THE SAUDI BRITISH BANK

BASEL II – PILLAR 3 ANNUAL DISCLOSURES

Cautionary statement regarding forward looking statements

These Capital and Risk Management Pillar 3 Disclosures as at 31December 2008 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 sets out The Saudi British Bank (SABB) approach to capital assessment.

b) Basis of consolidation

The basis of consolidation for accounting purposes is described on page 35 of the Annual Report and Accounts 2007.

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

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

Entities that are fully consolidated:

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

Significant Minority Investments:

Following significant minority investments are deducted from the capital:

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

Equity Investments which are risk weighted

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

c) Capital transferability between legal entities

Restrictions by Memorandum and Articles of Association

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

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

Statutory restriction

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

Regulatory restriction

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

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

Table 2
CAPITAL STRUCTURE

The authorized, issued and fully paid share capital of the Bank consists of 600 million shares of SAR 10 each (2007: 375 million shares of SAR 10 each). The ownership of the Bank's share capital is as follows:

	2008	***2007***
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 five different "types" of capital which SABB must manage. The distinctions between the different notions / definitions of capital, and the capital management principles which arise, are outlined below:

Category	Definition / meaning / significance	Implications for SABB capital management
Regulatory Capital	Proxy for Risk Capital, particularly under Basel II.	Requirements must be met on a SAMA regulatory rules basis at all times.
Accounting Capital	The capital recognised by accounting standards	Requirements must be met to achieve audited accounts
Invested Capital (Legal capital)	The equity capital invested in SABB by its shareholders for which SABB is accountable.	SABB must earn a return on its invested capital which is in excess of its cost of capital
Economic Capital	Capital actually held by SABB to bear risk, support growth etc. and upon which an 'economic' return is required.	Allocated to businesses in proportion to risks run, and acts as basis to set economic profit targets and inform e.g. pricing decisions.
Market value of equity	Market value of SABB's equity share capital arrived at by multiplying the outstanding number of shares by the current SABB share price.	Total Shareholder Return benchmark, of which the MV of equity is a major element, as a key driver of managing and assessing group performance.

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

Table 3
CAPITAL ADEQUACY

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

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

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

2008: 11.2%
2007: 13.5%
2006: 18.2%
2005: 15.6%
2004: 14.2%

TABLE 3
Risk Exposure and Assessment
GENERAL QUALITATIVE DISCLOSURE REQUIREMENTS

Credit Risk

SABB's credit culture is dedicated to achieving and maintaining risk assets of high quality. This requires commitment to soundness, prudence, professionalism and discipline in applying a consistently high standard of credit management. A strong universal credit culture is essential to the successful control and management of risk, seeking to minimize credit losses while enhancing risk-adjusted returns, thus contributing to the overall success of the Bank.

The following elements are fundamental to SABB's credit culture:

<u>Clear Policy and Guidance</u>
Credit manuals in various forms codify clear and consistent principles, lending guidelines, policies, and procedures

<u>Approval and Control</u>
Credit risk management functions have an appropriate degree of independence and responsibility for key aspects of rating systems, including selection, implementation, performance, and oversight. Approval processes observe high standards of governance, efficiency and facilitate timely decision-making. Emphasis is placed on the individual's responsibility for making credit decisions. 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;
- The central monitoring of credit concentrations and correlation risks in certain countries, specialized industries / sectors, products, customers and customer groups, at a macro level;
- The continual development of improved techniques for measuring and evaluating risk, and for optimizing risk-adjusted return on capital.

Credit Discipline

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

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

Credit Systems and Methodologies

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

SABB's association to the HSBC Group promotes the use of standard systems and methodologies for these purposes and employs common measurements of risk throughout the Group's credit and product systems. Wherever practicable, SABB deploys such Group standard systems and methodologies. At SABB, currently all consumer lending decisions are based on Credit Risk Score Models developed using internal data.

Capital Discipline

Credit risk consumes the largest proportion of SABB's capital. 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.

Only two customers in the Bank's entire commercial / corporate credit portfolio have been rated by an acceptable External Credit Agency (ECA).

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.

Analysis of this risk is complicated by having to make assumptions on embedded optionality in products such as mortgage prepayments, and from behavioural assumptions regarding the economic duration of liabilities, which are contractually repayable on demand.

The Governance process for Interest rate risk replicated the infrastructure and controls adopted for Market Risk.

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

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

Liquidity Risk

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

As a general policy SABB seeks to be self-sufficient with regards to funding its own operations. 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 assesses and manages liquidity risk through clearly defined liquidity policies, which are in line with HSBC Group policies.

SABB uses cash-flow stress testing as part of its control processes to assess liquidity risk. The cash-flow stress testing process has been recently extended to estimate and consider the potential severe adverse P&L and capital impacts in a liquidity crisis, with a view to assessing the Group's ability to maintain an adequate capital position in such a scenario.

- SABB's Liquidity and Funding framework is established by ALCO and endorsed by HSBC Group ALM.

- SABB has a Liquidity Management Committee, which monitors the Bank's liquidity position and proposes changes to ALCO on SABB's liquidity ratio limits and stress testing models.

- Monthly reporting is done on the Bank's liquidity position to Group ALM and SABB ALCO.

- 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 has a comprehensive Liquidity Contingency Plan, which is updated and tested on an annual basis by the Liquidity Management Committee and approved by ALCO / SABB's Board. 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.

Current accounts and savings deposits payable on demand or at short notice form a significant part of SABB’s funding. SABB places considerable importance on maintaining the stability of these deposits.

The stability of deposits, which are a primary source of funding, depends upon maintaining depositor confidence in SABB, and on maintaining competitive and transparent deposit-pricing strategies.

SABB also accesses Global debt markets in order to source longer term funding for its balance sheet. This is done through maintaining an ongoing EMTN programme.

SABB would meet unexpected net cash outflows by selling securities and accessing additional funding sources through inter-bank markets. It is recognised that as a last resort contingency measure, consideration will have to be given to approaching HSBC Group or SAMA to obtain liquidity support.

For assessment of capital requirements the Liquidity Management Committee considers the SABB market wide stress test to be the appropriate benchmark.

SABB will continue to develop the liquidity scenario stress testing process in conjunction with the Group to assess the potential capital impact in a stress scenario.

As SABB’s debt issuance grows in size it will need to establish a more formal debt investor relations programme to ensure that it keeps investors advised of developments and kept itself aware of their changing requirements.

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’s Excom has established clear investment objectives and for each investment portfolio and undertakes an annual review of the portfolio.

- SABB has a clearly defined governance structure assigning oversight responsibility and for managing its investment portfolios.

- Equity investment portfolios are managed on a discretionary basis by HSBC Saudi Arabia Investment Bank (IBSA) and monitored closely by ALCO.

- Private Equity Investments are administered by the Chief Financial Officer and managed by ALCO.

- All other investments, including investments in government bonds, corporate bonds, agency bonds, and Alternative investments are managed and administered within prescribed limits by Treasury and Finance and monitored weekly by ALCO.

- SABB also seeks the endorsement of SAMA for its revised investment strategy on an annual basis in view of the cross border implications.

- Investments are subject to defined due diligence policies, including the following management controls:
    - A detailed due diligence paper is required from the investment desk for all new asset classes as well as for all complex structures.
    - Clear Finance and/or Operations responsibility should be established for the independent valuation, administration and reporting of the investment portfolio.
    - Consistent and appropriate valuation processes are applied to all investments on a timely basis.
    - Treasury based investments are subject to Mark to Market loss control limits and PVBP limits to manage interest rate risk.
    - Alternative investments such as hedge funds are managed within VAR control limits.
    - Investment policies must comply with local regulatory requirements related to onshore and off shore investments.
    - All investments should be subject to an appropriate approval process

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.

As part of the continuing development of the SABB Economic Capital Process, a distinct assessment of Private Equity and Investments capital allocation will be made.

Concentration Risk

- 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.

- The Bank's ALCO and Excom regularly monitor adherence to the above policy for the total exposure book and the respective asset classes within the book.

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.

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

Risk profiles for Islamic financial products (Shariah Compliant Products) may be quite distinct and have not been addressed by Basel II. The new dimensions of risk emerge on both assets as well as liabilities sides of Islamic banks' balance sheet. The impact of Shariah compliance failures may be a potential reputaional risk for SABB. This can be minimized through strict adherence to the standards and policies governing Shariah Products and to implement a strong internal control structure at SABB.

SABB recognises that its implementation of a strong internal control structure, effective risk management, a strong financial position, maintenance of customer confidentiality and a sound corporate governance process to foster an ethical and value system are all ways to manage reputational risk. Our Group Policy Manuals are closely aligned to individual risk categories and the management of reputational risk is embedded in the Functional Instruction Manuals.

Macro Economic and Business Cycle Risk

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

As an intrinsic part of the process, SABB's in-house Chief Economist regularly monitors local key macroeconomic indicators, such as:

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

Strategic Risk

SABB prepares Strategic Plans over distinct three-year periods that establish common values, strategic goals and objectives, which should drive the Annual Operating Plan objectives in an aligned manner. In addition, there is an expectation that SABB's activities, as an associate of the HSBC Group, are aligned with the Group's "Global Pillars", which articulate the common principles and values that join up the company. The "Global Pillars" are: "Our Customers - Service Excellence", "Our Brand - The World's Local Bank, "Our Culture - The Best Place to Work", "Our Global Distribution - Our Global Advantage", "Our Businesses - Building for Sustained Growth", "Our Technology and Process - Joining Up the Company", and "Our Organization - Guidance and Wisdom and Delegation with Confidence".

Strategic and Operating Plans, which are approved by the local Management Board and Board of Directors, 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.

Market Risk

Please refer to Table 10.

Any other Risks identified:

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

Table 4
CREDIT RISK: GENERAL DISCLOSURES FOR ALL BANKS

Past due loans:

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

Impaired loan:

Specific Provisions:

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

Collective Impairment Provisions:

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

Credit Risk:

Standardised Approach

Overall, SABB currently calculates its models and assessments based on the Basel II Standardised Approach, as dictated by the guidance notes issued by SAMA. Specifically, SABB is segmenting its asset portfolio and generating associated RWAs and capital support data in accordance with SAMA guidelines and Q17 reports and use the Standardised approach to calculate the minimum capital requirements.

Advanced IRB Approach

SABB is developing its processes to enable it to move to the advanced approaches of Basel II. The advanced approach is being developed using the SAMA guidance notes.
SABB will develop processes to calculate the "Probability of default (PD)", "Loss given default (LGD)" and "Exposure at default (EAD)" appropriate for each exposure. SABB will be utilising the expertise as provided by its associate, HSBC, specifically in the implementation of a risk engine and risk analyser. The risk analyser, Moody's Risk Advisor (MRA), will be able to calculate given a number of subjective and financial inputs, the overall credit risk rating for each client. Along with this, a specific LGD engine will be utilised to calculate the LGD for each client. These engines feed the risk engine with the appropriate data to calculate the RWAs for SABB. Retail Risk Management has achieved significant strides in the development of a scorecard that will feed into their own risk engine. This will enable further refinements in the determination of the RWA for retail exposures. All these are expected to be full operational in 2010, as originally planned.

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:***

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 (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

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

Policies and processes for collateral valuation and management:

After receiving the final “Facility letter agreement” signed by the customer, and making sure that all the supporting documents in hand are completed, prior to loading the limit, Credit relationship officer checks if the facilities are secured by shares/funds. If so, as per approval, whether it is legal pledge over specific number of shares or simple deposit, an instruction is sent accordingly to the concerned function.

Pledge over shares --> Equity Brokerage Operations
Special Instructions --> Investment Operations
Pledge of funds unit --> Investment Operations

As per approval, the monitoring sheet is updated with the approved limit line(s) secured by collateral and Loan to Value.

Upon receiving any changes in Loan to Value, collateral, lines to be covered, as pre-approved, the sheet gets updated accordingly.

The sheet is circulated on a daily basis, based on the closing market values.

A description of the main types of collateral taken by the bank:

- Time deposits
- Government Bonds
- Listed Shares
- Mutual Funds Units
- Bank Guarantees
- Title deeds of property

International and Local Banks Guarantees are referred to Institutional Banking for approval

Within KSA, equity and collective investment schemes are not allowed for credit mitigation purposes.

Main types of guarantor counterparty and their creditworthiness

Preference is generally given to GCC/ OECD banks guarantees which are at least “A” rated.

Table 8
GENERAL DISCLOSURE FOR EXPOSURE RELATED TO COUNTERPARTY CREDIT RISK

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

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

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

Table 9
SECURITIZATION

Not Applicable

Table 10
MARKET RISK: DISCLOSURE FOR BANKS USING STANDARDIZED APPROACHES

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

The principal tool used by SABB to monitor and limit market risk exposure is Value at Risk ("VaR"). The SABB model is fully aligned with the HSBC Group VaR model, which has been approved by the UK FSA for the calculation of regulatory capital requirement under Basel 2, Pillar 1 advanced approach.

Summary of Bank's Governance and Control Infrastructure for Market Risk

For management purposes, SABB assesses the market risk in its trading portfolio on the basis of VaR. Regulatory reporting continues to follow the Standardised approach as prescribed by SAMA.

- SABB has an established risk management mandate that is reviewed and approved by Excom on an annual basis.

- Stop loss referral limits and triggers are established on the various banking and investment portfolios.

- Value at Risk (VaR) control levels have been established at a Bank level with sub limits placed on the banking and trading books. These limits are tracked by Risk Management on a daily basis with exceptions referred to senior management and Excom.

- Back testing methodologies are applied to validate the VaR model calculations.

- Investment portfolios managed by Treasury are managed within strict Mark to Market (MTM) limits.

- Present Value Basis Point (PVBP) limits are established covering the total bank exposure as well as having sub limits placed on the banking and trading books.

- FX exposures are controlled within specific limits.

- Stress testing is undertaken twice a month covering a range of scenarios as defined in the stress testing section covering Treasury and Market Risk models.

- ALCO reviews the market risk positions on a monthly basis.

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

Not Applicable

Table 12
OPERATIONAL RISK

Strategies and processes

SABB's Strategy has been to adopt the Standardised Approach requirements for Operational Risk as defined by the Basel II framework which states that Operational risk is defined as the risk of loss resulting from inadequate or failed internal processes, people, and systems or from external events. This approach has been approved by the SABB Board of Directors and Senior Management is involved in delivering and promoting the strategy at every level of the organisation.

SABB ensures that the management of an operational risk management framework is closely integrated with the business and functional units who are the primary owners of operational risk. The objectives of the primary owners must therefore include an expression of operational risk appetite - the level of acceptable risk and what types of operational risk are not acceptable

The strategic objectives for operational risk are supported by an effective strong governance model, policy manuals, systems, training and an environment that fosters the management of operational risk.

The structure and organisation of the relevant risk management function

SABB has established a centralised Operational Risk Management function, reporting to the Chief Risk Officer. The role is one of policy setting, implementation of operational risk management processes, coordination with business and functional units in respect of training, establishing mitigants, monitoring and producing reports to the Board of Directors and its major sub committees on an annual and quarterly basis. The Executive Committee (EXCOM), The Audit Committee (AUCOM) and the Risk Management Meeting (RMM) are the major sub committees.

The Operational Risk Management function is complimented by the line management who are responsible for the day-to-day activities and the Operational Risk Management Group (ORMG) whose members comprise of senior risk and business executives supported by an overall SABB entity -level Operational Risk Coordinator. This officer oversees the work of the Operational Risk Business Coordinators who are appointed for each key business and functions within the entity.

The Board of Directors and its sub committees provide oversight, through periodic Operational Risk Management's reports, on the level of operational risks faced by SABB.

The scope and nature of the risk reporting and/or measurement systems

Operational Risk reporting by SABB to the Board of Directors , Senior Management and their relevant sub committees involves the reporting of Operational Risk losses , the major risks identified by the business/ functional units through their risk assessment programmes and the Key Risk Indicators that have breached established escalation triggers,

Under the Standardised Approach these risk reports are qualitative but they trigger a programme for senior management action. Such programmes over time help SABB to continually manages its internal control environment and the level of operational risk.

Policies for hedging and mitigating risk and strategies and process for monitoring the continuing effectiveness of hedges and mitigants.

SABB monitoring process of operational risk helps the Board of Directors and Senior Management to understand the current risk profile, how it is changing and which risks warrant attention. Where risks cannot be managed internally the risks are transferred externally through the purchase of Insurance policies.

SABB Policies ensure that the business and functional units identify operational risks and recommend / mitigants at least annually as part of their risk assessment process. These mitigants are challenged by an independent risk management committee. Risk assessments and action plans are consistently recorded in a centralised database. Business management and Operational Risk Business coordinators monitor and follow up the progress of documented action plans.

The operational risk management framework helps managers to fulfill these responsibilities by defining standard risk assessment methodology and providing a tool for systematic reporting of operational data. Appropriate means of mitigation and controls are considered. These include:

-making specific changes to strengthen the internal control environment.

-investigating whether cost effective insurance cover is available to mitigate the risk; and

-other means of protecting SABB from loss.

Losses are entered in the SABB Operational Risk database and the business units are required to report individual losses when the net loss is expected to exceed USD10,000 and aggregate all other losses on under USD10,000. Losses are reviewed by the ORMG and EXCOM and mitigants reviewed to prevent recurrence or manage the potential exposure

Approach for Operational Risk capital assessment for which SABB qualifies.

Within the BASEL II framework, SABB has adopted the Standardised Approach for Capital Assessment under Pillar 1 where SABB must hold a percentage, depending on the business line, of average annual gross income, where positive, over the previous three years.

Furthermore SABB makes an Internal Capital Adequacy Assessment Process (ICAAP) for operational risk under Pillar 2 by reviewing whether the level of operational risks is acceptable, and if it is not what mitigating actions have been taken or are planned

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)

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.

Analysis of this risk is complicated by having to make assumptions on embedded optionality in products such as mortgage prepayments, and from behavioural assumptions regarding the economic duration of liabilities, which are contractually repayable on demand.

The Governance process for Interest rate risk replicated the infrastructure and controls adopted for Market Risk, which have already been highlighted within the Market risk section.