and are monitored accordingly.

The main contributors of the LCR of the Bank are unencumbered, high quality liquid assets (HQLAs) and net cash outflows primarily arising from customer deposits.

The 3 month average of the LCR has increased from 181% as at 30th September 2016 to 191% as at 31st December 2016, this was mainly due to an Increase in Average HQLA by SAR 10.24 B partially offset by an increase in Total Average cash outflows of around SAR 1.78 B and a decrease in Average cash inflows of around SAR 2.92 B. The intra period changes were in line with the banks activities and were well above the minimum requirements.