

2007

Annual Report and Accounts
The Saudi British Bank

Local vision, international expertise

SABB  ساب

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This report is issued by SABB (The Saudi British Bank)

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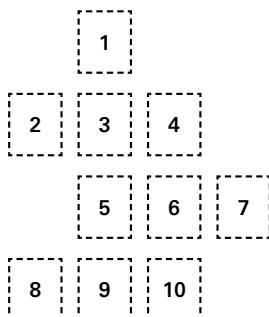


Custodian of The Two Holy Mosques
King Abdullah Bin Abdulaziz Al Saud



His Royal Highness
Prince Sultan Bin Abdulaziz Al Saud
The Crown Prince, Deputy Premier,
Minister of Defence and Aviation and Inspector General

Board of Directors

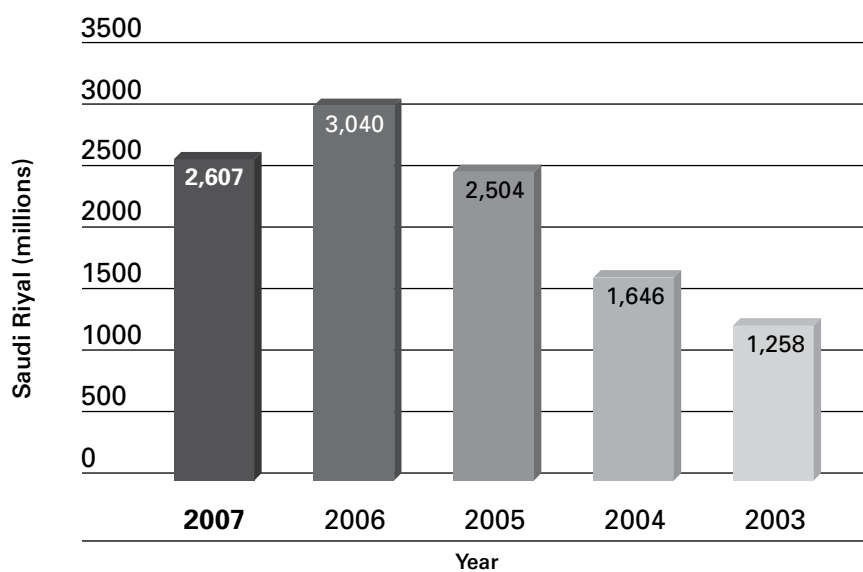


1. Abdullah Mohammad Al Hugail (Chairman)
2. John Edward Coverdale (Managing Director)
3. Khaled Suliman Olayan
4. Fouad Abdulwahab Bahrawi
5. Khalid Abdullah Al Molhem
6. David Howard Hodgkinson
7. Youssef Assad Nasr
8. Richard W L Groves
9. Sulaiman Abdulkader Al Muhaidib
10. Ahmed Sulaiman Banaja

Financial Highlights

Saudi Riyal (millions)	Year				
	2007	2006	2005	2004	2003
Customer Deposits	71,848	59,258	48,534	44,666	36,090
Shareholders' Equity	10,425	9,405	7,493	5,917	4,746
Investments, net	14,859	21,702	16,373	14,676	15,971
Loans and Advances, net	62,001	42,450	40,847	31,627	26,117
Total Assets	98,213	77,189	65,928	57,938	46,062
Net Income	2,607	3,040	2,504	1,646	1,258
Gross Dividend	1,500	1,500	813	990	832

Net income



Chairman's Statement

On behalf of the Board of Directors, I am pleased to present the Annual Report of SABB for the financial year ending 31 December 2007.

2007 has seen sustained growth in the Saudi economy for a fourth year in a row. This has been of continued benefit to the banking and finance sectors – and especially to SABB, which was well placed to take full advantage of the opportunities arising. Continued focus on the core fundamentals has ensured ongoing balanced growth as evidenced by a higher level of deposits, loans and total assets.

Net profits for the year amounted to SAR 2,607 million (USD 695 million), with a Return on Average Equity (RoE) of 26%. The Bank's continued efforts to strengthen its core businesses, as well as introduce new products and services, resulted in the achievement of balanced growth – evidenced by a significant rise in deposits, loans, advances and total assets, in addition to a huge increase in our customer base.

The Board of Directors recommended a final net dividend per share of SAR 2.22 (USD 0.59) which, added to the interim dividend of SAR 1.54 (USD 0.41) net per share paid during the year, makes a total of SAR 3.76 (USD 1.00) net per share for 2007.

In pursuit of our declared aim of providing detailed attention to the needs of our customers, we now have an expanded network of 63 branches, including 12 Ladies' sections, and 398 automated teller and cash deposit machines across the Kingdom. Of particular note is the attention given to the provision of superior 'Premier Lounge' facilities for our high net worth customers; the opening of new Investment Centres; and the development of our Direct Sales Teams to ensure a wider audience for both our conventional and Shariah-compliant products and services.

As part of our clearly defined strategy of diversification into the broader field of financial services, the year has seen marked progress by HSBC Saudi Arabia Limited, the investment banking affiliate in which SABB has a 40% interest, whose activities resulted in them receiving no less than seven international banking awards in 2007; the commencement of trading of SABB Takaful, offering Shariah-compliant insurance products; and further steps taken towards formation of a conventional insurance subsidiary.

In what has become an increasingly competitive environment, Corporate and Commercial Banking has maintained its highly successful role in the debt and Islamic finance structured markets, having participated either solely or jointly in most of the major deals transacted during the year for both public and private-sector corporations. Such success has been due in large part to the Bank's ability to introduce innovative global solutions to the local marketplace.

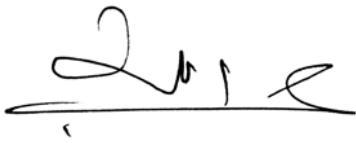
In accordance with the Capital Market Authority's Authorised Persons Regulations, Investment Banking has established SABB Securities Limited, a majority-owned subsidiary providing brokerage and securities services through SABB branches Kingdom-wide. The new company has already proved successful in increasing its market share such that by the year end its ranking had risen from sixth to second place.

Further growth has been seen in demand for Personal Banking's products and services, and specifically for Shariah-compliant offerings such as Amanah Home Finance and the new Amanah credit card. Private Banking has also enjoyed success and now has representation in all three main centres of the Kingdom and a dedicated Ladies' Unit in Riyadh.

SABB has continued to be an active and responsible citizen by making a number of humanitarian gestures during the year; by pioneering environmental awareness in the Kingdom; and through the long-term encouragement of Saudi citizens by supporting various higher-education programmes.

Looking to the future, SABB is well placed to derive maximum benefit from the strong economic circumstances prevailing in the Kingdom. The positive business outlook which this engenders, allied to the Bank's detailed attention to customers and to the provision of broadly based financial services, ensures considerable potential for balanced and sustained growth in the years to come.

On behalf of the Board of Directors, I am left with the pleasant task of expressing sincere thanks to all shareholders for your loyalty; my deep appreciation to every member of the Bank's staff, whose consistent and committed effort ensures continued success; and my thanks to our customers for their ongoing confidence and support. I would also like to express my gratitude to the Saudi Government, especially to the Ministries of Finance and Commerce & Industry and the Saudi Arabian Monetary Agency, and also to the Capital Market Authority, for their continued guidance and help to the Saudi Arabian banking and financial community. As a leading member of that community, SABB has a commitment to the growth and development of Saudi Arabia under the leadership of the Custodian of the Two Holy Mosques and the Crown Prince.

A handwritten signature in black ink, appearing to be 'Abdullah Mohammad Al Hugail', written over a horizontal line.

Abdullah Mohammad Al Hugail
Chairman

Directors' Report

The Board of Directors is pleased to submit to shareholders the Annual Report of SABB for the financial year ending 31 December 2007.

Introduction

SABB was established as The Saudi British Bank by Royal Decree No. M/4 dated 12 Safar 1398(H) (21 January 1978) and is an associated of the HSBC Group. Its main objective is to provide a range of banking services to both the retail and corporate sectors such as depository and lending services, import and export services and loans to corporate customers, and investment solutions and financial advisory services to its personal customers.

The Bank owns 100% of 'SABB Securities Limited.', a company based in Riyadh, KSA, with a registered capital of SAR 52.4 million. The company offers a full range of investment trading services including domestic, GCC and international equity brokerage services. It also acts as broker for exchange-traded futures and options. In addition, SABB Securities offers custody and clearing services to both local and foreign corporate and institutional investors. These services include safekeeping, receipt and delivery of securities, conversion of share certificates, portfolio reporting, corporate action reporting and payments collection.

The Bank has no subsidiaries outside the Kingdom of Saudi Arabia.

Five-year financial highlights

Saudi Riyal (millions)	Year				
	2007	2006	2005	2004	2003
Customer Deposits	71,848	59,258	48,534	44,666	36,090
Shareholders' Equity	10,425	9,405	7,493	5,917	4,746
Investments, net	14,859	21,702	16,373	14,676	15,971
Loans and Advances, net	62,001	42,450	40,847	31,627	26,117
Total Assets	98,213	77,189	65,928	57,938	46,062
Net Income	2,607	3,040	2,504	1,646	1,258
Gross Dividend	1,500	1,500	813	990	832

Geographical analysis of income:

SABB generates most of its income from its activities in the Kingdom of Saudi Arabia.

Business segments:

The Bank is organised into the following main business segments:

Retail Banking – which caters mainly to the banking requirement of personal and private banking customers.

Corporate Banking – which caters mainly to the banking requirements of commercial and corporate banking customers.

Treasury – which manages the Bank's liquidity, currency and special commission rate risks. It is also responsible for funding the Bank's operations and managing the Bank's investment portfolio and balance sheet.

Transactions between the business segments are reported as recorded by the Bank's transfer pricing system. The Bank's total assets and liabilities as at 31 December 2007, its total operating income and expenses, and the results for the year then ended, by business segment, are as follows:

	2007				Total SAR'000
	Retail Banking SAR'000	Corporate Banking SAR'000	Treasury SAR'000	Other SAR'000	
Total operating income	2,049,520	1,858,650	465,782	-	4,373,952
Total operating expenses	1,383,401	371,867	69,692	-	1,824,960
Share in earnings of associates, net	-	-	-	57,947	57,947
Net income	666,119	1,486,783	396,090	57,947	2,606,939

Five-year financial highlights *(continued)*

The Bank's share in earnings of associates represents profit share in the following companies:

HSBC Saudi Arabia Limited

SABB holds a 40% equity share of the capital, which is SAR 50 million. The company provides investment banking financing in the Kingdom of Saudi Arabia, in addition to investment financing services, Initial Public Offerings, Mergers & Acquisitions and Private Placements.

SABB Takaful

SABB Takaful is a Saudi joint stock company listed in the Tadawul (Saudi Arabia's Stock Market) index. The Bank owns 32.5% of the company's capital, which is comprised of 10 million shares, with a nominal price per share of SAR 10 for each share. The company offers Shariah-compliant insurance services, as well as Family and General Takaful products.

The business environment

During 2007, the economy of Saudi Arabia has seen sustained growth for a fourth year in succession. Forecast growth in GDP for the year approximates to 3.7%, whilst the Kingdom's foreign assets are considered likely to have increased to close to SAR 942 billion (USD 251 billion) by 31 December, with a figure in excess of SAR 1,000 billion (USD 267 billion) anticipated in 2008.

Inflation, measured by reference to the cost of living index, is estimated to have risen to 3.6% this year from less than 2% per annum in 2006, a rise due in large part to increases in the price of food and property rentals, allied to the relative strength of most major currencies against the US Dollar and the high level of import of consumer goods. Though the inflation figure is higher, year-on-year it remains considerably lower than the double-digit inflation in some neighbouring countries.

With oil prices remaining firm throughout the year, Government revenues are estimated to have risen to SAR 618.7 billion (USD 165 billion), allowing for a yet further reduction in public borrowing to an estimated SAR 309 billion (USD 82.4 billion) or 24.2% of GDP by the year end (2006: 28% of GDP). The higher revenues generated, which are thought likely to continue into 2008, have enabled the Government to budget for increased expenditure of SAR 444.6 billion (USD 118.6 billion) over the coming twelve months, as compared to a budgeted figure in 2007 of SAR 390 billion (USD 104 billion).

The increased levels of Government spending have given yet further impetus to the private sector in the Kingdom, including the growing banking sector. Sustained participation in the many major infrastructure and industrial projects being implemented, including the six major economic cities to be constructed in outlying areas of the Kingdom, power and water facilities, new railway lines across the country and a wide array of petrochemical plants, have been integral to the sector's activities.

The strong national economy has again impacted positively on the banking sector, although the substantial decline in the Saudi stock market, Tadawul, earlier in the year has had an adverse impact on investor confidence and therefore, on the level of investment-related business transacted through the banks. Nevertheless, SABB, whilst seeing a reduced level of profits for the first time in more than a decade, has witnessed significant growth in deposits, loans and total assets. Such an achievement has been due in large part to the Bank's focus on healthy corporate growth, which has been driven by the ongoing success of the Bank's retail business, where new products and improved customer services have featured strongly, especially Shariah-compliant products under the Amanah brand. Furthermore, continued high-quality training has ensured greater professionalism amongst staff at all levels of the Bank. Together, these ensure SABB's status as a leader in the Saudi banking community and position the Bank for sustained growth in the years to come.

Directors' Report (continued)**Profits**

In 2007, SABB enjoyed continuing success across all business areas, but has been unable to extend its twelve-year run of increased profits or Average Return on Equity (RoE).

Profits for the year amounted to SAR 2,607 million (USD 695 million), lower by SAR 433 million (USD 115 million) or 14% than the SAR 3,040 million (USD 811 million) attained in 2006. The profits as declared equate to Earnings per Share of SAR 6.95 (USD 1.85). (2006: SAR 8.11 (USD 2.16) per share). Operating income totalled SAR 4,374 million (USD 1,166 million) for the year ended 31 December 2007 – down by SAR 243 million (USD 65 million), or 5.3 per cent, compared with SAR 4,617 million (USD 1,231 million) for the same period in 2006.

SABB succeeded in mitigating the year-on-year fall, despite the large reduction in equity income streams, by strengthening its core business, developing new products and forging new client relationships. Notwithstanding the profit reduction, an increased level of dividend and a bonus issue of shares are being proposed by the Board of Directors.

Cost growth was maintained at 1.8% compared to the same period last year. The year has seen many investments, including changes to the SABB logo, recruitment of staff and system development. The level of doubtful debt is in line with asset growth, as well as the increase in credit cards and consumer finance business in the market. The Bank's credit quality maintained its strength, particularly in the corporate sector which continues to benefit from the strength of the Saudi economy. Liquidity and capital adequacy ratios remain strong as well.

As at the year end, customer deposits totalled SAR 71,848 million (USD 19,159 million) or 21% higher than the figure at 31 December 2006 of SAR 59,258 million (USD 15,802 million). Loans and advances to customers also rose, by 46% or SAR 19,551 million (USD 5,214 million) to SAR 62,001 million (USD 16,534 million) from SAR 42,450 million (USD 11,320 million) a year earlier. Total assets as at end 2007 had reached SAR 98,213 million (USD 26,190 million), an increase of SAR 21,024 million (USD 5,606 million) or 27% over the figure of SAR 77,189 million (USD 20,584 million) as at the previous year end. The primary factor in this healthy growth in assets has been the encouraging progress within the retail/corporate sector, particularly from cards and mortgages.

Cash dividends and bonus share issue

Subject to any unforeseen business contingencies, and assuming approximately 12% annual growth in net income, SABB should aim to maintain dividend distributions at 60% of net income to maintain a steady and increasing dividend stream for investors.

On the basis of the results declared, the Board of Directors proposes a final net dividend of SAR 2.22 (USD 0.59) net per share. This, together with the interim net dividend of SAR 1.54 (USD 0.41) net per share paid during the year, makes a total of SAR 3.76 (USD 1.00) net per share for 2007.

A bonus issue of 3 new shares for every 5 shares is proposed subject to all relevant official approvals. Shareholders' approval for the final dividend and the bonus share issue will be sought at the Annual General Meeting to be held early in 2008.

Zakat and income tax

Zakat attributable to the Saudi shareholders for the year 2007 amounted to approximately SAR 55.1 million. Income tax attributable to foreign shareholders' share of income – for the same year – is approximately SAR 215.6 million, and is deducted from its share of the dividend. The Bank will pay the zakat and income tax mentioned above, after the deduction of an income tax amount of SAR 184.5 paid in advance during the year.

Notification relating to substantial shareholdings:

During the year, the Bank received notifications from majority shareholders and relevant persons, with regard to the change in the ownership of the Bank's capital shares, in accordance with article (30) of the 'Listing Rules', issued by the Capital Market Authority. Below is a breakdown of percentages of share ownership, in addition to SABB's directors, senior executive management, spouses and minor children:

Name	Number of shares at the beginning of the year	Percentage of ownership at the beginning of the year	Net variance in the number of shares during the year	Percentage of variance during the year	Total number of shares at year end	Total percentage of ownership at year end
Foreign partner	150,000,000	40%	0	0	150,000,000	40%
Major shareholders other than foreign partner	99,629,933	26.57%	115,057	0.12%	99,744,990	26.60%
Board members, and senior executive management	2,221,617	0.592%	8,760	0.39%	2,230,377	0.0595%

Cash dividends and bonus share issue *(continued)*

Other major shareholders represent shareholdings (excluding the non-Saudi shareholder) of more than 5% of the Bank's issued share capital.

Property and branches

2007 has been another active year for SABB with the completion of the expansion of the Head Office building; the increase in the number of branches to 63, and 12 Ladies' sections; and the growth in the number of automated teller and cash deposit machines to 398, an increase of 120 over a year earlier.

Two new branches have been built and opened, at Al-Sahafa in Riyadh and at Hafr Al Batin, and four others have been relocated to new, purpose-built premises – with a fifth expected to be operational early in 2008. A further six new branches were under construction as at 31 December 2007, with another seven around the Kingdom under consideration for implementation during the coming year. Re-branding of the Bank's branches also continued apace with 14 more being completed during the twelve months.

To provide superior facilities for higher net worth customers, a new Premier lounge was finalised in Riyadh, the first in the Middle East to meet fully the HSBC's Group standard criteria. More Premier lounges are to follow at locations around the Kingdom. Two new Investment Centres have also become operational during the year.

Other property-related activities undertaken have included the relocation of Collections, to a newly renovated and refurbished building; the extensive refurbishment of SABB's main Call Centre; the securing of new premises for Investment Banking Saudi Arabia; and the sale of the Riyadh housing compound, including the relocation of staff resident there to other compounds around the city. The latter was part of the Bank's desire to provide adequate security for staff and customers alike, a move which also included installation of a new, state-of-the-art central monitoring system in Head Office.

Corporate and Commercial Banking

Corporate and Commercial Banking continued to play a highly successful role in the debt and Islamic finance structured markets. Participations during the year included that of sole arranger/book runner/underwriter of Saudi Electricity Company's SAR 5,000 million sukuk; joint arranger/book runner/underwriter of SABIC's SAR 8,000 million sukuk; and sole arranger/underwriter of SABIC's Shariah-compliant hedge swap. SABB was also mandated lead arranger of SABIC Innovative Plastics USD 5.4 billion 7-year syndicated loan and of the USD 5.4 billion 22-year syndicated loan for Marafiq IWPP.

Evidencing the depth and breadth of Corporate and Commercial Banking's activities, other deals in which SABB was involved included the co-underwriting of the Kingdom Holding IPO; a syndicated loan of USD 500 million for Saudi Oger; syndicated facilities of USD 250 million for Saad Trading and Contracting; an Islamic facility for AlWaha; an Islamic re-financing for International Methanol Company; a commercial facility for Jubail Acetate Company; a re-financing for Tihama; and 5-year and 364-day facilities for Saudi Aramco.

Corporate and Commercial Banking was also actively involved in the Financial Guarantee Programme, which is sponsored by the Kingdom's local banks and managed by the Saudi Industrial Development Fund.

Investment Banking

SABB Securities Limited *(managed by HSBC Saudi Arabia Limited)*

In compliance with Article 6f of the Capital Market Authority (CMA) Authorised Persons Regulations (APR), the brokerage and securities services businesses of SABB were transferred to a new company, SABB Securities Limited. SABB Securities is a 100%-owned subsidiary of SABB with a registered capital of SAR 52.4 million. The Company has an independent board of directors appointed by SABB and a chairman. The company is managed through a formal agreement with HSBC Saudi Arabia Limited and operates through a large network of branches throughout the Kingdom.

The company's main services are as follows:

Brokerage Services

SABB Securities provides customers with tailored domestic and international equity brokerage services and margin lending facilities (provided through SABB), and acts as broker for international exchange traded futures and options. Trading is offered through a variety of different channels, including two online services (SABBTadawul and SABBmubasher), a dedicated toll-free Telephone Service Centre and a wide network of Investment Centres.

Directors' Report (continued)

Investment Banking (continued)

International brokerage services provide access to global markets including those in the GCC, North and South America, Europe and the Asia-Pacific region.

SABB Securities' market share has shown steady growth in 2007, from 8.55% as of the end of December 2006 to 13.46% in December 2007, improving SABB Securities' market ranking from 6th to 2nd place within the year.

Securities Services

SABB Securities' Custody and Clearing unit provides custodial services to corporate and institutional investors, both domestic and international, offering a range of services such as receipt, safe-keeping and delivery of securities, conversion of share certificates, portfolio reporting, corporate action reporting and payments collection. This unit is also involved in the floatation and management of IPOs and rights issues. It is also promoting Institutional Fund Services products to external fund managers, as well as offering corporate trust and loan agency services.

Securities Services had a very successful 2007 and reported significant growth in revenue, assets under custody and new relationships. The unit continued its policy of diversification of products and introduced Non-Bank Financial Services during 2007. Its marketing strategy, supported by state-of-the-art systems and teamwork, resulted in growth of over 600% in assets under custody, which stood at over SAR 18.5 billion as at the end of 2007. HSBC Saudi Arabia Limited's strong position in the local debt and equity markets, coupled with the close association with HSBC's worldwide Securities Services business, gives SABB a distinct advantage in delivering quality custody and other related services to clients, both domestic and international. HSBC Saudi Arabia Limited has the largest custody network in the Middle East and Asia and a truly global reach. During 2007, HSBC Saudi Arabia Limited was named the 'Best Sub-custodian Bank in Saudi Arabia' by *Global Finance*, which reflects the cutting-edge reputation and standing of the company's business in the Kingdom.

HSBC Saudi Arabia Limited

HSBC Saudi Arabia Limited is SABB's and the HSBC Group's investment banking arm in the Kingdom. Incorporated in 2006 and licensed by the Saudi Capital Market Authority for all five licensable activities (Dealing, Managing, Arranging, Advising and Custody), HSBC Saudi Arabia Limited is owned 40% by SABB and 60% by HSBC Holdings plc, through HSBC Asia Holdings BV.

The company's main services are as follows:

Asset Management

The Asset Management department of HSBC Saudi Arabia Limited currently offers a wide variety of both local and international mutual funds. The assets under management in mutual funds have increased over the year by 77%, reaching SAR 17.7 billion as at the end of December 2007, compared to SAR 9.9 billion twelve months earlier.

During the year, the fund management of SABB Mutual Funds was transferred to HSBC Saudi Arabia Limited and all investors were advised of this change through individual letters and messages on the company's website.

During the first quarter of the year, a Shariah-compliant European Equity Fund, the Amanah Pan European Equity Fund, was launched. In December, given the underlying strength of the domestic economy, two Saudi equity-based mutual funds (the HSBC Saudi Equity Index Fund and the HSBC Saudi Petrochemical Equity Opportunities Fund) were also launched with a view to increasing foreign institutional investment in the Saudi equity markets. Plans were also in hand for the launch of the HSBC Global Emerging Markets Equity Fund (GEM) early in 2008.

Corporate Finance

SABB and HSBC Saudi Arabia Limited have maintained their leading position in Saudi Arabia during the year in the fields of financial advisory, lead manager and/or placing agent activities for equity and debt issues, whilst further consolidating its position in Islamic Finance transactions, leading the way in providing advice on and lead arranging the major Islamic financings and sukuk issues in the Kingdom. Furthermore, the Bank has expanded its capabilities over the past three years to attain a market-leading position, managing both conventional and Islamic debt issues locally and internationally in the petrochemical and power & water industries, whilst maintaining a strong position in the infrastructure, telecommunications, transportation, real estate, financial and retail sectors. HSBC Saudi Arabia Limited was named 'Best Debt House in Saudi Arabia' in 2007 by *Euromoney* magazine.

Investment Banking Advisory

During the year, HSBC Saudi Arabia Limited retained its status as the Kingdom's most active investment bank in terms of financial advisory, lead manager and/or placing agent for equity issues, and was named 'Best Mergers and Acquisitions House in Saudi Arabia' in 2007 by *Euromoney* magazine. The gross value of investment banking deals executed to date, both equity capital markets and mergers and acquisitions, well exceeds SAR 13,000 million. The most notable deals completed in 2007 included the following:

- Financial advisor, lead manager and sole underwriter of the SAR 142.4 million IPO of Malath Cooperative Insurance Company
- Financial advisor to Almarai Dairy Company on its SAR 705 million acquisition of Western Bakeries and International Baking Services companies
- Financial advisor to National Titanium Dioxide Company ('Cristal'), a subsidiary of National Industrialisation Company ('Tasnee') on its USD 1.2 billion acquisition of the Millennium Inorganic Chemicals subsidiary of Lyondell Chemical Company in the United States
- Financial advisor, lead manager and sole underwriter of the SAR 35 million IPO of SABB Takaful
- Financial advisor, lead manager and lead underwriter of National Shipping Company of Saudi Arabia's (NSCSA) SAR 1,440 million rights issue
- Co-underwriter and co-manager of the SAR 6,750 million IPO of Saudi Kayan
- Co-underwriter and co-manager of the SAR 3,228 million IPO of Kingdom Holding Company
- Co-underwriter and co-manager of the SAR 874 million IPO of Al-Abdullatif Industrial Investment Company

Investment Banking Financing

Early in the year, HSBC Saudi Arabia Limited advised the Saudi Electricity Company on obtaining debut international credit ratings from Standard & Poor's and Fitch, two of the leading global ratings agencies, which contributed to the company gaining the highest rating for a corporate in the Kingdom. The company subsequently led the largest international corporate syndicated loan ever by a Saudi corporate.

Following on the success of the first domestic sukuk issue by SABIC in 2006, HSBC Saudi Arabia Limited led sukuks in the local market for both Saudi Electricity Company and SABIC during the year, each of which successively set the record for the largest Saudi Riyal sukuk and the largest non-equity linked sukuk in the GCC. SABIC's sukuk was also the first public SAR-denominated Sukuk issue by a Saudi company in which GCC investors were also allowed to invest. This sukuk was skilfully managed by HSBC Saudi Arabia Limited and was successfully closed despite the 'sub-prime crisis' emerging in the international markets.

HSBC Saudi Arabia Limited was also a lead manager in the USD 9,200 million debt financing of SABIC's acquisition of GE Plastics from General Electric, a company subsequently renamed SABIC Innovative Plastics (SIP). The company also played a key role in the distribution of the newly named company's high yield bond, which was filed solely for 'exempt' distribution in Saudi Arabia.

Project and Export Finance

HSBC Saudi Arabia Limited's Project and Export Finance ('PEF') business continued to lead the advisory market and, jointly with SABB, the arranging market for complex project finance transactions. PEF was newly mandated to advise the Ministry of Water & Electricity on their upcoming wastewater privatisation programme, and to advise Marafiq on their second world-scale independent water and power project ('IWPP'). Additionally, PEF continued their ongoing advisory work to the Water & Electricity Company for the third project in their successful IWPP programme and with Sipchem for two world-scale petrochemical complexes.

PEF was also central to a groundbreaking Saudi private-sector acquisition of a US chemicals company, paving the way for future transactions working with leading private-sector Saudi companies. PEF/SABB reinforced their position as a leading arranger of project financing, having secured the role of Mandated Lead Arranger on the Saudi Kayan USD 10 billion petrochemical complex, the National ChevronPhillips USD 5 billion petrochemical complex, the Shuquaiq USD 1.8 billion IWPP project, the Marafiq USD 3.3 billion IWPP project, and re-financings for Tihama Power Generation and for the Saudi Polyolefins and International Methanol petrochemical projects. PEF was further provisionally mandated for the Kingdom's largest private-sector privatisation programme, expected to commence in 2008.

Directors' Report (continued)

Summary

The above transactions reinforce HSBC Saudi Arabia Limited's pioneering and leading investment banking position and provide a firm base for further enhancement of its reputation in the Kingdom in the coming year.

Personal Banking

Personal Banking has seen further substantial growth in demand for its products and services in 2007, especially the Shariah-compliant offerings under the SABB Amanah brand and the up-market services offered to more affluent customers under the newly relaunched Premier banner.

Of particular significance during the year has been the demand for Amanah Home Finance, with SABB again increasing its market share following the broadening of its product range to include construction and refinancing, and the increase in the number branches now operating under the Amanah brand to 48 (33 more than at the previous year end). The newly issued, Shariah-compliant Amanah Credit Card has also been well received.

For Premier customers, SABB has opened three global Premier Centres run by specially trained relationship staff offering a very high level of service, with five more Centres planned for the coming year. In association with the HSBC Group, SABB is now able to offer Premier customers a comparable level of service wherever they may be in the world, including online access to their accounts and direct connection with their home country telecommunications services. With Premier's unique level of service, substantial customer growth is anticipated in the coming years.

SABB's conventional credit card business continued to grow and now leads the way with a 25% market share of cards-in-issue and an increased share of cardholder spending. To simplify settlement of sums due on credit cards and on EasyBuy payments, these may now be made over SADAD. Of special importance, given the increased level of credit card spending outside the Kingdom, the Bank's fraud monitoring controls have been further improved during the year to ensure maximum protection for customers. To enable faster completion of transactions, all the Bank's merchant acquisition terminals have been upgraded to the INET network, resulting in faster completion of transactions, whilst shortly before the year end an eCommerce/Internet merchant acquisition service was launched.

Direct banking over SABBNET has again seen strong growth, as has telephone banking via SABB Direct. This is due largely to the continued enhancement of the services offered, including SADAD bill payment and portfolio breakdown, and the 25% increase in the number of ATMs and cash deposit machines installed across the Kingdom. Success in developing Direct Banking was recognised during the year when SABB was honoured with *Global Finance* magazine's awards for 'Best Bank Internet Investment Management Services' and 'Best Bank Online Consumer Credit' in the MENA region.

Private Banking

SABB Private Banking has grown yet further in 2007 and now has representation in the three main regions of Saudi Arabia, including a dedicated Ladies' Unit in Riyadh. Wider coverage of the Eastern Province, including Al-Qatif, Al-Ahsa and Seehat, is also now provided. All Private Banking offices are staffed by some of the most highly qualified relationship managers in the Kingdom, which has ensured Private Banking's status as a market leader in terms of market share.

Furthermore, a well-qualified professional has been recruited to cover Makkah, whilst three more qualified ladies have been recruited to enhance the Bank's capabilities in providing services to the female population. It is also noteworthy that 90% of Private Banking's relationship managers are fully accredited members of the Certified Financial Planning Programme, whilst most of them are also enrolled in the Wealth Management Programme.

To strengthen Private Banking's activities, in addition to all investment opportunities offered by HSBC Saudi Arabia Limited, SABB Private Banking has extended its services to clients by developing a close relationship with HSBC Private Bank in Geneva. In addition, clients are now able to benefit from the services offered by HSBC Global in a number of Premier Centres worldwide.

SABB has been recognised as the 'Best Private Bank in Saudi Arabia' in the *Euromoney* Private Banking and Wealth Management Survey 2008, which is regarded as the benchmark for the wealth management sector.

Insurance and Takaful

2007 has seen the launch of SABB Takaful by way of an Initial Public Offering (IPO) and a subsequent capacity upgrade for the company. Also during the year, close attention has been given to the formation of a new insurance brokerage subsidiary.

Operations

Considerable attention has been given in 2007 to implementing those business initiatives which enhance customer services and improve operational efficiency, thereby ensuring significant financial savings and increasing revenue. Of particular importance has been the completion of the major Basel II operational risk tasks, which now enable online loss reporting and enhanced, regular input to the risk management committee and external risk review bodies. Attention has also been given to compliance with Anti Money Laundering legislation and action to combat terrorist financing.

International recognition

This year, SABB was awarded ‘Best Investment Management Service’ and ‘Best Online Consumer Credit Site’ by *Global Finance* magazine, in its World’s Best Internet Banks 2007 awards. SABB also won the award of ‘Best Contact Centre’ among medium-sized operations and ‘Best Outbound Campaign’ in the 2007 Contact Centres World awards for the best in EMEA. SABB has now been honoured with a total of nine major awards since 2005.

In 2007, HSBC Saudi Arabia Limited received two prestigious awards for excellence from *Euromoney* magazine: ‘Best Debt House’ and ‘Best Mergers and Acquisitions House’.

Corporate Communications

SABB was honoured during the year by the visit to its new Head Office building in Riyadh of HRH Prince Andrew, the second son of HM Queen Elizabeth II, who was in the Kingdom in support of British investment in Saudi Arabia. This visit followed on from the high-level talks with Government officials by the HSBC Group Chairman, Mr. Stephen Green, during which he made a significant long-term commitment to the development of the Saudi economy by HSBC, a 40% shareholder in SABB.

Community support

SABB is an active and responsible corporate citizen. During 2007, as part of its ‘SABB in the Community’ programme, the Bank made a number of humanitarian gestures which included providing assistance to needy local families and to the Prince Salman Centre for Disability Research, the Orphan Care Charitable Society (INSAN) and the Down’s Syndrome Charitable Association.

In further support of this policy and the Bank’s pioneering role as a ‘Friend of the Environment’, e-Eid cards were designed and distributed this year to replace paper cards, whilst initiatives were taken to conserve water and electricity and to recycle paper used in the Bank in order to raise environmental awareness amongst staff. Inter-related with these activities was SABB’s sponsorship late in the year of the British Council’s ‘North-South-East-West’ photographic exhibition, emphasising the challenge of climate change.

In pursuit of its long-term encouragement of Saudi citizens to enhance their personal value to the local community, the Bank continued to offer scholarships for MBA courses in the United Kingdom; maintained its sponsorship of the Chair-in-Finance at King Fahad University of Petroleum and Minerals in Dhahran; and sponsored and supported the ‘Banking and Finance Section’ at Dar Al-Hekma College for Girls in Jeddah, the first programme in the Kingdom to train Saudi ladies in the fields of financial management and banking.

In addition, SABB provided further support to the Centennial Foundation, which was established to help young Saudi entrepreneurs attain economic independence by becoming successfully self-employed, and to the Saudi-British Farasan Archaeology Project, which is investigating the archaeology and pre-history of the Red Sea coastline over the past one million years in collaboration with King Saud University, Riyadh and the University of York in the United Kingdom.

Directors' Report (continued)

Human Resources

SABB fully recognises that comprehensive development of all the Bank's staff is absolutely vital to future success. With this in mind, considerable attention has been given in 2007 to ensuring every individual is equipped with the necessary knowledge and expertise to attain his or her full potential and an unsurpassed level of professionalism.

To these ends, a wide range series of training programmes has been further developed for presentation to staff across the Bank, from the newest arrival to senior management. Programmes have addressed sales, service and accreditation, basic investment certification, management, systems and operations, information technology (IT), Takaful, commercial, corporate and credit training, and tuition in the English language. Additionally, group training has been provided on leadership and sales management. In presenting the various modules, the Bank provides for the comprehensive development of every attendee by honing his or her knowledge and skills to enhance their role in the Bank.

Throughout the year, attention has been given to staff motivation by offering programmes on career and executive development and succession planning, whilst utilising the balanced scorecard appraisal system throughout employees' careers as they rise through the Bank to attain positions of responsibility and authority. The Bank has also continued to pursue its Reward Scheme, undertaking a compensation and benefits survey to ensure all staff derive a level of remuneration comparable with their peers, and to offer the Super Performance Incentive Scheme.

In support of Saudisation, SABB initiated further recruitment drives across the Kingdom in 2007 seeking high-calibre Saudis to join the Bank from differing educational backgrounds. Integral to this activity were career days at universities and schools; the support of universities and institutes under the Co-operative Programme to provide students with work experience as part of their graduation requirements; participation in the Al-Masrafi Programme, which is supervised by SAMA and enables Saudi graduates to acquire skills enabling them to play effective roles in the domestic banking sector; encouraging students to spend time with the Bank during the summer break; offering Junior Officer Development programmes; and introducing an e-recruitment programme. Another vital activity has been the ongoing search for mid-career executives with commercial or industrial experience to join the Bank, bringing with them their specialist areas of knowledge and expertise.

Statistically, during 2007, a total of 6,844 individuals attended 33,643 days of training and SABB's Saudisation ratio by the end of the year had risen to 87 per cent, being 2,623 out of a total staff complement of 3,005, which figure includes 392 Saudi ladies.

Future plans

SABB is currently carrying out numerous plans and programmes for implementation in the future, which include:

- Increasing the number of SABB branches in the Kingdom and developing existing locations
- Updating communications and information technology systems across the country
- Apply the new requirements for measuring capital adequacy as per the Basel II agreement

Risk management

The Bank manages exposure to credit risk, by analysing how great is the risk that one party to a financial instrument will fail to discharge an obligation and cause the other party to incur a financial loss. The Bank assesses the probability of default of counterparties using internal rating tools. The Bank assesses counterparties using the same techniques as for its lending activities. Actual exposures against limits are monitored daily.

The Treasury department also manages the Bank's liquidity, currency and special commission rate risks, in addition to the fluctuations in financial assets and liabilities.

Board of Directors and subsidiary committees

Directors

At the Ordinary General Meeting held on 10 December 2007, all the existing Saudi members of the Board of Directors were re-elected as representatives of Saudi shareholders for a further three-year period from 01 January 2008 to 31 December 2010.

On 15 May 2007, Mr. Youssef Nasr was appointed a director of the Bank in place of Mr. Niall Booker and on 1 November 2007, Mr. Richard Groves was appointed a director of the Bank replacing Mr. John Richards.

In the light of these changes, the Board of Directors as at 31 December 2007 comprised:

Mr. Abdullah Mohammad Al Hugail, CHAIRMAN, INDEPENDENT (SAUDI)

President, Trading & Development Partners Company; Member, Resources Development Committee, Prince Salman Centre for Disability Research; Board Member, Prince Fahd Bin Salman Charitable Society for the Care of Kidney Patients; Ex-member of the Shoura Council; Member, Saudi Association for Disabled Children.

Mr. Fouad Abdulwahab Bahrawi, BOARD MEMBER, INDEPENDENT (SAUDI)

Partner in The Bahrawi Trading Company; Chairman of Watani Trading Company; Board Member, SABB Takaful Co.

Engr. Khalid Abdullah Al Molhem, BOARD MEMBER, INDEPENDENT (SAUDI)

Member, Saudi Economic Committee; Board Member, Asseer Company; General Manager, Saudia Airlines; Board Member, Saudia Airlines; Board Member, King Khalid Economic City (from commencement of the company to the present).

Mr. Khaled Suliman Olayan, BOARD MEMBER, INDEPENDENT (SAUDI)

Board Member, Al-Zamil Industrial Investment Company; Chairman, Olayan Financing Company; Chairman, Olayan Real-Estate Company; Chairman, The Coca-Cola Bottling Company of Saudi Arabia; Chairman, Colgate-Palmolive Arabia; Chairman, Olayan Kimberly-Clark Arabia; Chairman, Olayan Kimberly-Clark (Bahrain); Chairman, National Child Care Products Company; Chairman, Olayan Descon Engineering Company; Chairman, Olayan Descon Industrial Company; Chairman, Nabisco Arabia Company Ltd; Chairman, United Arab Can Manufacturing Company; Chairman, Arabian Paper Products Company; Chairman, Restaurant Service Company, WLL, Bahrain; Chairman, General Franchise Services Holding Company, WLL, Bahrain; Chairman, Olayan Investments Company Establishment, Vaduz, Liechtenstien.

Mr. Sulaiman Abdulkader Al Muhaidib, BOARD MEMBER, INDEPENDENT (SAUDI)

Chairman, A. K. Al-Muhaidib & Sons Group of Companies; Chairman, Jubar International Contracting; Chairman, Communication Solutions Co.; Chairman, Middle East Paper; Chairman, Dar Chemicals Ltd.; Chairman, Amwal Al-Khaleej Commercial Investment Co.; Chairman, Al Shamiyah Urban Development Co.; Chairman, Al-Oula Development Co.; Board Member, Riyadh Chamber of Commerce & Industry; Board Member, Riyadh Cables Group; Board Member, Yamamah Steel Co.; Board Member, Al-Azizia Investments Co.; Board Member, Arabian Pipes Co.; Board Member, Al-Toukhi Co. for Industry & Trading; Board Member, Disabled Children Association; Board Member, Prince Salman Centre for Disability Research; Board Member, Prince Fahd Bin Salman Charitable Society for the Care of Kidney Patients; Board Member, The Centennial Fund.

Mr. Ahmed Sulaiman Banaja, BOARD MEMBER, INDEPENDENT (SAUDI)

Member of Audit Committee, SEDCO; Board Member, Aluminium Products Company (ALUPCO); Board Member, Emaar Economic City; and Head of SABB Audit Committee, SABB.

Mr. John Coverdale, MANAGING DIRECTOR, NON-INDEPENDENT (BRITISH)

Board Member, HSBC Middle East Limited; Board Member, HSBC Bank Egypt SAE; Board Member, HSBC Saudi Arabia Limited; Board Member, SABB Takaful Company.

Mr. David Hodgkinson, NON-INDEPENDENT (BRITISH)

Board Member, HSBC Middle East Limited; Board Member, British Arab Commercial Bank; Board Member, HSBC Bank Egypt SAE; Chairman, HSBC Middle East Finance Company Limited.

Mr. Youssef Assad Nasr, NON-INDEPENDENT (AMERICAN)

Chief Executive Officer, HSBC Bank Middle East Ltd; Director, British Arab Commercial Bank, London; Director, HSBC Private Bank Holdings, Geneva, Switzerland; Deputy Chairman and Director, HSBC Bank Egypt SAE.

Mr. Richard Groves, CHIEF OPERATING OFFICER, NON-INDEPENDENT (BRITISH)

Chairman, SABB Securities Limited

Directors' Report (continued)**Executive Committee**

The Executive Committee, comprising the Managing Director and four Board Members, met on twelve occasions during 2007. Following Mr. John Richards' departure from SABB's Board of Directors, the members of the Executive Committee as at 31 December 2007 were: Mr John Coverdale, Chairman; Mr Fouad Abdulwahab Bahrawi; H.E. Mr. Khalid Abdullah Al Molhem; Mr. Ahmed Sulaiman Banaja; and Mr. Richard Groves.

Audit Committee

SABB's Audit Committee was formed in 1992. Reporting directly to the Board of Directors, the Committee monitors the Bank's internal and external audit functions and reviews control weaknesses and system deficiencies. It is also responsible for ensuring all financial information is of the highest quality, concentrating on critical business issues, which enable the Bank's external auditors and management to focus on those areas of greatest risk to the business. Mr. Ahmed Sulaiman Banaja (Chairman), Mr. Peter Boland and Mr. Mohamed Omran Al Omran are members of the Committee.

Property Committee

In 2006, a Property Committee was formed, comprising four members of the Board, with a brief to consider and approve the Bank's expenditure and liabilities in respect of properties including rentals, project costs and support expenditure such as safety and security. As at 31 December 2007, the committee was presided over by Mr. Abdullah Mohammad Al Hugail (Chairman) with Mr. Sulaiman Abdulkader Al Muhaidib, Mr. John Coverdale, Mr. Adel Marzook Al Nasser and Mr Richard Groves as members.

Corporate governance

SABB is generally in compliance with the corporate governance guidelines issued by the Capital Market Authority and the Saudi Arabian Monetary Authority, whilst continuing to adhere to the new Basel II principles related to risk measurement and capital adequacy. A team has been formed by the Bank's management to ensure ongoing compliance with all the guidelines laid down in accordance with best international practice.

Related party transactions

Managerial and specialised expertise is provided under a technical services agreement with the parent company of one of the shareholders, HSBC Holdings BV. This agreement was renewed on 30 September 2007 for a period of five years.

In the ordinary course of its activities, the Bank transacts business with related parties. In the opinion of the management and the Board, the related party transactions are performed on an arm's-length basis. The related party transactions are governed by limits set by the Banking Control Law and the regulations issued by SAMA.

The year end balances included in the consolidated financial statements resulting from such transactions are as follows:

	<u>2007</u>
	<u>SAR'000</u>
The HSBC Group:	
Due from banks and other financial institutions	744,086
Investments	733,238
Derivatives (at fair value)	313,133
Due to banks and other financial institutions	3,792,098
Other liabilities	20,659
Commitments and contingencies	846,789

Related party transactions (continued)

The above-mentioned investments include investments in associates, amounting to SAR 110.4 million.

	<u>2007</u>
	<u>SAR'000</u>
Directors, audit committee, major shareholders and their affiliates:	
Loans and advances	2,356,137
Customers' deposits	3,714,385
Derivatives (at fair value)	4,990
Commitments and contingencies	213,524

Shareholders who hold more than 5% of the Bank's share capital are classified as major shareholders.

	<u>2007</u>
	<u>SAR'000</u>
Bank's mutual funds:	
Loans and advances	43,494
Customers' deposits	607,314

Other major shareholders represent shareholdings (excluding the non-Saudi shareholder) of more than 5% of the Bank's issued share capital.

Income and expenditure pertaining to transactions with related parties included in the consolidated financial statements are as follows:

	<u>2007</u>
	<u>SAR'000</u>
Special commission income	68,170
Special commission expense	(425,923)
Fees from banking services	11,575
Profit share arrangement relating to investment banking activities	(17,886)
Share in earnings of associates	57,947
Directors' remuneration	2,829

The total amount of compensation paid to key management personnel during the year is as follows:

	<u>2007</u>
	<u>SAR'000</u>
Short-term employee benefits (salaries and allowances)	35,935
Employment termination benefits (end-of-service indemnity and social security)	5,130

Key management personnel are those persons, including an executive director, having authority and responsibility for planning, directing and controlling the activities of the Bank, directly or indirectly.

The Bank offers share-based payment scheme arrangements to certain senior management and employees. There were two such schemes outstanding at 31 December 2007. The details of these schemes have not been separately disclosed in these consolidated financial statements as the amounts are not material.

Directors' Report (continued)**Borrowings and debt securities in issue**

	<u>2007</u>
	<u>SAR'000</u>
USD 600 million 5-year Floating Rate Notes	2,248,399
Euro 325 million 5-year Floating Rate Notes	1,789,968
Borrowings (Floating Rate)	<u>187,500</u>
Total	<u>4,225,867</u>

USD 600 million 5-year floating rate notes

These notes were issued during March 2005 under the Bank's Euro Medium Term Note programme and mature on 8 March 2010. They are unsecured and carry effective special commission at three months' Libor plus 40.76 bps payable quarterly. The notes are non-convertible and listed on the Luxembourg Stock Exchange.

The special commission rate exposure on these notes has been partially hedged by a floating-to-fixed special commission rate swap to the extent of USD 50 million. The special commission rate swap forms part of a designated and effective hedging relationship and is accounted for as a cashflow hedge in these financial statements.

Euro 325 million 5-year floating rate notes

These notes were issued during 2006 under the Bank's Euro Medium Term Note programme and mature on 13 April 2011. The notes carry effective special commission at three months' Euribor plus 34.68 bps, payable on a quarterly basis. The notes are non-convertible, unsecured and listed on the Luxembourg Stock Exchange.

The Bank has converted the foreign currency exposure on these notes into US Dollars by means of a cross-currency swap. This swap does not form part of a designated hedging relationship and, hence, is carried as a derivative in the trading book.

Borrowings

The Bank's borrowings comprise a 12-year floating rate loan. The loan, which carries a special commission rate of Libor plus 65 basis points, was taken on 7 July 2005 and is repayable by 15 June 2017.

Directors' remuneration and meetings

Directors' fees during 2007 totalled SAR 2,829,000, including SAR 292,500 in attendance fees at Board of Directors' and Executive Committee meetings.

Remuneration of Directors in their capacity as employees of the Bank during the year amounted to SAR 3,798,809.

The Board of Directors conducted five meetings during 2007 at which attendance was as follows:

First meeting – 26 March 2007 (*Attendees*)

Mr. Khaled Suliman Olayan; Mr. Fouad Abdulwahab Bahrawi; Mr. Khalid Abdullah Al Molhem; Mr. Sulaiman Abdulkader Al Muhaidib; Mr. Ahmed Sulaiman Banaja; Mr. David Hodgkinson; Mr. Niall Booker; Mr. John Coverdale; Mr John Richards.

Second meeting – 28 May 2007 (*Attendees*)

Mr. Khaled Suliman Olayan; Mr. Fouad Abdulwahab Bahrawi; Mr. Khalid Abdullah Al Molhem; Mr. Sulaiman Abdulkader Al Muhaidib; Mr. Ahmed Sulaiman Banaja; Mr. David Hodgkinson; Mr. John Coverdale; Mr. John Richards.

Third meeting – 25 July 2007 (*Attendees*)

Mr. Abdullah Mohammad Al Hugail; Mr. Fouad Abdulwahab Bahrawi; Mr. Khalid Abdullah Al Molhem; Mr. Khaled Suliman Olayan; Mr. Sulaiman Abdulkader Al Muhaidib; Mr. David Hodgkinson; Mr. Youssef A Nasr; Mr. John Coverdale.

Fourth meeting – 29 October 2007 (*Attendees*)

Mr. Abdullah Mohammad Al Hugail; Mr. Fouad Abdulwahab Bahrawi; Mr. Khalid Abdullah Al Molhem; Mr. Khaled Suliman Olayan; Mr. Sulaiman Abdulkader Al Muhaidib; Mr. Youssef A Nasr; Mr. John Coverdale; Mr. John Richards.

Fifth meeting – 10 December 2007 (*Attendees*)

Mr. Abdullah Mohammad Al Hugail; Mr. Fouad Abdulwahab Bahrawi; Mr. Khalid Abdullah Al Molhem; Mr. Khaled Suliman Olayan; Mr. Sulaiman Abdulkader Al Muhaidib; Mr. Ahmed Sulaiman Banaja; Mr. David Hodgkinson; Mr. Youssef A. Nasr; Mr. John Coverdale; Mr. Richard Groves.

Staff benefits and schemes

According to the Labour Law of the Kingdom of Saudi Arabia and to the Bank's internal policies, staff benefits are due for payment during or at the end of an employee's period of service. The end of service benefit outstanding at 31 December 2007 amounted to SAR 231.42 million.

The Bank operates three equity-settled, share-based plans that entitle eligible staff to purchase shares in the Bank at a pre-determined strike price that approximates to the market price of the shares at the date of the grant, where the book value for these programmes amounted to SAR 57.1 million.

Directors' Report (continued)

Board of Directors' assurance

The Board of Directors assures shareholders and other interested parties that to the best of its knowledge and in all material aspects the Bank has:

- Maintained accurate books of account
- A sound financial system audited by the Bank's Internal Audit Department, which submits its reports to the Bank's Audit Committee
- No evidence that might cast significant doubt on the Bank's ability to continue as a going concern

Donations

During the year, the Bank made a number of donations to authorised charitable societies and organisations. Given the Bank's continued commitment to philanthropic support for the wider Saudi community, the Board recommends an amount of SAR 6,000,000 be allocated for this purpose for the coming year.

Auditors

The Ordinary General Meeting held on 26 March 2007 reaffirmed the appointment of Messrs. KPMG Al Fozan & Al Sadhan and Ernst & Young as the Bank's auditors.

Accounting standards

The consolidated financial statements have been prepared in accordance with the accounting standards for financial institutions promulgated by the Saudi Arabian Monetary Agency (SAMA) and International Financial Reporting Standards (IFRS). The Bank also prepares its consolidated financial statements to comply with the Banking Control Law and the Regulations for Companies in the Kingdom of Saudi Arabia, and the Bank's Articles of Association, and there are no material departures from accounting standards issued by SOCPA.

Expressions of gratitude

The achievements of SABB during 2007 would not have been possible without the full support of many people and organisations in Saudi Arabia. This is especially true of the Bank's loyal staff, whose commitment, professionalism and contribution to SABB are not only fully appreciated, but also recognised as vital to the Bank's ongoing success.

The Board of Directors would also like to express its appreciation and gratitude to the Bank's customers and shareholders for their continued confidence and support; to the members of the Amanah Shariah Supervisory Committee for their continued guidance and encouragement; to a number of Government departments, especially the Ministry of Finance, the Ministry of Commerce & Industry, the Saudi Arabian Monetary Agency and the Capital Market Authority for their continued cooperation, encouragement and support of the banking sector in the Kingdom, which together have enabled it to make a major contribution to the Saudi economy under the direction of the Custodian of the Two Holy Mosques and the Crown Prince.

Auditors' Report

To: The shareholders of SABB (Saudi joint stock company)

We have audited the accompanying consolidated financial statements of SABB (the 'Bank') and its subsidiary, which comprise the consolidated balance sheet as at 31 December 2007, and the consolidated statement of income, consolidated statement of changes in shareholders' equity and consolidated cash flow statement for the year then ended, and a summary of significant accounting policies and other explanatory notes.

Management's responsibility for the consolidated financial statements

Management is responsible for the preparation and fair presentation of these consolidated financial statements in accordance with Accounting Standards for Financial Institutions issued by the Saudi Arabian Monetary Agency, International Financial Reporting Standards, the provisions of the Regulations for Companies and the Banking Control Law in the Kingdom of Saudi Arabia and the Bank's articles of associations. This responsibility includes: designing, implementing and maintaining internal control relevant to the preparation and fair presentation of consolidated financial statements that are free from material mis-statement, whether due to fraud or error; selecting and applying appropriate accounting policies; and making accounting estimates that are reasonable in the circumstances.

Auditors' responsibility

Our responsibility is to express an opinion on these consolidated financial statements based on our audit. We conducted our audit in accordance with generally accepted auditing standards in the Kingdom of Saudi Arabia and International Standards of Auditing. Those standards require that we comply with ethical requirements and plan and perform the audit to obtain reasonable assurance whether the consolidated financial statements are free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on the auditor's judgement, including the assessment of the risk of material misstatement of the financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the entity's preparation and fair presentation of the financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control. An audit also includes evaluation of the appropriateness of accounting policies used and the reasonableness of accounting estimates made by management, as well as evaluation of the overall presentation of the financial statements.

We believe that the evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinion.

To: The shareholders of SABB (Saudi joint stock company) *(continued)*

Opinion

In our opinion, the consolidated financial statements taken as a whole:

- Present fairly, in all material respects, the consolidated financial position of the Bank and its subsidiary as at 31 December 2007, and of their consolidated financial performance and their consolidated cash flows for the year then ended, in accordance with Accounting Standards for Financial Institutions issued by the Saudi Arabian Monetary Agency and with International Financial Reporting Standards, and
- Comply with the requirements of the Regulations for Companies, the Banking Control Law and the Bank's Articles of Association in so far as they affect the preparation and presentation of the consolidated financial statements

ERNST & YOUNG

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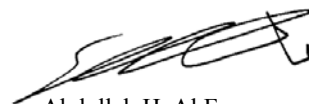
Riyadh: 14 Muharram 1429H
(22 January 2008)



KPMG

KPMG Al Fozan & Al Sadhan

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P.O. Box 92876
Riyadh 11663
Kingdom of Saudi Arabia



Abdullah H. Al Fozan
Certified Public Accountant
Licence No. 348



Consolidated Balance Sheet

As at 31 December 2007 and 2006

	Notes	2007 SAR'000	2006 SAR'000
ASSETS			
Cash and balances with SAMA	3	16,643,746	7,795,020
Due from banks and other financial institutions	4	1,723,576	3,137,510
Investments	5	14,858,747	21,702,420
Loans and advances, net	6	62,000,858	42,450,243
Investment in associates	7	110,447	72,209
Property and equipment, net	8	551,840	541,235
Other assets	9	2,323,696	1,490,741
Total assets		98,212,910	77,189,378
LIABILITIES AND SHAREHOLDERS' EQUITY			
LIABILITIES			
Due to banks and other financial institutions	11	8,045,047	2,171,835
Customers' deposits	12	71,847,852	59,257,642
Debt securities in issue	13	4,038,367	3,853,194
Borrowings	14	187,500	187,500
Other liabilities	15	3,669,211	2,314,608
Total liabilities		87,787,977	67,784,779
SHAREHOLDERS' EQUITY			
Share capital	16	3,750,000	3,750,000
Statutory reserve	17	3,750,000	3,750,000
Other reserves		(16,220)	70,385
Retained earnings		2,050,528	943,589
Proposed dividend	25	890,625	890,625
Total shareholders' equity		10,424,933	9,404,599
Total liabilities and shareholders' equity		98,212,910	77,189,378

The accompanying notes 1 to 40 form an integral part of these consolidated financial statements.

Consolidated Statement of Income

For the years ended 31 December 2007 and 2006

	Notes	2007 SAR'000	2006 SAR'000
Special commission income	19	5,219,955	4,436,721
Special commission expense	19	2,161,258	1,852,899
Net special commission income		3,058,697	2,583,822
Fees from banking services, net	20	861,924	1,650,483
Exchange income, net		107,236	91,405
Income from FVIS financial instruments, net	21	63,777	133,317
Trading income, net	22	189,968	85,807
Dividend income		4,433	5,042
Gains on non-trading investments, net	23	83,319	64,721
Other operating income		4,598	2,093
Operating income		4,373,952	4,616,690
Salaries and employee-related expenses		760,029	778,907
Rent and premises-related expenses		64,214	58,857
Depreciation	8	102,895	97,604
Other general and administrative expenses		500,045	466,675
Provision for credit losses, net	6	396,264	224,563
Other operating expenses		1,513	2,013
Operating expenses		1,824,960	1,628,619
Income from operating activities		2,548,992	2,988,071
Share in earnings of associates, net	7	57,947	52,209
Net income for the year		2,606,939	3,040,280
Basic and fully diluted earnings per share (in SAR)	24	6.95	8.11

The accompanying notes 1 to 40 form an integral part of these consolidated financial statements.

Consolidated Statement of Changes in Shareholders' Equity

For the years ended 31 December 2007 and 2006

		<i>Share capital</i>	<i>Statutory reserve</i>	<i>Other reserves</i>	<i>Retained earnings</i>	<i>Proposed dividend</i>	<i>Total</i>
	Notes	SAR'000	SAR'000	SAR'000	SAR'000	SAR'000	SAR'000
2007							
Balance at beginning of the year		3,750,000	3,750,000	70,385	943,589	890,625	9,404,599
Net changes in fair value of cash flow hedges (note 10)		–	–	4,349	–	–	4,349
Net changes in fair value of available-for-sale investments		–	–	(8,879)	–	–	(8,879)
Transfer to consolidated statement of income		–	–	(82,075)	–	–	(82,075)
Net income recognised directly in equity		–	–	(86,605)	–	–	(86,605)
Net income for the year		–	–	–	2,606,939	–	2,606,939
Total recognised income and expense for the year		–	–	(86,605)	2,606,939	–	2,520,334
2006 final dividend paid		–	–	–	–	(890,625)	(890,625)
2007 interim dividend paid	25	–	–	–	(609,375)	–	(609,375)
2007 final proposed dividend	25	–	–	–	(890,625)	890,625	–
Balance at end of the year		<u>3,750,000</u>	<u>3,750,000</u>	<u>(16,220)</u>	<u>2,050,528</u>	<u>890,625</u>	<u>10,424,933</u>
2006							
Balance at beginning of the year		2,500,000	2,500,000	302,843	1,903,309	287,000	7,493,152
Net changes in fair value of cash flow hedges (note 10)		–	–	5,391	–	–	5,391
Net changes in fair value of available-for-sale investments		–	–	(112,084)	–	–	(112,084)
Transfer to consolidated statement of income		–	–	(125,765)	–	–	(125,765)
Net income recognised directly in equity		–	–	(232,458)	–	–	(232,458)
Net income for the year		–	–	–	3,040,280	–	3,040,280
Total recognised income and expense for the year		–	–	(232,458)	3,040,280	–	2,807,822
Bonus shares issued		1,250,000	–	–	(1,250,000)	–	–
Transfer to statutory reserve		–	1,250,000	–	(1,250,000)	–	–
2005 final dividend paid		–	–	–	–	(287,000)	(287,000)
2006 interim dividend paid	25	–	–	–	(609,375)	–	(609,375)
2006 final proposed dividend	25	–	–	–	(890,625)	890,625	–
Balance at end of the year		<u>3,750,000</u>	<u>3,750,000</u>	<u>70,385</u>	<u>943,589</u>	<u>890,625</u>	<u>9,404,599</u>

The accompanying notes 1 to 40 form an integral part of these consolidated financial statements.

Consolidated Statement of Cash Flows

For the years ended 31 December 2007 and 2006

	Notes	2007 SAR'000	2006 SAR'000
OPERATING ACTIVITIES			
Net income for the year		2,606,939	3,040,280
Adjustments to reconcile net income to net cash from operating activities:			
(Accretion of discount) and amortisation of premiums on non-trading investments		(582)	2,546
(Gain)/loss from FVIS financial instruments	21	11,523	(7,663)
Gains on non-trading investments		(83,319)	(64,721)
Depreciation	8	102,895	97,604
Losses on disposal of property and equipment, net		(4,598)	268
Share in earnings of associates, net	7	(57,947)	(52,209)
Provision for credit losses, net	6	396,264	224,563
Change in fair value		238,101	(126,816)
		<u>3,209,276</u>	<u>3,113,852</u>
Net (increase) decrease in operating assets:			
Statutory deposit with SAMA	3	(971,848)	(473,870)
Investments held for trading		114,622	(64,218)
Loans and advances		(19,946,879)	(1,828,214)
Other assets		(832,955)	(447,677)
Net increase (decrease) in operating liabilities:			
Due to banks and other financial institutions		5,873,212	(1,877,790)
Customers' deposits		12,590,210	10,724,384
Other liabilities		1,339,354	(1,105,204)
Net cash from operating activities		<u>1,374,992</u>	<u>8,041,263</u>
INVESTING ACTIVITIES			
Proceeds from sale and maturities of non-trading investments		11,996,325	11,025,608
Purchase of non-trading investments		(5,314,720)	(16,466,850)
Investment in an associate		-	(20,000)
Purchase of property and equipment	8	(113,682)	(112,114)
Proceeds from disposal of property and equipment		4,780	732
Net cash from (used in) investing activities		<u>6,572,703</u>	<u>(5,572,624)</u>
FINANCING ACTIVITIES			
Debt securities in issue		-	1,604,480
Dividends paid		(1,484,751)	(878,097)
Net cash (used in) from financing activities		<u>(1,484,751)</u>	<u>726,383</u>
Increase in cash and cash equivalents		6,462,944	3,195,022
Cash and cash equivalents at the beginning of the year		8,583,113	5,388,091
Cash and cash equivalents at the end of the year	26	<u>15,046,057</u>	<u>8,583,113</u>
Special commission received during the year		5,201,815	4,380,737
Special commission paid during the year		2,137,319	1,841,861
SUPPLEMENTAL NON-CASH INFORMATION			
Net changes in fair value and cash flow hedges		(86,605)	(232,458)
Share in earnings of associates, net	7	57,947	52,209
Investment in associate		32,500	-

The accompanying notes 1 to 40 form an integral part of these consolidated financial statements.

Notes to the Financial Statements (31 December 2007)

1. General

The Saudi British Bank (the Bank) is a Saudi Joint Stock Company and was established by Royal Decree No. M/4 dated 12 Safar 1398H (21 January 1978). The Bank formally commenced business on 26 Rajab 1398H (1 July 1978) with the taking over of the operations of The British Bank of the Middle East in the Kingdom of Saudi Arabia. The Bank operates under Commercial Registration No. 1010025779 dated 22 Dhul Qadah 1399H (13 October 1979) as a commercial bank through a network of 63 branches (2006: 61) and 12 exclusive Ladies' sections (2006: 12) in the Kingdom of Saudi Arabia. The Bank employed 3,005 staff as at 31 December 2007 (2006: 2,717). The address of the Bank's head office is as follows:

The Saudi British Bank
P.O. Box 9084
Riyadh 11413
Kingdom of Saudi Arabia

The objectives of the Bank are to provide a range of banking services. The Bank also provides non-interest-bearing products, which are approved and supervised by an independent Shariah Board established by the Bank.

The Bank has 100% (2006: Nil) 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 1428 H (25 June 2007) and registered in the Kingdom of Saudi Arabia under commercial registration No. 1010235982 dated 8 Rajab 1428 H (22 July 2007). The Bank has 98% direct and 2% indirect ownership interest in its subsidiary (the indirect ownership is held via a Limited Liability Company registered in the Kingdom of Saudi Arabia). Activities of the subsidiary are to engage in business of Custody and Dealing as an agent, excluding underwriting.

1.1. Basis of preparation

a) *Statement of compliance*

The consolidated financial statements have been prepared in accordance with the accounting standards for financial institutions promulgated by the Saudi Arabian Monetary Agency (SAMA) and International Financial Reporting Standards (IFRS). The Bank also prepares its consolidated financial statements to comply with the Banking Control Law and the Regulations for Companies in the Kingdom of Saudi Arabia.

b) *Basis of measurement*

These consolidated financial statements have been prepared under the historical cost convention except for the measurement at fair value of derivatives, financial assets held at fair value through income statement (FVIS) and available for sale. In addition, assets and liabilities that are hedged in a fair value hedging relationship are carried at fair value to the extent of risk being hedged.

The Bank has adopted IFRS 7, Financial Instruments: disclosures, amendments to IAS 1, Presentation of Financial Statements – Capital Disclosures and International Financial Reporting Interpretations Committee, (IFRIC) 10 – Interim Financial Reporting and Impairment effective 1 January 2007 with retrospective effect. IFRS 7 introduces new disclosures of qualitative and quantitative information about exposure to risks arising from financial instruments, including specified minimum disclosures about credit risk, liquidity risk and market risk, including sensitivity analysis to market risk. It replaces IAS 30, Disclosures in the Financial Statements of Banks and Similar Financial Institutions, and disclosure requirements in IAS 32, Financial Instruments: Disclosure and Presentation.

The amendment to IAS 1 introduces disclosures about the level of capital and how the Bank manages capital. IFRIC 10 requires that the Bank shall not reverse any impairment losses recognised in a previous interim period in respect of an investment in equity instrument or a financial asset carried at cost because the fair value cannot be reliably measured.

There is no impact on the consolidated financial statements due to adoption of the above standards.

c) *Functional and presentation currency*

These consolidated financial statements are expressed in Saudi Arabian Riyals (SAR), rounded off to the nearest thousand, which is the functional currency of the Bank.

1.1. Basis of preparation *(continued)*

d) *Basis of consolidation*

The consolidated financial statements comprise the financial statements of “The Saudi British Bank” and its subsidiary, SABB Securities Limited. The financial statements of the subsidiary are prepared for the same reporting year as that of the Bank, using consistent accounting policies.

A subsidiary is an entity over which the Bank has the power to govern the financial and operating policies, so as to obtain benefits from its activities, generally accompanying an ownership interest of more than half of the voting rights. A subsidiary is consolidated from the date on which control is transferred to the Bank and ceases to be consolidated from the date on which the control is transferred from the Bank.

Inter-company transactions and balances have been eliminated upon consolidation.

e) *Critical accounting judgements and estimates*

The preparation of consolidated financial statements in conformity with IFRS requires the use of certain critical accounting estimates and assumptions that affect the reported amounts of assets and liabilities. It also requires management to exercise its judgement in the process of applying the Bank’s accounting policies. Such estimates, assumptions and judgements are continually evaluated and are based on historical experience and other factors, including obtaining professional advice and expectations of future events that are believed to be reasonable under the circumstances. Significant areas where management has used estimates, assumptions or exercised judgements are as follows:

i) *Impairment losses on loans and advances*

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, judgement 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.

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 judgements 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.

ii) *Fair value of financial instruments that are not quoted in an active market*

The fair values of financial instruments that are not quoted in active markets are determined by using valuation techniques. Where valuation techniques (for example, models) are used to determine fair values, they are validated and periodically reviewed by qualified personnel independent of the area that created them. All models are certified before they are used, and models are calibrated to ensure that outputs reflect actual data and comparative market prices. To the extent practical, models use only observable data, however areas such as credit risk (both own and counterparty), volatilities and correlations require management to make estimates. Changes in assumptions about these factors could affect reported fair value of financial instruments.

iii) *Impairment of available-for-sale equity investments*

The Bank exercises judgement to consider impairment on the available-for-sale equity investments. This includes determination of a significant or prolonged decline in the fair value below its cost. The determination of what is ‘significant’ or ‘prolonged’ requires judgement. In making this judgement, the Bank evaluates among other factors, the normal volatility in share price. In addition, the Bank considers impairment to be appropriate when there is evidence of deterioration in the financial health of the investee, industry and sector performance, changes in technology, and operational and financing cash flows.

Notes to the Financial Statements (31 December 2007) (continued)

1.1. Basis of preparation (continued)

Due to current volatility in the market, 25% or more is used as a reasonable measure for significant decline below its cost, irrespective of the duration of the decline, and is recognised in the consolidated statement of income as provision for impairment for other financial assets.

Prolonged decline represents decline below cost that persists for 1 year or longer irrespective of the amount and is, thus, recognised in the consolidated statement of income as provision for impairment for other financial assets.

iv) Classification of held-to-maturity investments

The Bank follows the guidance of IAS 39 on classifying non-derivative financial assets with fixed or determinable payments and fixed maturity as held-to-maturity. In making this judgement, the Bank evaluates its intention and ability to hold such investments to maturity.

v) Classification of Fair Value through income statement

The Bank follows IAS 39 criteria on classifying financial assets and liabilities to Fair Value through income statement. In making this judgement, the Bank evaluates its compliance with the conditions as prescribed in IAS 39.

2. Summary of accounting policies

The accounting policies adopted in the preparation of these consolidated financial statements are consistent with those used in the previous year.

The significant accounting policies adopted in the preparation of these consolidated financial statements are set out below:

a) Trade date accounting

All regular way purchases and sales of financial assets are recognised and derecognised on the trade date i.e. the date on which the Bank commits to purchase or sell the assets. Regular way purchases and sales are purchases and sales of financial assets that require delivery of assets within the time frame generally established by regulation or convention in the market place.

b) Derivative financial instruments and hedging

Derivative financial instruments including foreign exchange contracts, special commission rate futures, forward rate agreements, currency and special commission rate swaps, currency and special commission rate options (both written and purchased), are measured at fair value (premium received for written options). All derivatives are carried at their fair value as assets where the fair value is positive, and as liabilities where the fair value is negative.

Fair values are generally obtained by reference to quoted market prices, discounted cash flow models or pricing models, as is appropriate.

Any changes in the fair value of derivatives that are held for trading purposes are taken directly to consolidated statement of income for the year and are disclosed in trading income. Derivatives held for trading also include those derivatives which do not qualify for hedge accounting described below.

For the purpose of hedge accounting, hedges are classified into two categories; (a) fair value hedges which hedge the exposure to changes in the fair value of a recognised asset or liability, and (b) cash flow hedges which hedge exposure to variability in cash flows that is either attributable to a particular risk associated with a recognised asset or liability, or a highly probable forecasted transaction that will affect the reported net gain or loss.

In order to qualify for hedge accounting, it is required that the hedge should be expected to be highly effective i.e. the changes in fair value or cash flows of the hedging instrument should effectively offset corresponding changes in the hedged item, and should be reliably measurable. At the inception of the hedge, the risk management objective and strategy is documented including the identification of the hedging instrument, the related hedged item, the nature of risk being hedged, and how the Bank will assess the effectiveness of the hedging relationship. Subsequently, the effectiveness of the hedge is assessed on an ongoing basis.

2. Summary of accounting policies (continued)

Hedge accounting is discontinued when the hedging instrument expires or is sold, terminated or exercised, or no longer qualifies for hedge accounting.

In relation to fair value hedges, which meet the criteria for hedge accounting, any gain or loss from re-measuring the hedging instruments to fair value is recognised immediately in the consolidated statement of income. The related portion of the hedged item is recognised in the consolidated statement of income. Where the fair value hedge of a special commission bearing financial instrument ceases to meet the criteria for hedge accounting, the adjustment in the carrying value is amortised to the consolidated statement of income over the remaining life of the instrument. If the hedged item is derecognised, the unamortised fair value adjustment is recognised immediately in the statement of income.

In relation to cash flow hedges which meet the criteria for hedge accounting, the portion of the gain or loss on the hedging instrument that is determined to be an effective hedge is recognised in other reserves under shareholders' equity. The ineffective portion, if any, is recognised in the consolidated statement of income. For cash flow hedges affecting future transactions, the gains or losses recognised in other reserves are transferred to the consolidated statement of income in the same period in which the hedged transaction affects the consolidated statement of income.

On discontinuation of hedge accounting on cash flow hedges, any cumulative gain or loss that was recognised in other reserves is retained in shareholders' equity until the forecasted transaction occurs. Where the hedged forecasted transaction is no longer expected to occur, the net cumulative gain or loss recognised in other reserves is transferred to the consolidated statement of income for the year.

c) *Foreign currencies*

Transactions in foreign currencies are translated into Saudi Arabian Riyals at the exchange rates prevailing at transaction dates. Monetary assets and liabilities at year-end, denominated in foreign currencies, are translated into Saudi Arabian Riyals at the exchange rates prevailing at the balance sheet date. Foreign exchange gains or losses on translation of monetary assets and liabilities denominated in foreign currencies are recognised in the consolidated statement of income except when deferred in equity as qualifying cash flow hedges.

d) *Offsetting*

Financial assets and liabilities are offset and are reported net in the consolidated balance sheet when there is a legally enforceable right to set off the recognised amounts and when the Bank intends to settle on a net basis, or to realise the asset and settle the liability simultaneously.

e) *Revenue recognition*

Special commission income and expense for all special commission-bearing financial instruments, except for Held-as-FVIS financial instruments, including fees which are considered an integral part of the effective yield of a financial instrument, are recognised in the consolidated statement of income on the effective yield basis including premiums amortised and discounts accreted during the year.

The carrying amount of the financial asset or financial liability is adjusted if the Bank revises its estimates of payments or receipts. The adjusted carrying amount is calculated based on the original effective interest rate and the change in carrying amount is recorded as special commission income or expense.

The calculation of the effective interest rate includes all fees and points paid or received transaction costs, and discounts or premiums that are an integral part of the effective interest rate. Transaction costs are incremental costs that are directly attributable to the acquisition, issue or disposal of a financial asset or liability.

Exchange income is recognised when contractually earned. Dividend income is recognised when declared.

Fees and commission are recognised on an accrual basis when the service has been provided. Loan commitment fees for loans that are likely to be drawn down are deferred and, together with the related direct cost, are recognised as an adjustment to the effective yield on the loan. Portfolio and other management advisory and service fees are recognised based on the applicable service contract, usually on a time proportionate basis. Fees received on the asset management, wealth management, financial planning, custody services and other similar services that are provided in an extended period of time are recognised rateably over the period when the service is being provided.

Notes to the Financial Statements (31 December 2007) (continued)

2. Summary of accounting policies (continued)

When the Bank enters into a special commission rate swap to change special commission from fixed to floating (or vice versa), the amount of special commission income or expense is adjusted by the net special commission on the swap.

Once the recorded value of a financial asset or a group of similar financial assets has been reduced due to an impairment loss, special commission income continues to be recognised using the original effective interest rate applied to the new carrying amount.

Results arising from trading activities include all gains and losses from changes in fair value and related special commission income or expense and dividends for financial assets and financial liabilities held for trading. This includes any ineffectiveness recorded in hedging transactions.

f) *Sale and repurchase agreements*

Assets sold with a simultaneous commitment to repurchase at a specified future date (repos) continue to be recognised in the consolidated balance sheet and are measured in accordance with related accounting policies for the underlying financial assets held as FVIS, available for sale, held to maturity and other investments held at amortised cost. The counterparty liability for amounts received under these agreements is included in “due to banks and other financial institutions” or “customers’ deposits”, as appropriate. The difference between sale and repurchase price is treated as special commission expense and amortised over the life of the repo agreement using the effective yield method.

Assets purchased with a corresponding commitment to resell at a specified future date (reverse repo) are not recognised in the consolidated balance sheet, as the Bank does not obtain control over the assets. Amounts paid under these agreements are included in “Cash and balances with SAMA”, “Due from banks and other financial institutions” or “Loans and advances”, as appropriate. The difference between purchase and resale price is treated as special commission income and amortised over the life of the reverse repo agreement, using the effective yield method.

g) *Investments*

All investment securities are initially recognised at cost, being the fair value of consideration given, including acquisition charges associated with the investment except for investments held as FVIS, which are not added to the cost at initial recognition and are charged to the consolidated statement of income. Premiums are amortised and discounts accreted using the effective yield method and are taken to special commission income.

For securities traded in organised financial markets, fair value is determined by reference to exchange-quoted market bid prices at the close of business on the consolidated balance sheet date. Fair value of managed assets and investments in mutual funds are determined by reference to declared net asset values.

For securities where there is no quoted market price, a reasonable estimate of the fair value is determined by reference to the current market value of another instrument which is substantially the same, or is based on the expected cash flows or the underlying net asset base of the security.

Following initial recognition, subsequent transfers between the various classes of investments are not ordinarily permissible. The subsequent period end reporting values for each class of investment are determined on the basis set out in the following paragraphs.

i) *Held as FVIS*

Investments in this category are classified as either investment held for trading or those designated as FVIS at inception or on adoption of the revised International Accounting Standard 39. Investments classified as trading are acquired principally for the purpose of selling or repurchasing in short term. An investment may be designated as FVIS by the management if it satisfies the criteria set out below (except for the equity instruments that do not have a quoted market price in an active market and whose fair values cannot be reliably measured):

- It is a financial instrument containing one or more embedded derivatives that significantly modify the cash flows resulting from the financial instrument, or
- It is a financial instrument with an embedded derivative that is required to be separated from the host contract under International Accounting Standard 39, but the Bank is unable to measure reliably the embedded derivative separately either at acquisition or at a subsequent reporting date.

2. Summary of accounting policies (continued)

The fair value designation is made in accordance with the Risk Management Strategy approved by the Bank's Assets and Liabilities Committee (ALCO) and is irrevocable. Designated financial assets are recognised when the Bank enters into the contractual provisions of the arrangements with counterparties on trade date and derecognised when sold.

After initial recognition, investments at FVIS are measured at fair value and any change in the fair value is recognised in the consolidated statement of income for the period in which it arises. Special commission income and dividend income received on financial assets held as FVIS are reflected as income from financial instruments designated as FVIS in the consolidated statement of income.

ii) Available for sale

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

Investments, which are classified as "available for sale", are subsequently measured at fair value. For an available-for-sale investment where the fair value has not been hedged, any gain or loss arising from a change in its fair value is recognised directly in "Other reserves" under Shareholders' equity. On derecognition, any cumulative gain or loss previously recognised 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.

iii) Held to maturity

Investments having fixed or determinable payments and fixed maturity that the Bank has the positive intention and ability to hold to maturity other than those that meet the definition of "held at amortised cost" are classified as held to maturity. Held-to-maturity investments are subsequently measured at amortised cost, less provision for impairment in value. Amortised cost is calculated by taking into account any discount or premium on acquisition using the effective yield method. Any gain or loss on such investments is recognised in the consolidated statement of income when the investment is derecognised or impaired.

Investments classified as held to maturity cannot ordinarily be sold or reclassified without impacting the Bank's ability to use this classification and cannot be designated as a hedged item with respect to special commission rate or prepayment risk, reflecting the intention to hold them to maturity.

iv) Held at amortised cost

Investment securities with fixed or determinable payments that are not quoted in an active market are classified as "held at amortised cost". Such investments whose fair values have not been hedged are stated at amortised cost, less provision for impairment. Investments in a fair value hedge relationship are adjusted for fair value changes to the extent of the risk being hedged. Any gain or loss is recognised in the consolidated statement of income when the investment is derecognised and is disclosed as gains (losses) on non-trading investments. Amortised cost is calculated by taking into account any discount or premium on acquisition using the effective yield method.

h) Investment in associates

Investment in associates 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 an 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 the 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.

Notes to the Financial Statements (31 December 2007) (continued)

2. Summary of accounting policies (continued)

i) Loans and advances

Loans and advances are non-derivative financial assets originated or acquired by the Bank with fixed or determinable payments and that are not quoted in an active market.

All loans and advances are initially measured at cost, being the fair value of consideration given, including acquisition charges associated with the loans and advances.

Following the initial recognition, subsequent transfers between the various classes of loans and advances are not ordinarily permissible.

The Bank's loans and advances are classified as held at amortised cost less any amount written off and provisions for impairment.

For loans and advances which are hedged, the related portion of the hedged fair value is adjusted against the carrying amount.

j) Due from banks and other financial institutions

Due from banks and other financial institutions are financial assets which are mainly money market placements with fixed or determinable payments and fixed maturities that are not quoted in an active market. Money market placements are not entered into with the intention of immediate or short-term resale. Due from banks and other financial institutions are initially measured at cost, being the fair value of the consideration given.

Following the initial recognition, due from banks and other financial institutions are stated at cost less any amount written off and provisions for impairment, if any.

k) Impairment of financial assets

An assessment is made at each balance sheet date to determine whether there is objective evidence that a financial asset or group of financial assets may be impaired. If such evidence exists, the estimated recoverable amount of that asset is determined and any impairment loss, based on the net present value of future anticipated cash flows, is recognised for changes in its carrying amounts as follows:

When a financial asset is uncollectable, it is written off against the related provision for impairment. Financial assets are written off only in circumstances where effectively all possible means of recovery have been exhausted, and the amount of the loss has been determined.

Once a financial asset has been written down to its estimated recoverable amount, special commission income is thereafter recognised based on the rate of special commission that was used to discount the future cash flows for the purpose of measuring the recoverable amount.

If, in a subsequent period, the amount of the impairment loss on investments other than available-for-sale equity investments decreases and the decrease can be related objectively to an event occurring after the impairment was recognised (such as an improvement in the debtor's credit rating), the previously recognised impairment loss is reversed by adjusting the allowance account. The amount of the reversal is recognised in the consolidated income statement in impairment charge for credit losses.

i) Impairment of financial assets held at amortised cost

A financial asset is classified as impaired when there is an objective evidence of credit-related impairment as a result of one or more loss events that occurred after the initial recognition of the asset and that a loss event(s) has an impact on the estimated future cash flows of the financial asset or group of financial assets that can be reliably estimated.

A specific provision for credit losses due to impairment of a loan or any other financial asset held at amortised cost, including those arising from sovereign risk exposures, is established if there is objective evidence that the Bank will not be able to collect all amounts due. The amount of the specific provision is the difference between the carrying amount and the estimated recoverable amount. The estimated recoverable amount is the present value of expected cash flows, including amounts estimated to be recoverable from guarantees and collateral, discounted based on the original effective special commission rate.

2. Summary of accounting policies (continued)

In addition to specific provision for credit losses, provision for collective impairment is made on a portfolio basis for credit losses where there is an objective evidence that unidentified losses exist at the reporting date. These are based on any deterioration in the risk rating (i.e. downward migration of risk ratings) of the financial assets since it was originally granted. This provision is estimated based on various factors including credit ratings allocated to a borrower or group of borrowers, the current economic conditions, the experience the Bank has had in dealing with a borrower or group of borrowers and available historical default information.

The carrying amount of the asset is adjusted through the use of an allowance account and the amount of the adjustment is included in the consolidated statement of income.

ii) Impairment of financial assets held at fair value

For financial assets at fair value, where a loss has been recognised directly under consolidated shareholders' equity, the cumulative net loss recognised in consolidated shareholders' equity is transferred to the consolidated statement of income when the asset is considered to be impaired.

For equity investments held as available for sale, a significant or prolonged decline in fair value below its cost represents objective evidence of impairment. Unlike debt securities, the previously recognised impairment loss cannot be reversed through consolidated statement of income as long as the asset continues to be recognised i.e. any increase in fair value after impairment has been recorded can only be recognised in equity. On derecognition, any cumulative gain or loss previously recognised in consolidated shareholders' equity is included in consolidated statement of income for the period.

The Bank writes off its financial assets when the respective business units together with Risk Management determine that the financial assets are uncollectable. This determination is reached after considering information such as the occurrence of significant changes in the borrower/issuer's financial position such that the borrower/issuer can no longer pay the obligations, or that proceeds from collateral will not be sufficient to pay back the entire exposure. The financial assets are, then, written off only in circumstances where effectively all possible means of recovery have been exhausted. For consumer loans, write-off decisions are generally based on a product specific past due status. When a financial asset is uncollectable, it is written off against the related provision for impairment, if any, and any amounts in excess of available provision are directly charged to consolidated statement of income.

Loans whose terms have been renegotiated are no longer considered to be past due but are treated as new loans. Restructuring policies and practices are based on indicators or criteria which indicate that payment will most likely continue. The loans continue to be subject to an individual or collective impairment assessment, calculated using the loan's original effective interest rate.

1) Property and equipment

Property and equipment are stated at cost and presented net of accumulated depreciation. Freehold land is not depreciated.

The cost of other property and equipment is depreciated on the straight-line method over the estimated useful lives of the assets as follows:

Buildings	20 years
Leasehold improvements	over the period of the lease contract
Furniture, equipment and vehicles	3 to 4 years

Gains and losses on disposals are determined by comparing proceeds with carrying amount. These are included in the consolidated statement of income and are disclosed as other non-operating income (expenses).

The assets' residual values and useful lives are reviewed for impairment whenever events or changes in circumstances indicate that the carrying amount may not be recoverable. Any carrying amount is written down immediately to its recoverable amount if the asset's carrying amount is greater than its estimated recoverable amount.

Notes to the Financial Statements (31 December 2007) (continued)

2. Summary of accounting policies (continued)

m) Liabilities

All money market deposits, customer deposits, borrowing and debt securities in issue are initially recognised at cost, being fair value of consideration received.

Subsequently all commission bearing financial liabilities, or where fair values have not been hedged, are measured at amortised cost. Amortised cost is calculated by taking into account any discount or premium. Premiums are amortised and discounts accreted on an effective yield basis to maturity and taken to special commission expense.

Financial liabilities in a fair value hedge relationship are adjusted for fair value changes to the extent of the risk being hedged. The resultant gain or loss is recognised in the consolidated statement of income.

n) Provisions

Provisions are recognised when a reliable estimate can be made by the Bank to a present legal or constructive obligation as a result of past events. It is more likely than not that an outflow of resources will be required to settle the obligation.

o) Guarantees

In ordinary course of business, the Bank extends credit-related commitments, consisting of letter of credit, guarantees and acceptances. Financial guarantees are initially recognised in the financial statements at fair value in other liabilities, being the value of the premium received. Subsequent to the initial recognition, the Bank's liability under each guarantee is measured at the higher of the amortised premium and the best estimate of expenditure required to settle any financial obligations arising as a result of guarantees. Any increase in the liability relating to the financial guarantee is taken to the income statement in "credit loss expenses". The premium received is recognised in the income statement in "Net fees and commission income" on a straight-line basis over the life of the guarantee.

p) Accounting for leases

Leases entered into by the Bank as a lessee are all operating leases. Payments made under these operating leases are charged to the consolidated statement of income on a straight-line basis over the period of the lease.

q) Cash and cash equivalents

For the purpose of the consolidated statement of cash flows, cash and cash equivalents comprise cash, balances with SAMA and Reverse Repo with SAMA excluding the statutory deposit, and due from banks and other financial institutions with original maturity of ninety days of acquisition.

r) Derecognition of financial instruments

A financial asset (or a part of a financial asset, or a part of a group of similar financial assets) is derecognised when the contractual rights to the cash flows from the financial asset expire.

In instances where the Bank is assessed to have transferred a financial asset, the asset is derecognised if the Bank has transferred substantially all the risks and rewards of ownership. Where the Bank has neither transferred nor retained substantially all the risks and rewards of ownership, the financial asset is derecognised only if the Bank has not retained control of the financial asset. The Bank recognises separately as assets or liabilities any rights and obligations created or retained in the process.

A financial liability (or a part of a financial liability) can only be derecognised when it is extinguished, that is when the obligation specified in the contract is either discharged, cancelled or expired.

2. Summary of accounting policies (continued)

s) *Assets held in trust or in fiduciary capacity*

Assets held in trust or in a fiduciary capacity are not treated as assets of the Bank and, accordingly, are not included in the accompanying consolidated financial statements.

t) *Zakat and income taxes*

Zakat is computed on the Saudi shareholders' share of equity or net income using the basis defined under the zakat regulations. Income taxes are computed on the foreign shareholder's share of net income for the year.

Zakat and income taxes are not charged to the Bank's consolidated statement of income as they are the liabilities of the shareholders and therefore are deducted from the dividends paid to the shareholders.

u) *Non-interest-based banking products*

In addition to the conventional banking, the Bank offers its customers certain non-interest-based banking products, which are approved by its Shariah Board.

All non-interest-based banking products are accounted for using IFRS and are in conformity with the accounting policies described in these consolidated financial statements.

3. Cash and balances with SAMA

	<u>2007</u>	<u>2006</u>
	<u>SAR'000</u>	<u>SAR'000</u>
Cash in hand	747,610	757,506
Statutory deposit	3,321,265	2,349,417
Reverse repos	12,356,627	4,442,200
Other balances	218,244	245,897
Total	<u>16,643,746</u>	<u>7,795,020</u>

In accordance with the Banking Control Law and regulations issued by SAMA, the Bank maintains a statutory deposit with SAMA at stipulated percentages of its demand, time, savings and other deposits, calculated at the end of each month.

4. Due from banks and other financial institutions

	<u>2007</u>	<u>2006</u>
	<u>SAR'000</u>	<u>SAR'000</u>
Current accounts	771,401	608,153
Money market placements	952,175	2,529,357
Total	<u>1,723,576</u>	<u>3,137,510</u>

Notes to the Financial Statements (31 December 2007) (continued)

5. Investments

a) Investment securities are classified as follows:

	Domestic		International		Total	
	2007	2006	2007	2006	2007	2006
	SAR'000	SAR'000	SAR'000	SAR'000	SAR'000	SAR'000
i) Held as FVIS						
Fixed rate securities	80,914	69,956	18,637	18,804	99,551	88,760
Floating rate securities	82,716	239,054	194,396	1,788,807	277,112	2,027,861
Held as FVIS	163,630	309,010	213,033	1,807,611	376,663	2,116,621
FVIS investments above include investment held for trading of SAR 211.9 million (2006: SAR 327.8 million), and floating rate notes designated as FVIS at inception or an early adoption of the revised IAS 39 as at 1 January 2005 of SAR 164.8 million (2006: SAR 1,788.8 million).						
ii) Available for sale						
Fixed rate securities	973,925	5,638,206	2,586,360	2,118,901	3,560,285	7,757,107
Floating rate securities	2,014,750	3,144,204	2,553,873	1,597,372	4,568,623	4,741,576
Equities	99,798	146,170	31,249	18,836	131,047	165,006
Other	-	45,826	-	-	-	45,826
Available-for-sale investments	3,088,473	8,974,406	5,171,482	3,735,109	8,259,955	12,709,515
iii) Held at amortised cost						
Fixed rate securities	4,492,077	5,142,585	-	-	4,492,077	5,142,585
Floating rate securities	1,221,000	1,221,000	-	-	1,221,000	1,221,000
Held at amortised cost	5,713,077	6,363,585	-	-	5,713,077	6,363,585
iv) Held to maturity						
Fixed rate securities	509,052	512,699	-	-	509,052	512,699
Held-to-maturity investments	509,052	512,699	-	-	509,052	512,699
Investments	9,474,232	16,159,700	5,384,515	5,542,720	14,858,747	21,702,420

b) The analysis of the composition of investment is as follows:

	2007			2006		
	Quoted	Unquoted	Total	Quoted	Unquoted	Total
	SAR'000	SAR'000	SAR'000	SAR'000	SAR'000	SAR'000
Fixed rate securities	2,549,079	6,111,887	8,660,966	2,118,901	11,382,250	13,501,151
Floating rate securities	3,493,924	2,572,810	6,066,734	867,412	7,123,025	7,990,437
Equities	88,902	42,145	131,047	104,344	60,662	165,006
Other	-	-	-	45,826	-	45,826
Investments	6,131,905	8,726,842	14,858,747	3,136,483	18,565,937	21,702,420

Unquoted investments include securities of SAR 7,677.3 million (2006: SAR 15,787.5 million) issued by the Saudi Arabian Government and its agencies.

5. Investments (continued)

c) The analysis of unrecognised gains and losses and the fair values of held at amortised cost and held-to-maturity investments are as follows:

	2007				2006			
	Carrying value	Gross unrealised gain	Gross unrealised loss	Fair value	Carrying value	Gross unrealised gain	Gross unrealised loss	Fair value
	SAR'000	SAR'000	SAR'000	SAR'000	SAR'000	SAR'000	SAR'000	SAR'000
i) Held at amortised cost								
Fixed rate securities	4,492,077	151,531	–	4,643,608	5,142,585	93,288	(64,446)	5,171,427
Floating rate securities	1,221,000	3,014	–	1,224,014	1,221,000	3,858	(1,223)	1,223,635
Total	5,713,077	154,545	–	5,867,622	6,363,585	97,146	(65,669)	6,395,062
ii) Held to maturity								
Fixed rate securities	509,052	22,077	–	531,129	512,699	12,433	(3,425)	521,707
Total	509,052	22,077	–	531,129	512,699	12,433	(3,425)	521,707

d) The analysis of investments by counterparty is as follows:

	2007	2006
	SAR'000	SAR'000
Government and quasi-Government	11,763,987	17,581,767
Corporate	454,667	2,569,037
Banks and other financial institutions	2,599,478	1,476,621
Other	40,615	74,995
Total	14,858,747	21,702,420

Equities reported under available-for-sale investments include unquoted shares of SAR 42.1 million (2006: SAR 61.7 million) that are carried at cost, as their fair value cannot be reliably measured.

e) Credit quality of investments

	2007	2006
	SAR'000	SAR'000
Saudi Government Bonds	7,595,366	15,557,303
Investment Grade	6,999,183	5,934,285
Non-investment Grade	20,763	–
Unrated	243,435	210,832
Total	14,858,747	21,702,420

The Saudi Government Bonds comprise of Saudi Government Development Bonds, Floating Rate Notes and Treasury Bills.

Investment Grade includes those investments having credit exposure equivalent to Standard and Poor's Rating of AAA to BBB.

The unrated category mainly comprises private equities, hedge funds and quoted and unquoted equities.

Notes to the Financial Statements (31 December 2007) (continued)**6. Loans and advances, net**a) *Loans and advances are classified as follows:*

	2007			
	<i>Credit Cards</i>	<i>Consumer Loans</i>	<i>Commercial Loans and Overdrafts</i>	<i>Total</i>
	<u>SAR'000</u>	<u>SAR'000</u>	<u>SAR'000</u>	<u>SAR'000</u>
Performing loans and advances, gross	1,852,463	11,063,570	49,458,783	62,374,816
Non-performing loans and advances, net	–	21,338	175,752	197,090
Total loans and advances	1,852,463	11,084,908	49,634,535	62,571,906
Allowance for impairment of credit losses (specific and collective)	(98,881)	(131,702)	(340,465)	(571,048)
Loans and advances, net	1,753,582	10,953,206	49,294,070	62,000,858
	2006			
	<i>Credit Cards</i>	<i>Consumer Loans</i>	<i>Commercial Loans and Overdrafts</i>	<i>Total</i>
	<u>SAR'000</u>	<u>SAR'000</u>	<u>SAR'000</u>	<u>SAR'000</u>
Performing loans and advances, gross	1,372,877	9,862,385	31,547,563	42,782,825
Non-performing loans and advances, net	–	19,991	145,107	165,098
Total loans and advances	1,372,877	9,882,376	31,692,670	42,947,923
Allowance for impairment of credit losses (specific and collective)	(100,068)	(94,873)	(302,739)	(497,680)
Loans and advances, net	1,272,809	9,787,503	31,389,931	42,450,243

Loans and advances, net include non-interest-bearing products totalling SAR 27,530 million (2006: SAR 21,547.0 million) which are stated at cost less provision for credit losses, of SAR 252.1 million (2006: SAR 146.8 million).

Provision for credit losses charged to consolidated statement of income related to non-interest-bearing products is SAR 119.4 million (2006: SAR 16.6 million).

Loans and advances include loans hedged on a portfolio basis amounting to SAR 743.0 million (2006: SAR 1,220.4 million). The positive mark to market of these loans is SAR 3.4 million (2006: negative SAR 6.3 million).

Non-performing loans and advances are disclosed net of accumulated special commission in suspense of SAR 126.0 million (2006: SAR 103.0 million).

b) *Movement in allowance for impairment account*

	2007			
	<i>Credit Cards</i>	<i>Consumer Loans</i>	<i>Commercial Loans and Overdrafts</i>	<i>Total</i>
	<u>SAR'000</u>	<u>SAR'000</u>	<u>SAR'000</u>	<u>SAR'000</u>
Balance at beginning of the year	100,068	94,873	302,739	497,680
Bad debts written off	(122,909)	(195,391)	(4,596)	(322,896)
Provided during the year	121,722	232,220	64,483	418,425
Recoveries of amounts previously provided	–	–	(22,161)	(22,161)
Balance at the end of the year	98,881	131,702	340,465	571,048

6. Loans and advances, net (continued)

	2006			
	Credit Cards	Consumer Loans	Commercial	Total
			Loans and Overdrafts	
SAR'000	SAR'000	SAR'000	SAR'000	
Balance at beginning of the year	31,142	54,986	299,792	385,920
Bad debts written off	(45,565)	(59,044)	(8,194)	(112,803)
Provided during the year	114,491	98,931	36,310	249,732
Recoveries of amounts previously provided	–	–	(25,169)	(25,169)
Balance at the end of the year	<u>100,068</u>	<u>94,873</u>	<u>302,739</u>	<u>497,680</u>

The allowance for credit losses above includes a collective allowance amounting to SR 150.5 million (2006: SR 127.0 million) related to the performing portfolio.

The net charge to income on account of provision for credit losses is SAR 396.2 million (2006: SAR 224.5 million), which is net of recoveries of amounts previously provided as shown above.

c) Credit quality of loans and advances

i) Ageing of loans and advances (past due but not impaired)

	2007			
	Credit Cards	Consumer Loans	Commercial	Total
			Loans and Overdrafts	
SAR'000	SAR'000	SAR'000	SAR'000	
Within 3 months	254,053	879,000	342,286	1,475,339
3-6 months	60,549	91,031	9,696	161,276
Total loans and advances	<u>314,602</u>	<u>970,031</u>	<u>351,982</u>	<u>1,636,615</u>

	2006			
	Credit Cards	Consumer Loans	Commercial	Total
			Loans and Overdrafts	
SAR'000	SAR'000	SAR'000	SAR'000	
Within 3 months	188,758	835,029	348,381	1,372,168
3-6 months	62,170	67,333	3,352	132,855
Total loans and advances	<u>250,928</u>	<u>902,362</u>	<u>351,733</u>	<u>1,505,023</u>

Notes to the Financial Statements (31 December 2007) (continued)**6. Loans and advances, net** (continued)

ii) Economic sector risk concentrations for the loans and advances and provision for credit losses are as follows:

	2007			
	<i>Performing</i>	<i>Non-performing, net</i>	<i>Credit loss provision</i>	<i>Loans and advances, net</i>
	SAR'000	SAR'000	SAR'000	SAR'000
Government and quasi-Government	2,131,850	–	–	2,131,850
Banks and other financial institutions	56,250	–	–	56,250
Agriculture and fishing	918,859	–	–	918,859
Manufacturing	6,986,804	43,760	(41,132)	6,989,432
Mining and quarrying	22,926	–	–	22,926
Electricity, water, gas and health services	118,471	7,128	(7,128)	118,471
Building and construction	2,716,467	38,638	(38,715)	2,716,390
Commerce	15,844,081	56,667	(42,109)	15,858,639
Transportation and communication	1,215,596	1,729	(2,729)	1,214,596
Services	3,820,255	1,188	(1,190)	3,820,253
Consumer loans and credit cards	12,688,801	20,942	(230,583)	12,479,160
Other	15,854,456	27,038	(56,960)	15,824,534
Collective impairment provision	–	–	(150,502)	(150,502)
Total	62,374,816	197,090	(571,048)	62,000,858

	2006			
	<i>Performing</i>	<i>Non-performing, net</i>	<i>Credit loss provision</i>	<i>Loans and advances, net</i>
	SAR'000	SAR'000	SAR'000	SAR'000
Government and quasi-Government	1,581,228	–	–	1,581,228
Banks and other financial institutions	142,500	–	–	142,500
Agriculture and fishing	833,140	–	–	833,140
Manufacturing	5,379,819	45,670	(43,339)	5,382,150
Mining and quarrying	37,079	–	–	37,079
Electricity, water, gas and health services	58,636	7,128	(7,128)	58,636
Building and construction	1,289,248	31,142	(33,981)	1,286,409
Commerce	9,518,089	24,568	(24,737)	9,517,920
Transportation and communication	995,097	4,716	(5,727)	994,086
Services	2,232,731	1,222	(1,224)	2,232,729
Consumer loans and credit cards	13,455,544	41,380	(194,941)	13,301,983
Other	7,259,714	9,272	(59,603)	7,209,383
Collective impairment provision	–	–	(127,000)	(127,000)
Total	42,782,825	165,098	(497,680)	42,450,243

The credit loss provision on the consumer loans and advances is calculated on a collective basis.

The collective impairment provision is based on an asset quality matrix, which includes the grading structure in respect of the credit risk of the customers as well as general economic outlook.

d) Collateral

The Bank in the ordinary course of lending activities holds collaterals as security to mitigate credit risk in the loans and advances. These collaterals mostly include time and demand and other cash deposits, financial guarantees, local and international equities, real estate and other fixed assets.

6. Loans and advances, net (continued)

e) Neither past due nor impaired loans

	2007			
	<i>Credit Cards</i>	<i>Consumer Loans</i>	<i>Commercial Loans</i>	<i>Total</i>
	SAR'000	SAR'000	SAR'000	SAR'000
Standard	1,676,012	10,789,143	47,712,187	60,177,342
Special mention	96,207	127,439	1,973,828	2,197,474
Total	1,772,219	10,916,582	49,686,015	62,374,816

	2006			
	<i>Credit Cards</i>	<i>Consumer Loans</i>	<i>Commercial Loans</i>	<i>Total</i>
	SAR'000	SAR'000	SAR'000	SAR'000
Standard	1,276,567	9,749,846	30,134,412	41,160,825
Special mention	96,310	112,539	1,413,151	1,622,000
Total	1,372,877	9,862,385	31,547,563	42,782,825

7. Investments in associates

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.

	2007			2006		
	<i>HSBC Saudi Arabia Limited</i>	<i>SABB Takaful</i>	<i>Total</i>	<i>HSBC Saudi Arabia Limited</i>	<i>SABB Takaful</i>	<i>Total</i>
	SAR'000	SAR'000	SAR'000	SAR'000	SAR'000	SAR'000
Balance at beginning of the year	72,209	–	72,209	–	–	–
Cost of investment during the year	–	32,500	32,500	20,000	–	20,000
Dividend received	(52,209)	–	(52,209)	–	–	–
Share of undistributed profit (loss)	70,411	(12,464)	57,947	52,209	–	52,209
Total	90,411	20,036	110,447	72,209	–	72,209

Share of the associate's financial statements:

	2007		2006	
	<i>HSBC Saudi Arabia Limited</i>	<i>SABB Takaful</i>	<i>HSBC Saudi Arabia Limited</i>	<i>SABB Takaful</i>
	SAR'000	SAR'000	SAR'000	SAR'000
Total assets	130,051	27,987	109,143	–
Total liabilities	39,640	7,951	36,934	–
Total equity	90,411	20,036	72,209	–
Total income	114,212	2,461	77,735	–
Total expenses	43,801	14,925	25,526	–

Notes to the Financial Statements (31 December 2007) (continued)**8. Property and equipment, net**

	<i>Land and buildings</i>	<i>Leasehold improvements</i>	<i>Equipment, furniture and vehicles</i>	2007 Total	2006 <i>Total</i>
	<u>SAR'000</u>	<u>SAR'000</u>	<u>SAR'000</u>	<u>SAR'000</u>	<u>SAR'000</u>
Cost					
As at 1 January	650,966	223,902	464,382	1,339,250	1,236,036
Additions	4,438	29,387	79,857	113,682	112,114
Disposals	(69,073)	(13)	(3,343)	(72,429)	(8,900)
As at 31 December	<u>586,331</u>	<u>253,276</u>	<u>540,896</u>	<u>1,380,503</u>	<u>1,339,250</u>
Accumulated depreciation					
As at 1 January	303,399	163,781	330,835	798,015	708,311
Charge for the year	24,230	15,532	63,133	102,895	97,604
Disposals	(69,073)	(6)	(3,168)	(72,247)	(7,900)
As at 31 December	<u>258,556</u>	<u>179,307</u>	<u>390,800</u>	<u>828,663</u>	<u>798,015</u>
Net book value					
As at 31 December 2007	<u>327,775</u>	<u>73,969</u>	<u>150,096</u>	<u>551,840</u>	
As at 31 December 2006	<u>347,567</u>	<u>60,121</u>	<u>133,547</u>		<u>541,235</u>

Land and buildings and leasehold improvements and equipment include work in progress as at 31 December 2007 amounting to SAR 57.3 million (2006: SAR 55.8 million), SAR 29.0 million (2006: SAR 10.8 million) and SAR nil million (2006: SAR 6.7 million), respectively.

9. Other assets

	2007	2006
	<u>SAR'000</u>	<u>SAR'000</u>
Accrued special commission receivable		
– banks and other financial institutions	1,477	3,225
– investments	220,787	221,359
– loans and advances	579,998	469,432
Total accrued special commission receivable	<u>802,262</u>	694,016
Accounts receivable	198,186	128,306
Other real estate	12,929	13,449
Positive fair value of derivatives (note 10)	983,432	337,704
Advance tax	184,451	153,422
Other	142,436	163,844
Total	<u>2,323,696</u>	<u>1,490,741</u>

10. Derivatives

In the ordinary course of business, the Bank utilises the following derivative financial instruments for both trading and hedging purposes:

a) *Forwards and futures*

Forwards and futures are contractual agreements to either buy or sell a specified currency, commodity or financial instrument at a specified price and date in the future. Forwards are customised contracts transacted in the over-the-counter market. Foreign currency and special commission rate futures are transacted in standardised amounts on regulated exchanges, and changes in futures contract values are settled daily.

b) *Options*

Options are contractual agreements under which the seller (writer) grants the purchaser (holder) the right, but not the obligation, to either buy or sell at fixed future date or at any time during a specified period, a specified amount of a currency, commodity or financial instrument at a predetermined price.

c) *Swaps*

Swaps are commitments to exchange one set of cash flows for another. For special commission rate swaps, counterparties generally exchange fixed and floating rate special commission payments in a single currency without exchanging principal. For currency swaps, fixed special commission payments and principal are exchanged in different currencies. For cross-currency special commission rate swaps, principal, fixed and floating special commission payments are exchanged in different currencies.

d) *Forward rate agreements*

Forward rate agreements are over-the-counter negotiated special commission rate contracts that call for a cash settlement for the difference between a contracted special commission rate and the market rate on a specified future date, based on a notional principal for an agreed period of time.

Derivatives held for trading

Most of the Bank's derivative trading activities relate to sales, positioning and arbitrage. Sales activities involve offering products to customers in order, inter alia, to enable them to transfer, modify or reduce current and future risks. Positioning involves managing market risk positions with the expectation of profiting from favourable movements in prices, rates or indices. Arbitrage involves identifying, with the expectation of profiting from price differentials between markets or products.

Derivatives held for hedging

The Bank has adopted a comprehensive system for the measurement and the management of risk (see note 28 – credit risk, note 30 – market risk and note 33 – liquidity risk). Part of the risk management process involves managing the Bank's exposure to fluctuations in foreign exchange and special commission rates to reduce its exposure to currency and special commission rate risks to acceptable levels, as determined by the Board of Directors within the guidelines issued by SAMA. The Board of Directors has established the levels of currency risk by setting limits on currency position exposures. Positions are monitored on a daily basis and hedging strategies are used to ensure that positions are maintained within the established limits. The Board of Directors has also established the levels of special commission rate risk by setting limits on special commission rate gaps for stipulated periods. Asset and liability special commission rate gaps are reviewed on a periodic basis and hedging strategies are used to maintain special commission rate gaps within the established limits.

As part of its asset and liability management process, the Bank uses derivatives for hedging purposes in order to adjust its exposure to currency and special commission rate risks. This is generally achieved by hedging specific transactions as well as by strategic hedging against overall balance sheet exposures. Strategic hedging other than portfolio hedging does not qualify for hedge accounting and the related derivatives are accounted for as held for trading.

Notes to the Financial Statements (31 December 2007) (continued)**10. Derivatives** (continued)

The Bank uses forward foreign exchange contracts and currency swaps to hedge against specifically identified currency risks. In addition, the Bank uses special commission rate swaps to hedge against the special commission rate risk arising from specifically identified fixed special commission rate exposures. The Bank also uses special commission rate swaps to hedge against the cash flow risk arising on certain floating rate exposures. In all such cases, the hedging relationship and objective, including the details of the hedged items and hedging instruments, are formally documented and the transactions are accounted for as fair value or cash flow hedges.

The tables below show the positive and negative fair values of derivative financial instruments held, together with their notional amounts as at 31 December, analysed by the term-to-maturity and the monthly average. The notional amounts, which provide an indication of the volumes of the transactions outstanding at the year end, do not necessarily reflect the amounts of future cash flows involved. These notional amounts, therefore, are neither indicative of the Bank's exposure to market risk or credit risk, which is generally limited to the positive fair value of the derivatives.

	Notional amounts by term to maturity							
	<i>Positive fair value</i>	<i>Negative fair value</i>	<i>Notional amount total</i>	<i>Within 3 months</i>	<i>3 - 12 months</i>	<i>1 - 5 years</i>	<i>Over 5 years</i>	<i>Monthly average</i>
	<u>SAR'000</u>	<u>SAR'000</u>	<u>SAR'000</u>	<u>SAR'000</u>	<u>SAR'000</u>	<u>SAR'000</u>	<u>SAR'000</u>	<u>SAR'000</u>
2007								
Derivatives held for trading:								
Special commission rate swaps	540,149	(456,580)	34,588,421	917,554	1,471,686	5,587,033	26,612,148	27,130,361
Special commission rate futures and options	8	(8)	400,000	–	400,000	–	–	400,000
Spot and forward foreign exchange contracts	85,574	(128,594)	11,624,530	7,092,407	4,478,532	53,591	–	14,757,459
Currency options	6,984	(6,828)	2,138,699	163,879	98,820	1,876,000	–	597,669
Currency swaps	322,790	–	1,475,297	–	–	1,475,297	–	1,475,297
Derivatives held as fair value hedges:								
Special commission rate swaps	17,696	(13,278)	1,524,591	224,000	74,327	743,014	483,250	2,153,311
Derivatives held as cash flow hedges:								
Special commission rate swaps	10,231	(2,990)	1,021,250	100,000	190,000	731,250	–	749,896
Total	983,432	(608,278)	52,772,788	8,497,840	6,713,365	10,466,185	27,095,398	

10. Derivatives (continued)

	Notional amounts by term to maturity							Monthly average
	<i>Positive fair value</i>	<i>Negative fair value</i>	<i>Notional amount total</i>	<i>Within 3 months</i>	<i>3 - 12 months</i>	<i>1 - 5 years</i>	<i>Over 5 years</i>	
	SAR'000	SAR'000	SAR'000	SAR'000	SAR'000	SAR'000	SAR'000	
2006								
Derivatives held for trading:								
Special commission rate swaps	124,500	(90,606)	14,058,291	219,571	539,380	10,334,320	2,965,020	11,766,417
Special commission rate futures and options	396	(396)	400,000	–	–	400,000	–	421,875
Spot and forward foreign exchange contracts	50,290	(41,181)	21,449,674	11,479,053	9,172,450	798,171	–	18,410,284
Currency options	1,046	(1,046)	407,136	263,899	128,430	14,807	–	469,406
Currency swaps	130,913	–	1,475,297	–	–	1,475,297	–	1,113,249
Derivatives held as fair value hedges:								
Special commission rate swaps	23,848	(12,308)	3,106,820	540,705	1,374,947	799,514	391,654	2,098,738
Derivatives held as cash flow hedges:								
Special commission rate swaps	6,711	(3,818)	727,500	–	100,000	477,500	150,000	627,500
Total	337,704	(149,355)	41,624,718	12,503,228	11,315,207	14,299,609	3,506,674	

The tables below show a summary of the hedged items, the nature of the risk being hedged, the hedging instruments and their fair values.

Description of the hedged items:	2007					
	<i>Fair value</i>	<i>Hedge inception value</i>	<i>Risk</i>	<i>Hedging instrument</i>	<i>Positive fair value</i>	<i>Negative fair value</i>
	SAR'000	SAR'000			SAR'000	SAR'000
Fixed commission rate investments	479,549	481,671	Fair value	Special commission rate swap	14,492	(13,278)
Fixed commission rate loans	742,971	739,550	Fair value	Special commission rate swap	2,614	–
Fixed commission rate deposits	297,704	298,327	Fair value	Special commission rate swap	590	–
Floating commission rate investments	830,602	832,760	Cash flow	Special commission rate swap	10,231	(1,805)
Floating commission rate debt securities in issue	187,149	187,306	Cash flow	Special commission rate swap	–	(1,185)

Notes to the Financial Statements (31 December 2007) (continued)**10. Derivatives** (continued)

Description of the hedged items:	2006					
	<i>Fair value</i>	<i>Hedge inception value</i>	<i>Risk</i>	<i>Hedging instrument</i>	<i>Positive fair value</i>	<i>Negative fair value</i>
	SAR'000	SAR'000			SAR'000	SAR'000
Fixed commission rate investments	451,417	446,497	Fair value	Special commission rate swap	6,749	(12,271)
Fixed commission rate loans	1,220,396	1,226,739	Fair value	Special commission rate swap	16,097	–
Fixed commission rate deposits	1,444,838	1,446,000	Fair value	Special commission rate swap	1,002	(37)
Floating commission rate investments	541,200	540,276	Cash flow	Special commission rate swap	1,776	(3,818)
Floating commission rate debt securities in issue	186,720	187,306	Cash flow	Special commission rate swap	4,935	–

The losses on the hedging instruments for fair value hedges are SAR 3.4 million (2006: SAR 0.99 million). The gains on the hedged items attributable to the hedged risk are SAR 9.2 million (2006: losses SAR 5.9 million). The net fair value of the derivatives is SAR 4.4 million (2006: SAR 11.6 million).

Reconciliation of movements in the other reserve of cash flow hedges:

	2007	2006
	SAR'000	SAR'000
Balance at beginning of the year	2,159	(3,232)
Gains from changes in fair value recognised directly in equity	4,349	5,391
Losses removed from equity and included in net special commission income	1,244	–
Balance at end of the year	7,752	2,159

Approximately 54% (2006: 83%) of the positive fair value of the Bank's derivatives is entered into with financial institutions and less than 46% (2006: 59%) of the total of the positive fair value contracts is with any single counterparty at the consolidated balance sheet date.

11. Due to banks and other financial institutions

	2007	2006
	SAR'000	SAR'000
Current accounts	2,161,736	965,132
Money market deposits	5,883,311	1,206,703
Total	8,045,047	2,171,835

Money market deposits also include deposits placed by SAMA of SAR 420.0 million (2006: SAR 510.0 million).

12. Customers' deposits

	2007	2006
	<u>SAR'000</u>	<u>SAR'000</u>
Demand	27,162,175	20,797,507
Savings	2,781,835	2,362,130
Time	41,287,322	35,568,576
Other	616,520	529,429
Total	<u>71,847,852</u>	<u>59,257,642</u>

Time deposits include SAR 26,490.6 million (2006: SAR 19,871.4 million) deposits taken under non-interest-bearing product contracts.

Other customer deposits include SAR 613.8 million (2006: SAR 526.4 million) of margins held for irrevocable commitments.

The above deposits include the following foreign currency deposits:

	2007	2006
	<u>SAR'000</u>	<u>SAR'000</u>
Demand	2,208,386	1,141,293
Savings	155,568	124,826
Time	7,356,175	12,294,164
Other	247,966	254,138
Total	<u>9,968,095</u>	<u>13,814,421</u>

13. Debt securities in issue

	2007	2006
	<u>SAR'000</u>	<u>SAR'000</u>
USD 600 million 5-year Floating Rate Notes	2,248,399	2,247,666
Euro 325 million 5-year Floating Rate Notes	1,789,968	1,605,528
Total	<u>4,038,367</u>	<u>3,853,194</u>

USD 600 million 5-year floating rate notes

These notes were issued during March 2005 under the Bank's Euro Medium Term Note programme and mature on 8 March 2010. They are unsecured and carry effective special commission at three months' LIBOR plus 40.76 bps payable quarterly. The notes are non-convertible and are listed on the Luxembourg Stock Exchange.

The special commission rate exposure on these notes has been partially hedged by a floating to fixed special commission rate swap to the extent of USD 50 million. The special commission rate swap forms part of a designated and effective hedging relationship and is accounted for as a cash flow hedge in these financial statements.

Euro 325 million 5-year floating rate notes

These notes were issued during 2006 under the Bank's Euro Medium Term Note programme and mature on 13 April 2011. The notes carry effective special commission at three months' Euribor plus 34.68 bps which is payable on a quarterly basis. The notes are non-convertible, are unsecured and are listed on the Luxembourg Stock Exchange.

The Bank has converted the foreign currency exposure on these notes into US Dollars by means of a cross-currency swap. This swap does not form part of a designated hedging relationship and, hence, is carried as a derivative in the trading book.

14. Borrowings

This represents a 12-year floating rate loan. The loan carries special commission rate of Libor plus 65 basis points. This was taken on 7 July 2005 and is repayable by 15 June 2017.

Notes to the Financial Statements (31 December 2007) (continued)**15. Other liabilities**

	<u>2007</u>	<u>2006</u>
	SAR'000	SAR'000
Accrued special commission payable		
– banks and other financial institutions	43,934	43,778
– customers' deposits	278,611	259,370
– debt securities in issue	27,137	22,127
– borrowings	452	920
Total accrued special commission payable	<u>350,134</u>	<u>326,195</u>
Accounts payable	631,256	615,688
Drawings payable	745,981	243,505
Negative fair value of derivatives (note 10)	608,278	149,355
Other	1,333,562	979,865
Total	<u>3,669,211</u>	<u>2,314,608</u>

16. Share capital

The authorised, issued and fully paid share capital of the Bank consists of 375 million shares of SAR 10 each (2006: 375 million shares of SAR 10 each). The ownership of the Bank's share capital is as follows:

	<u>2007</u>	<u>2006</u>
Saudi shareholders	60%	60%
HSBC Holdings BV (a wholly owned subsidiary of HSBC Holdings plc)	40%	40%

The Board of Directors has recommended on 18 Shawwal 1428H (30 October 2007) a bonus issue of 225 million shares of nominal value SAR 10 each to the existing shareholders on the basis of 3 bonus shares for every 5 shares held through the capitalisation of retained earnings which is subject to approval of shareholders at Extraordinary General Meeting and regulatory agencies.

17. Statutory reserve

In accordance with the Banking Control Law of the Kingdom of Saudi Arabia, a minimum of 25% of the net income for the year is required to be transferred to a statutory reserve until this reserve is equal to the paid-up capital of the Bank. Accordingly, a sum of SAR Nil (2006: SAR 1,250 million) was transferred to statutory reserve. The statutory reserve is not currently available for distribution.

18. Commitments and contingencies**a) Legal proceedings**

As at 31 December 2007, there are legal proceedings outstanding against the Bank. No material provision has been made as professional advice indicates that it is unlikely that any significant loss will occur.

b) Capital commitments

The Bank has capital commitments of SAR 45.02 million (2006: SAR 51.5 million) in respect of buildings and equipment purchases.

c) Credit-related commitments and contingencies

Credit-related commitments and contingencies mainly comprise guarantees, letters of credit, acceptances and commitments to extend credit. Guarantees and standby letters of credit, which represent irrevocable assurances that the Bank will make payments in the event that a customer cannot meet its obligations to third parties, carry the same credit risk as loans and advances. Documentary letters of credit, which are written undertakings by the Bank on behalf of a customer authorising a third party to draw drafts on the Bank up to a stipulated amount under

18. Commitments and contingencies (continued)

specific terms and conditions, are generally collateralised by the underlying shipments of goods to which they relate and therefore have significantly less risk. Acceptances comprise undertakings by the Bank to pay bills of exchange drawn on customers. The cash requirement under these instruments is considerably less than the amount of the related commitment because the Bank generally expects customers to fulfil their primary obligation.

Commitments to extend credit represent the unutilised portion of authorisations to extend credit, principally in the form of loans and advances, guarantees and letters of credit. With respect to credit risk on commitments to extend credit, the Bank is potentially exposed to a loss in an amount equal to the total unutilised commitments. However, the likely amount of loss, which cannot readily be quantified, is expected to be considerably less than the total unutilised commitment as most commitments to extend credit are contingent upon customers maintaining specific credit standards. The total outstanding commitments to extend credit do not necessarily represent future cash requirements, as many of the commitments could expire or be terminated without being funded.

d) *The contractual maturity structure of the Bank's credit-related commitments and contingencies is as follows:*

	<i>Within 3 months</i>	<i>3 - 12 months</i>	<i>1 - 5 years</i>	<i>Over 5 years</i>	<i>Total</i>
	SAR'000	SAR'000	SAR'000	SAR'000	SAR'000
2007					
Letters of credit	5,485,246	1,733,191	908,059	–	8,126,496
Guarantees	5,102,411	5,464,673	2,839,202	23,302	13,429,588
Acceptances	1,767,257	1,229,852	63,475	–	3,060,584
Irrevocable commitments to extend credit	7,260	1,706,896	3,308,468	–	5,022,624
Total	12,362,174	10,134,612	7,119,204	23,302	29,639,292
	<i>Within 3 months</i>	<i>3 - 12 months</i>	<i>1 - 5 years</i>	<i>Over 5 years</i>	<i>Total</i>
	SAR'000	SAR'000	SAR'000	SAR'000	SAR'000
2006					
Letters of credit	3,739,014	1,414,655	131,261	–	5,284,930
Guarantees	3,545,045	3,864,235	2,358,328	44,572	9,812,180
Acceptances	1,466,276	824,635	18,043	–	2,308,954
Irrevocable commitments to extend credit	150,040	783,648	760,172	–	1,693,860
Total	8,900,375	6,887,173	3,267,804	44,572	19,099,924

The unutilised portion of non-firm commitments, which can be revoked unilaterally at any time by the Bank, is SAR 35,019.4 million (2006: SAR 27,940.1 million).

e) *The analysis of credit-related commitments and contingencies by counterparty is as follows:*

	2007	2006
	SAR'000	SAR'000
Government and quasi-Government	146,948	346,260
Corporate	25,763,087	15,731,020
Banks and other financial institutions	3,639,020	2,759,774
Other	90,237	262,870
Total	29,639,292	19,099,924

Notes to the Financial Statements (31 December 2007) (continued)**18. Commitments and contingencies** (continued)**f) Operating lease commitments**

The future minimum lease payments under non-cancellable leases where the Bank is the lessee are as follows:

	2007	2006
	SAR'000	SAR'000
Less than 1 year	33,007	29,345
1 to 5 years	154,965	145,635
Over 5 years	70,356	66,740
Total	258,328	241,720

19. Net special commission income

	2007	2006
	SAR'000	SAR'000
Special commission income:		
Investments		
– available-for-sale investments	502,954	395,351
– held at amortised cost	322,211	357,995
– held-to-maturity investments	29,645	29,645
	854,810	782,991
Due from banks and other financial institutions	620,209	556,308
Loans and advances	3,744,936	3,097,422
Total	5,219,955	4,436,721
Special commission expense:		
Due to banks and other financial institutions	119,906	115,094
Customers' deposits	1,811,616	1,563,082
Debt securities in issue	219,453	164,440
Borrowing	10,283	10,283
Total	2,161,258	1,852,899
Net special commission income	3,058,697	2,583,822

20. Fees from banking services, net

	2007	2006
	SAR'000	SAR'000
Fees income:		
– Share trading and fund management	339,825	1,223,018
– Trade finance	215,688	167,672
– Corporate finance and advisory	99,106	79,831
– Other banking services	313,944	233,233
Total fees income	968,563	1,703,754
Fees expense:		
– Cards	(28,008)	(17,478)
– Custodial services	(840)	(712)
– Other banking services	(77,791)	(35,081)
Total fees expense	(106,639)	(53,271)
Fees from banking services, net	861,924	1,650,483

21. Income from FVIS financial instruments, net

	<u>2007</u>	<u>2006</u>
	<u>SAR'000</u>	<u>SAR'000</u>
Fair value change on investments held as FVIS	(11,523)	7,663
Special commission income on FVIS investments	75,300	125,654
Total	<u>63,777</u>	<u>133,317</u>

The maximum credit exposure of investments under FVIS as at 31 December 2007 is SAR 171.18 million (2006: SAR 1,795.96 million). The impact of change in credit risk to the consolidated statement of income is immaterial.

22. Trading income, net

	<u>2007</u>	<u>2006</u>
	<u>SAR'000</u>	<u>SAR'000</u>
Foreign exchange, net	125,976	69,139
Derivatives	49,106	9,867
Debt instruments	17,839	3,409
Others	(2,953)	3,392
Total	<u>189,968</u>	<u>85,807</u>

23. Gains on non-trading investments, net

	<u>2007</u>	<u>2006</u>
	<u>SAR'000</u>	<u>SAR'000</u>
Available-for-sale investments	<u>83,319</u>	<u>64,721</u>

24. Basic and fully diluted earnings per share

Basic earnings per share for the years ended 31 December 2007 and 2006 is calculated by dividing the net income for the year attributable to the equity holders by 375 million shares.

Diluted earnings per share is the same as basic earnings per share, as the Bank has not issued any instruments which would have an impact on earnings per share when exercised.

25. Gross dividend, zakat and income tax

The gross dividend for the year is SAR 1,500 million (2006: SAR 1,500 million). The gross dividend includes an interim dividend of SAR 609.4 million (2006: SAR 609.4 million) and final proposed dividend of SAR 890.6 million (2006: SAR 890.6 million). Dividends are paid to the Saudi and non-Saudi shareholders after deduction of zakat and income tax respectively as follows:

Saudi shareholders

Zakat attributable to the Saudi shareholders for the year amounted to approximately SAR 55.1 million (2006: SAR 56.2 million), and is deducted from their share of the dividend. The net total dividend for the year to the Saudi shareholders is SAR 844.9 million (2006: SAR 843.8 million) representing SAR 3.76 per share (2006: SAR 3.75 per share) of which SAR 1.54 (2006: SAR 1.50) was paid on an interim basis.

Notes to the Financial Statements (31 December 2007) (continued)**25. Gross dividend, zakat and income tax** (continued)**Non-Saudi shareholders**

Income tax attributable to the foreign shareholder on its current year's share of income is approximately SAR 215.6 million (2006: SAR 276.5 million) and is deducted from its share of the dividend. The net total dividend for the year to the foreign shareholder is SAR 384.4 million (2006: SAR 323.5 million) representing SAR 3.08 per share (2006: SAR 2.16 per share) of which SAR 1.12 per share (2006: SAR 0.56 per share) was paid on an interim basis.

In accordance with the requirements of the revised IAS 10, the Bank has discontinued reporting the final proposed dividend as a liability until approved by the shareholders' annual general assembly. Consequently, the final proposed dividend is not shown as a liability and is included within the shareholders' equity.

26. Cash and cash equivalents

Cash and cash equivalents included in the statement of cash flows comprise the following:

	<u>2007</u>	<u>2006</u>
	<u>SAR'000</u>	<u>SAR'000</u>
Cash and balances with SAMA excluding the statutory deposit (note 3)	13,322,481	5,445,603
Due from banks and other financial institutions with original maturity of ninety days of acquisition	1,723,576	3,137,510
Total	<u>15,046,057</u>	<u>8,583,113</u>

27. Business segments

The Bank's primary segment reporting format is determined by business segment. A business segment is a group of assets and operations engaged in providing products or services that are subject to risks and returns that are distinct from those of other business segments.

Transactions between the business segments are on normal commercial terms and conditions. Funds are ordinarily reallocated between business segments, resulting in funding cost transfers. Special commission charged for these funds is based on inter-bank rates.

The Bank's primary business is conducted in the Kingdom of Saudi Arabia.

a) *The Bank is organised into the following main business segments:*

Retail Banking

Which caters mainly to the banking requirements of personal and private banking customers.

Corporate Banking

Which caters mainly to the banking requirements of commercial and corporate banking customers.

Treasury

Which manages the Bank's liquidity, currency and special commission rate risks. It is also responsible for funding the Bank's operations and managing the Bank's investment portfolio and balance sheet.

27. Business segments (continued)

Transactions between the business segments are reported as recorded by the Bank's transfer pricing system. The Bank's total assets and liabilities as at 31 December 2007 and 2006, its total operating income and expenses, and the results for the years then ended, by business segment, are as follows:

	<i>Retail Banking</i>	<i>Corporate Banking</i>	<i>Treasury</i>	<i>Others</i>	<i>Total</i>
	<u>SAR'000</u>	<u>SAR'000</u>	<u>SAR'000</u>	<u>SAR'000</u>	<u>SAR'000</u>
2007					
Total assets	21,525,884	42,043,291	34,533,288	110,447	98,212,910
Total liabilities	29,637,918	34,231,719	23,918,340	–	87,787,977
Total operating income	2,049,520	1,858,650	465,782	–	4,373,952
Total operating expenses	1,383,401	371,867	69,692	–	1,824,960
Share in earnings of associates, net	–	–	–	57,947	57,947
Net income	666,119	1,486,783	396,090	57,947	2,606,939
Capital expenditure	106,181	5,906	1,595	–	113,682
Depreciation	96,106	5,346	1,443	–	102,895
	<i>Retail Banking</i>	<i>Corporate Banking</i>	<i>Treasury</i>	<i>Others</i>	<i>Total</i>
	<u>SAR'000</u>	<u>SAR'000</u>	<u>SAR'000</u>	<u>SAR'000</u>	<u>SAR'000</u>
2006					
Total assets	17,288,162	26,998,786	32,830,221	72,209	77,189,378
Total liabilities	29,327,331	27,912,528	10,544,920	–	67,784,779
Total operating income	2,794,271	1,391,060	431,359	–	4,616,690
Total operating expenses	1,348,315	225,302	55,002	–	1,628,619
Share in earnings of associates, net	–	–	–	52,209	52,209
Net income	1,445,956	1,165,758	376,357	52,209	3,040,280
Capital expenditure	104,810	5,343	1,961	–	112,114
Depreciation	91,246	4,652	1,706	–	97,604

b) The Bank's credit exposure by business segment is as follows:

	<i>Retail Banking</i>	<i>Corporate Banking</i>	<i>Treasury</i>	<i>Total</i>
	<u>SAR'000</u>	<u>SAR'000</u>	<u>SAR'000</u>	<u>SAR'000</u>
2007				
Balance sheet assets	20,606,147	41,505,158	32,478,459	94,589,764
Commitments and contingencies	125,428	10,481,018	–	10,606,446
Derivatives	–	–	2,481,164	2,481,164
Total	<u>20,731,575</u>	<u>51,986,176</u>	<u>34,959,623</u>	<u>107,677,374</u>
	<i>Retail Banking</i>	<i>Corporate Banking</i>	<i>Treasury</i>	<i>Total</i>
	<u>SAR'000</u>	<u>SAR'000</u>	<u>SAR'000</u>	<u>SAR'000</u>
2006				
Balance sheet assets	15,923,095	26,599,357	31,877,444	74,399,896
Commitments and contingencies	114,600	6,690,354	–	6,804,954
Derivatives	–	–	1,530,379	1,530,379
Total	<u>16,037,695</u>	<u>33,289,711</u>	<u>33,407,823</u>	<u>82,735,229</u>

Credit exposure comprises the carrying value of consolidated balance sheet assets excluding cash, property and equipment and other assets, and the credit equivalent value for commitments, contingencies and derivatives.

Notes to the Financial Statements (31 December 2007) (continued)

28. Credit risk

The Bank manages exposure to credit risk, which is the risk that one party to a financial instrument will fail to discharge an obligation and cause the other party to incur a financial loss. Credit exposures arise principally in lending activities that lead to loans and advances, and investment activities. There is also credit risk in off-balance sheet financial instruments, such as loan commitments.

The Bank assesses the probability of default of counterparties using internal rating tools. Also the Bank uses the external ratings, of the major rating agency, where available.

The Bank attempts to control credit risk by monitoring credit exposures, limiting transactions with specific counterparties, and continually assessing the creditworthiness of counterparties. The Bank's risk management policies are designed to identify and set appropriate risk limits and to monitor the risks and adherence to limits. Actual exposures against limits are monitored daily. In addition to monitoring credit limits, the Bank manages the credit exposure relating to its trading activities by entering into master netting agreements and collateral arrangements with counterparties in appropriate circumstances, and limiting the duration of exposure. In certain cases, the Bank may also close out transactions or assign them to other counterparties to mitigate credit risk. The Bank's credit risk for derivatives represents the potential cost to replace the derivative contracts if counterparties fail to fulfil their obligation, and to control the level of credit risk taken, the Bank assesses counterparties using the same techniques as for its lending activities.

Concentrations of credit risk arise when a number of counterparties are engaged in similar business activities, or activities in the same geographic region, or have similar economic features that would cause their ability to meet contractual obligations to be similarly affected by changes in economic, political or other conditions.

Concentrations of credit risk indicate the relative sensitivity of the Bank's performance to developments affecting a particular industry or geographical location.

The Bank seeks to manage its credit risk exposure through diversification of lending activities to ensure that there is no undue concentration of risks with individuals or groups of customers in specific locations or business. It also takes security when appropriate. The Bank also seeks additional collateral from the counterparty as soon as impairment indicators are noticed for the relevant individual loans and advances.

Management monitors the market value of collateral, requests additional collateral in accordance with the underlying agreement and monitors the market value of collateral obtained during its review of the adequacy of the allowance for impairment losses.

The Bank regularly reviews its risk management policies and systems to reflect changes in markets, products and emerging best practice.

The debt securities included in the investment portfolio are mainly sovereign risk. Analysis of investments by counterparty is provided in note 5. For details of the composition of loans and advances, refer to note 6. Information on credit risk relating to derivative instruments is provided in note 10 and for commitments and contingencies in note 18. Information on the Bank's maximum credit exposure by business segment is given in note 27. Information on maximum credit risk exposure and relative risk weights is also provided in note 36.

29. Geographical concentration of assets, liabilities, commitments and contingencies, and credit exposure

The Bank's main credit exposure by geographical region is as follows:

	2007					<i>Total</i> SAR'000
	<i>Kingdom of Saudi Arabia</i>	<i>GCC and Middle East</i>	<i>Europe</i>	<i>North America</i>	<i>Other countries</i>	
	SAR'000	SAR'000	SAR'000	SAR'000	SAR'000	
ASSETS						
Cash and balances with SAMA	16,643,746	–	–	–	–	16,643,746
Due from banks and other financial institutions	2,676	151,435	925,115	614,347	30,003	1,723,576
Investments	9,752,571	1,211,740	1,632,573	2,025,404	236,459	14,858,747
Loans and advances, net	61,965,116	11,250	24,492	–	–	62,000,858
Investment in associates	110,447	–	–	–	–	110,447
Total	88,474,556	1,374,425	2,582,180	2,639,751	266,462	95,337,374
LIABILITIES						
Due to banks and other financial institutions	3,235,242	2,331,694	1,370,852	1,034,235	73,024	8,045,047
Customer deposits	71,823,487	1,691	4,400	–	18,274	71,847,852
Debt securities in issue	–	–	4,038,367	–	–	4,038,367
Borrowings	–	–	187,500	–	–	187,500
Total	75,058,729	2,333,385	5,601,119	1,034,235	91,298	84,118,766
Commitments and contingencies	28,167,099	370,946	347,001	27,662	726,584	29,639,292
CREDIT EXPOSURE (STATED AT CREDIT EQUIVALENT AMOUNTS)						
Balance sheet assets	87,726,946	1,374,425	2,582,180	2,639,751	266,462	94,589,764
Commitments and contingencies	10,166,900	97,978	129,317	13,448	198,803	10,606,446
Derivatives	1,347,399	4,295	773,395	308,558	47,517	2,481,164
Total credit exposure	99,241,245	1,476,698	3,484,892	2,961,757	512,782	107,677,374

Notes to the Financial Statements (31 December 2007) (continued)**29. Geographical concentration of assets, liabilities, commitments and contingencies, and credit exposure**
(continued)

	2006					Total SAR'000
	Kingdom of Saudi Arabia	GCC and Middle East	Europe	North America	Other countries	
	SAR'000	SAR'000	SAR'000	SAR'000	SAR'000	
ASSETS						
Cash and balances with SAMA	7,795,020	–	–	–	–	7,795,020
Due from banks and other financial institutions	178,957	14,042	585,661	2,342,032	16,818	3,137,510
Investments	16,459,968	700,823	2,787,004	1,473,131	281,494	21,702,420
Loans and advances, net	42,335,329	–	114,914	–	–	42,450,243
Investment in an associate	72,209	–	–	–	–	72,209
Total	66,841,483	714,865	3,487,579	3,815,163	298,312	75,157,402
LIABILITIES						
Due to banks and other financial institutions	1,085,058	202,732	160,132	720,035	3,878	2,171,835
Customer deposits	58,976,858	23,873	16,501	–	240,410	59,257,642
Debt securities in issue	–	–	3,853,194	–	–	3,853,194
Borrowings	–	–	187,500	–	–	187,500
Total	60,061,916	226,605	4,217,327	720,035	244,288	65,470,171
Commitments and contingencies	17,990,187	257,425	335,115	46,149	471,048	19,099,924
CREDIT EXPOSURE (STATED AT CREDIT EQUIVALENT AMOUNTS)						
Balance sheet assets	66,083,977	714,865	3,487,579	3,815,163	298,312	74,399,896
Commitments and contingencies	6,374,974	77,660	158,386	21,289	172,645	6,804,954
Derivatives	601,955	13,988	695,616	186,886	31,934	1,530,379
Total credit exposure	73,060,906	806,513	4,341,581	4,023,338	502,891	82,735,229

All non-performing loans and advances relate to customers in the Kingdom of Saudi Arabia.

30. Market risk

Market risk is the risk that the fair value or future cash flows of the financial instruments will fluctuate due to changes in market variables such as commission rates, foreign exchange rates and equity prices. The Bank classifies exposures to market risk into either trading or non-trading or banking book.

The market risk for the trading book is managed and monitored using VAR methodology. Market risk for non-trading book is managed and monitored using a combination of VAR, stress testing and sensitivity analysis.

a) Market risk trading book

The Board has set limits for the acceptable level of risks in managing the trading book. The Bank applies a VAR methodology to assess the market risk positions held and to estimate the potential economic loss based upon a number of parameters and assumptions for change in market conditions.

A VAR methodology estimates the potential negative change in market value of a portfolio at a given confidence level and over a specified time horizon. The Bank uses simulation models to assess the possible changes in the market value of the trading book based on historical data. VAR models are usually designed to measure the market risk in a normal market environment and therefore the use of VAR has limitations because it is based on historical correlations and volatilities in market prices and assumes that the future movements will follow a statistical distribution.

30. Market risk (continued)

The VAR that the Bank measures is an estimate, using a confidence level of 99% of the potential loss that is not expected to be exceeded if the current market positions were to be held unchanged for one day. The use of 99% confidence level depicts that within a one-day horizon, losses exceeding the VAR figure should occur, on average, not more than once every hundred days.

The VAR represents the risk of portfolios at the close of a business day, and it does not account for any losses that may occur beyond the defined confidence interval. The actual trading results, however, may differ from the VAR calculations and, in particular, the calculation does not provide a meaningful indication of profits and losses in stressed market conditions.

To overcome the VAR limitations mentioned above, the Bank also carries out stress tests of its portfolio to simulate conditions outside normal confidence intervals. The potential losses occurring under stress test conditions are reported regularly to the Bank's ALCO committee for their review.

The Bank's VAR related information is as stated below:

	<i>Foreign exchange</i>	<i>Special commission rate</i>	<i>Total</i>
	<u>SAR'000</u>	<u>SAR'000</u>	<u>SAR'000</u>
2007			
VAR as at 31 December 2007	649	405	694
Average VAR for 2007	486	514	791
	<i>Foreign exchange</i>	<i>Special commission rate</i>	<i>Total</i>
	<u>SAR'000</u>	<u>SAR'000</u>	<u>SAR'000</u>
2006			
VAR as at 31 December 2006	294	734	904
Average VAR for 2006	347	806	936

b) Market risk – non-trading or banking book

Market risk on non-trading or banking positions mainly arises from the special commission rate, foreign currency exposures and equity price changes.

i) Special Commission Rate Risk

Special commission rate risk arises from the possibility that the changes in commission rates will affect either the fair values or the future cash flows of the financial instruments. The Board has established commission rate gap limits for stipulated periods. The Bank monitors positions daily and uses hedging strategies to ensure maintenance of positions within the established gap limits.

The following table depicts the sensitivity to a reasonable possible change in commission rates, with other variables held constant, on the Bank's consolidated statement of income or equity. The sensitivity of the income is the effect of the assumed changes in commission rates on the net special commission income for one year, including the effect of hedging instruments. The sensitivity of equity is calculated by revaluing the fixed rate available for sale financial assets, including the effect of any associated hedges, as at 31 December 2007, for the effect of assumed changes in commission rates. The sensitivity of equity is analysed by maturity of the asset or swap.

2007							
<i>Currency</i>	<i>Increase in basis</i>	<i>Sensitivity of income</i>		<i>Sensitivity of Equity</i>			<i>Total</i>
		<u>SAR'000</u>	<u>SAR'000</u>	<i>6 months or less</i>	<i>1 year or less</i>	<i>1-5 years or less</i>	
				<u>SAR'000</u>	<u>SAR'000</u>	<u>SAR'000</u>	<u>SAR'000</u>
SAR	+ 100	85,505	(5,556)	(5,014)	(23,220)	(844)	(34,634)
USD	+ 100	7,915	(8,484)	(7,997)	(68,497)	(1,714)	(86,692)
EUR	+ 100	(13,735)	–	–	–	–	–
Others	+ 100	779	–	–	–	–	–

Notes to the Financial Statements (31 December 2007) (continued)**30. Market risk** (continued)

2007							
Currency	Decrease in basis	Sensitivity of income	Sensitivity of Equity				Total
			6 months or less	1 year or less	1-5 years or less	Over 5 years	
		SAR'000	SAR'000	SAR'000	SAR'000	SAR'000	SAR'000
SAR	- 100	(85,505)	5,556	5,014	23,220	844	34,634
USD	- 100	(7,915)	8,484	7,997	55,072	1,714	73,267
EUR	- 100	13,735	-	-	-	-	-
Others	- 100	(779)	-	-	-	-	-

2006							
Currency	Increase in basis	Sensitivity of income	Sensitivity of Equity				Total
			6 months or less	1 year or less	1-5 years or less	Over 5 years	
		SAR'000	SAR'000	SAR'000	SAR'000	SAR'000	SAR'000
SAR	+ 100	94,216	(12,559)	(7,967)	(19,217)	(1,904)	(41,647)
USD	+ 100	(10,338)	(6,945)	(6,230)	(32,127)	(4,785)	(50,087)
EUR	+ 100	(12,836)	-	-	-	-	-
Others	+ 100	582	-	-	-	-	-

2006							
Currency	Decrease in basis	Sensitivity of income	Sensitivity of Equity				Total
			6 months or less	1 year or less	1-5 years or less	Over 5 years	
		SAR'000	SAR'000	SAR'000	SAR'000	SAR'000	SAR'000
SAR	- 100	(94,216)	12,559	7,967	19,217	1,904	41,647
USD	- 100	10,338	6,945	6,230	29,359	3,475	46,009
EUR	- 100	12,836	-	-	-	-	-
Others	- 100	(582)	-	-	-	-	-

ii) Currency Risk

Currency risk represents the risk of change in the value of financial instruments due to changes in foreign exchange rates. The Bank does not maintain material non-trading open currency positions. Foreign currency exposures that arise in the non-trading book are transferred to the trading book and are managed as part of the trading portfolio. The foreign exchange risk VAR disclosed in note 30 a) reflects the Bank's total exposure to currency risk.

31. Currency risk

The Bank is exposed to fluctuations in foreign currency exchange rates. The Board of Directors sets limits on the level of exposure by currency, and in total for both overnight and intra-day positions, which are monitored daily. At the end of the year, the Bank had the following significant net exposures denominated in foreign currencies:

	2007		2006	
	Long	(short)	Long	(short)
	SAR'000		SAR'000	
US Dollar	135,444	(681,345)		
Euro	6,154	(600)		
Pound Sterling	(728)	176		
Other	14,751	8,419		

32. Special commission rate risk

Special commission sensitivity of assets, liabilities and off-balance-sheet items

The Bank is exposed to risks associated with fluctuations in the levels of market special commission rates. The table below summarises the Bank's exposure to special commission rate risks. Included in the table are the Bank's assets and liabilities at carrying amounts, categorised by the earlier of the contractual repricing or the maturity dates. The Bank is exposed to special commission rate risks as a result of mismatches or gaps in the amounts of assets and liabilities and off-balance-sheet instruments that reprice or mature in a given period. The Bank manages this risk by matching the repricing of assets and liabilities through risk management strategies.

	2007						Effective commission Rate %
	<i>Within 3 months</i>	<i>3 - 12 months</i>	<i>1 - 5 years</i>	<i>Over 5 years</i>	<i>Non-special- commission bearing</i>	<i>Total</i>	
	SAR'000	SAR'000	SAR'000	SAR'000	SAR'000	SAR'000	
Assets							
Cash and balances with SAMA	12,574,871	–	–	–	4,068,875	16,643,746	4.0
Due from banks and other financial institutions	952,175	–	–	–	771,401	1,723,576	4.2
Investments	6,968,072	1,226,301	4,405,038	1,735,138	524,198	14,858,747	5.3
Loans and advances, net	33,313,799	10,499,052	17,897,900	–	290,107	62,000,858	4.7
Investment in an associate	–	–	–	–	110,447	110,447	
Property and equipment, net	–	–	–	–	551,840	551,840	
Other assets	–	–	–	–	2,323,696	2,323,696	
Total assets	53,808,917	11,725,353	22,302,938	1,735,138	8,640,564	98,212,910	
Liabilities and shareholders' equity							
Due to banks and other financial institutions	5,445,683	–	437,628	–	2,161,736	8,045,047	4.2
Customer deposits	29,710,090	8,010,676	3,452,300	–	30,674,786	71,847,852	2.4
Debt Securities in issue	4,038,367	–	–	–	–	4,038,367	5.4
Borrowings	–	–	–	187,500	–	187,500	5.1
Other liabilities	–	–	–	–	3,669,211	3,669,211	
Shareholders' equity	–	–	–	–	10,424,933	10,424,933	
Total liabilities and shareholders' equity	39,194,140	8,010,676	3,889,928	187,500	46,930,666	98,212,910	
On-balance- sheet gap	14,614,777	3,714,677	18,413,010	1,547,638	(38,290,102)	–	
Off-balance- sheet gap	111,333	1,356,569	(238,478)	(1,229,424)	–	–	
Total special commission rate sensitivity gap	14,726,110	5,071,246	18,174,532	318,214	(38,290,102)	–	
Cumulative special commission rate sensitivity gap	14,726,110	19,797,356	37,971,888	38,290,102	–	–	

Notes to the Financial Statements (31 December 2007) (continued)**32. Special commission rate risk** (continued)

	2006						Effective commission Rate %
	<i>Within 3 months</i>	<i>3 - 12 months</i>	<i>1 - 5 years</i>	<i>Over 5 years</i>	<i>Non-special- commission bearing</i>	<i>Total</i>	
	SAR'000	SAR'000	SAR'000	SAR'000	SAR'000	SAR'000	
Assets							
Cash and balances with SAMA	4,688,097	–	–	–	3,106,923	7,795,020	4.4
Due from banks and other financial institutions	2,529,357	–	–	–	608,153	3,137,510	5.2
Investments	7,107,112	7,124,491	4,972,441	2,093,948	404,428	21,702,420	5.4
Loans and advances, net	20,376,281	7,203,116	14,602,575	–	268,271	42,450,243	5.2
Investment in an associate	–	–	–	–	72,209	72,209	
Property and equipment, net	–	–	–	–	541,235	541,235	
Other assets	–	–	–	–	1,490,741	1,490,741	
Total assets	34,700,847	14,327,607	19,575,016	2,093,948	6,491,960	77,189,378	
Liabilities and shareholders' equity							
Due to banks and other financial institutions	732,595	–	607,500	–	831,740	2,171,835	5.2
Customer deposits	32,593,723	5,130,735	206,248	–	21,326,936	59,257,642	2.4
Debt Securities in issue	3,853,194	–	–	–	–	3,853,194	5.0
Borrowings	–	–	–	187,500	–	187,500	5.1
Other liabilities	–	–	–	–	2,314,608	2,314,608	
Shareholders' equity	–	–	–	–	9,404,599	9,404,599	
Total liabilities and shareholders' equity	37,179,512	5,130,735	813,748	187,500	33,877,883	77,189,378	
On-balance- sheet gap	(2,478,665)	9,196,872	18,761,268	1,906,448	(27,385,923)	–	
Off-balance- sheet gap	2,575,403	(1,213,055)	(1,064,194)	(298,154)	–	–	
Total special commission rate sensitivity gap	96,738	7,983,817	17,697,074	1,608,294	(27,385,923)	–	
Cumulative special commission rate sensitivity gap	96,738	8,080,555	25,777,629	27,385,923	–	–	

The off-balance-sheet gap represents the net notional amounts of off-balance-sheet financial instruments, which are used to manage the special commission rate risk.

33. Liquidity risk

Liquidity risk is the risk that the Bank will be unable to meet its payment obligations when they fall due under normal and stress circumstances. Liquidity risk can be caused by market disruptions or credit downgrades, which may cause certain sources of funding to be less readily available. To mitigate this risk, management has diversified funding sources in addition to its core deposit base, manages assets with liquidity in mind, maintains an appropriate balance of cash, cash equivalents and readily marketable securities, and monitors future cash flows and liquidity on a daily basis. The Bank also has committed lines of credit that it can access to meet liquidity needs.

In accordance with the Banking Control Law and the regulations issued by SAMA, the Bank maintains a statutory deposit with SAMA of 9% of total demand deposits and 2% of savings and time deposits. In addition to the statutory deposit, the Bank also maintains liquid reserves of not less than 20% of the deposit liabilities, in the form of cash, Saudi Government Development Bonds or assets, which can be converted into cash within a period not exceeding 30 days. The Bank has the ability to raise additional funds through repo facilities available with SAMA against Saudi Government Development Bonds up to 75% of the nominal value of bonds held.

The table below summarises the maturity profile of the Bank's financial liabilities. The contractual maturities liabilities have been determined on the basis of the remaining period at the consolidated balance sheet date to the contractual maturity date and do not take account of the effective maturities as indicated by the Bank's deposit retention history. The amounts disclosed in the table are the contractual undiscounted cash flows, whereas the Bank manages the inherent liquidity risk based on expected undiscounted cash inflows.

Management monitors the maturity profile to ensure that adequate liquidity is maintained. The daily liquidity position is monitored and regular liquidity stress testing is conducted under a variety of scenarios covering both normal and more severe market conditions. All liquidity policies and procedures are subject to review and approval by ALCO. Daily reports cover the liquidity position of both the Bank and operating subsidiary. A summary report, including any exceptions and remedial action taken, is submitted regularly to ALCO.

a) Analysis of financial liabilities by remaining contractual maturities :

	2007				Total
	Within 3 months	3 - 12 months	1 - 5 years	Over 5 years	
	SAR'000	SAR'000	SAR'000	SAR'000	SAR'000
Financial liabilities					
Due to banks and other financial institutions	7,686,727	397,988	–	–	8,084,715
Customer deposits	60,216,455	8,669,621	3,694,086	5,772	72,585,934
Debt securities in issue	53,515	160,545	4,424,310	–	4,638,370
Borrowings	–	9,741	84,546	158,835	253,122
Derivatives:					
– Contractual amounts payable	7,397,902	4,615,101	2,867,620	–	14,880,623
– Contractual amounts receivable	(7,374,240)	(4,642,239)	(3,281,254)	(12,440)	(15,310,173)
Total undiscounted financial liabilities	67,980,359	9,210,757	7,789,308	152,167	85,132,591

Notes to the Financial Statements (31 December 2007) (continued)**33. Liquidity risk** (continued)

	2006				<i>Total</i> SAR'000
	<i>Within 3</i>	<i>3 - 12</i>	<i>1 - 5</i>	<i>Over 5</i>	
	<i>months</i>	<i>months</i>	<i>years</i>	<i>years</i>	
SAR'000	SAR'000	SAR'000	SAR'000	SAR'000	
Financial liabilities					
Due to banks and other financial institutions	1,758,044	446,484	–	–	2,204,528
Customer deposits	53,725,855	5,717,950	302,640	6,829	59,753,274
Debt securities in issue	47,945	155,563	4,638,370	–	4,841,878
Borrowings	–	9,714	54,514	198,609	262,837
<u>Derivatives:</u>					
– Contractual amounts payable	11,764,635	9,391,613	2,546,170	1,162	23,703,580
– Contractual amounts receivable	(11,756,852)	(9,422,072)	(2,704,290)	(7,639)	(23,890,853)
Total undiscounted financial liabilities	<u>55,539,627</u>	<u>6,299,252</u>	<u>4,837,404</u>	<u>198,961</u>	<u>66,875,244</u>

b) Maturity analysis of assets and liabilities:

The table below shows an analysis of assets and liabilities analysed according to when they are expected to be recovered or settled. See note (a) above for the Bank's contractual undiscounted financial liabilities.

	2007					<i>Total</i> SAR'000
	<i>Within 3</i>	<i>3 - 12</i>	<i>1 - 5</i>	<i>Over 5</i>	<i>No, fixed</i>	
	<i>months</i>	<i>months</i>	<i>years</i>	<i>years</i>	<i>maturity</i>	
SAR'000	SAR'000	SAR'000	SAR'000	SAR'000	SAR'000	
Assets						
Cash and balances with SAMA	13,322,481	–	–	–	3,321,265	16,643,746
Due from banks and other financial institutions	1,723,576	–	–	–	–	1,723,576
Investments	559,943	1,352,761	9,403,722	3,298,888	243,433	14,858,747
Loans and advances, net	29,647,545	10,952,936	13,211,157	8,189,220	–	62,000,858
Investment in associates, net	–	–	–	–	110,447	110,447
Property and equipment, net	–	–	–	–	551,840	551,840
Other assets	–	–	–	–	2,323,696	2,323,696
Total assets	<u>45,253,545</u>	<u>12,305,697</u>	<u>22,614,879</u>	<u>11,488,108</u>	<u>6,550,681</u>	<u>98,212,910</u>
Liabilities and shareholders' equity						
Due to banks and other financial institutions	7,660,247	384,800	–	–	–	8,045,047
Customer deposits	59,973,183	8,335,257	3,533,628	5,784	–	71,847,852
Debt securities in issue	–	–	2,248,399	1,789,968	–	4,038,367
Borrowings	–	–	–	187,500	–	187,500
Other liabilities	–	–	–	–	3,669,211	3,669,211
Shareholders' equity	–	–	–	–	10,424,933	10,424,933
Total liabilities and shareholders' equity	<u>67,633,430</u>	<u>8,720,057</u>	<u>5,782,027</u>	<u>1,983,252</u>	<u>14,094,144</u>	<u>98,212,910</u>

33. Liquidity risk (continued)

	2006					Total SAR'000
	Within 3 months	3 - 12 months	1 - 5 years	Over 5 years	No fixed maturity	
	SAR'000	SAR'000	SAR'000	SAR'000	SAR'000	
Assets						
Cash and balances with SAMA	5,445,603	–	–	–	2,349,417	7,795,020
Due from banks and other financial institutions	3,137,510	–	–	–	–	3,137,510
Investments	1,430,265	9,175,010	7,715,710	3,170,603	210,832	21,702,420
Loans and advances, net	18,510,868	8,512,155	14,462,172	965,048	–	42,450,243
Investment in an associate	–	–	–	–	72,209	72,209
Property and equipment, net	–	–	–	–	541,235	541,235
Other assets	–	–	–	–	1,490,741	1,490,741
Total assets	28,524,246	17,687,165	22,177,882	4,135,651	4,664,434	77,189,378
Liabilities and shareholders' equity						
Due to banks and other financial institutions	1,747,735	424,100	–	–	–	2,171,835
Customer deposits	53,482,406	5,481,172	294,064	–	–	59,257,642
Debt securities in issue	–	–	3,853,194	–	–	3,853,194
Borrowings	–	–	–	187,500	–	187,500
Other liabilities	–	–	–	–	2,314,608	2,314,608
Shareholders' equity	–	–	–	–	9,404,599	9,404,599
Total liabilities and shareholders' equity	55,230,141	5,905,272	4,147,258	187,500	11,719,207	77,189,378

Assets available to meet all of the liabilities and to cover outstanding loan commitments include cash, balances with SAMA, items in the course of collection; loans and advances to banks; and loans and advances to customers. The maturities of commitments and contingencies is given in note 18(d) of the financial statements.

34. Fair values of financial assets and liabilities

Fair value is the amount for which an asset could be exchanged or a liability settled between knowledgeable, willing parties in an arm's length transaction. Consequently, differences can arise between the carrying values and fair value estimates.

The fair values of on-balance sheet financial instruments, except for other investments held at amortised cost, held-to-maturity investments, loans and advances and customer deposits, are not significantly different from the carrying values included in the financial statements.

The estimated fair values of held-to-maturity investments and other investments held at amortised cost are based on quoted market prices, when available, or pricing models in the case of certain fixed rate bonds. The fair values of these investments are disclosed in note 5. It is not practicable to determine the fair value of loans and advances and customer deposits with sufficient reliability.

The fair values of derivatives and other off-balance-sheet financial instruments are based on the quoted market prices or by using the appropriate valuation technique. The total amount of the changes in fair value recognised in the statement of income, which was estimated using the valuation technique, is SAR 39.4 million (2006: SAR 7.3 million).

Notes to the Financial Statements (31 December 2007) (continued)**35. Related party transactions**

Managerial and specialised expertise is provided under a technical services agreement with the parent company of one of the shareholders, HSBC Holdings BV. This agreement was renewed on 30 September 2007 for a period of five years.

In the ordinary course of its activities, the Bank transacts business with related parties. In the opinion of the management and the Board, the related party transactions are performed on an arm's length basis. The related party transactions are governed by limits set by the Banking Control Law and the regulations issued by SAMA.

The year end balances included in the consolidated financial statements resulting from such transactions are as follows:

	<u>2007</u>	<u>2006</u>
	<u>SAR'000</u>	<u>SAR'000</u>
The HSBC Group:		
Due from banks and other financial institutions	744,086	2,433,918
Investments	733,238	622,635
Other assets	–	22,076
Derivatives (at fair value)	313,133	179,021
Due to banks and other financial institutions	3,792,098	986,599
Other liabilities	20,659	7,656
Commitments and contingencies	846,789	618,917

Above investments include investment in associates, amounting to SAR 110.4 million (2006: SAR 72.2 million).

Directors, audit committee, major shareholders and their affiliates:

Loans and advances	2,356,137	1,345,568
Customers' deposits	3,714,385	3,474,176
Derivatives (at fair value)	4,990	2,247
Commitments and contingencies	213,524	195,675

Shareholders who hold more than 5% of the Bank's share capital are classified as major shareholders.

Bank's mutual funds:

Investments	–	45,826
Loans and advances	43,494	10,701
Customers' deposits	607,314	1,316,218

Other major shareholders represent shareholdings (excluding the non-Saudi shareholder) of more than 5% of the Bank's issued share capital.

Income and expense pertaining to transactions with related parties included in the consolidated financial statements are as follows:

	<u>2007</u>	<u>2006</u>
	<u>SAR'000</u>	<u>SAR'000</u>
Special commission income	68,170	52,658
Special commission expense	(425,923)	(263,235)
Fees from banking services	11,575	6,849
Profit share arrangement relating to investment banking activities	(17,886)	(37,562)
Share in earnings of associates	57,947	52,209
Directors' remuneration	2,829	1,584

The total amount of compensation paid to key management personnel during the year is as follows:

Short-term employee benefits (salaries and allowances)	35,935	29,182
Employment termination benefits (end-of-service indemnity and social security)	5,130	6,460

35. Related party transactions (continued)

Key management personnel are those persons, including an executive director, having authority and responsibility for planning, directing and controlling the activities of the Bank, directly or indirectly.

The Bank offers share-based payment scheme arrangements to certain senior management and employees. There were two such schemes outstanding at 31 December 2007. The details of these schemes have not been separately disclosed in these consolidated financial statements as the amounts are not material.

36. Capital adequacy

The Bank's objectives when managing capital are to comply with the capital requirements set by SAMA; to safeguard the Bank's ability to continue as a going concern; and to maintain a strong capital base.

Capital adequacy and the use of regulatory capital are monitored daily by the Bank's management. SAMA requires the Bank to hold the minimum level of the regulatory capital and maintain a ratio of total regulatory capital to the risk-weighted asset at or above the agreed minimum of 8%.

The Bank monitors the adequacy of its capital using the methodology and ratios established by SAMA. These ratios measure capital adequacy by comparing the Bank's eligible capital with its balance sheet assets, commitments and contingencies, and the notional amount of derivatives at a weighted amount to reflect their relative risk.

	2007		2006	
	<i>Capital</i> SAR'000	<i>Ratio</i> %	<i>Capital</i> SAR'000	<i>Ratio</i> %
Tier 1	10,424,933	13.5	9,404,599	17.9
Tier 1 + Tier 2	10,478,432	13.5	9,552,271	18.2

Risk-weighted assets

	2007			2006		
	<i>Carrying value/notional amount</i> SAR'000	<i>Credit equivalent</i> SAR'000	<i>Risk weighted assets</i> SAR'000	<i>Carrying value/notional amount</i> SAR'000	<i>Credit equivalent</i> SAR'000	<i>Risk weighted assets</i> SAR'000
Balance sheet assets						
0%	25,281,561		–	24,182,796		–
20%	7,042,474		1,408,494	8,247,202		1,649,441
100%	65,888,875		65,888,875	44,759,380		44,753,704
Total	98,212,910		67,297,369	77,189,378		46,403,145
Commitments and contingencies						
0%	2,466,677	254,191	–	1,571,348	211,916	–
20%	3,176,587	1,338,952	267,791	2,816,319	1,273,349	254,670
100%	23,996,028	9,013,301	9,013,301	14,712,257	5,319,688	5,319,688
Total	29,639,292	10,606,444	9,281,092	19,099,924	6,804,953	5,574,358
Derivatives						
0%	903,339	–	–	2,812,447	–	–
20%	30,271,726	1,498,717	299,744	29,015,979	940,385	188,077
50%	21,597,723	982,447	491,223	9,796,292	466,064	233,032
Total	52,772,788	2,481,164	790,967	41,624,718	1,406,449	421,109
Total risk-weighted assets			77,369,428			52,398,612

Notes to the Financial Statements (31 December 2007) (continued)

37. Post balance sheet events

Basel II Framework

Effective 1 January 2008 as required by SAMA, the Bank plans to implement new Basel framework on capital adequacy, commonly known as Basel II Framework issued by the Basel Committee on banking supervision. This might change the capital adequacy ratios depicted in note 36.

38. Prospective changes in accounting standards

Certain new IFRS and IAS have been published in their final form and are mandatory for compliance for the Bank's accounting year beginning 1 January 2008, which the Bank has opted not to adopt earlier. These include:

IFRS 8 Operating Segments

IFRS 8 Operating Segments was issued by the IASB in November 2006, becoming effective for periods commencing on or after 1 January 2009. The new standard may require changes in the way the Bank discloses information about its operating segments.

Management do not expect these interpretations to have a significant impact on the Bank's consolidated financial statements when implemented in 2008.

IAS 1 Presentation of Financial Statements

The Bank has not adopted the revised IAS 1 "Presentation of Financial Statements" which will be effective for the year ending 31 December 2009. The application of this standard will result in amendment to the presentation of consolidated financial statements.

39. Comparative figures

Certain prior-year figures have been reclassified to conform with the current year's presentation.

40. Board of Directors' approval

The consolidated financial statements were approved by the Board of Directors on 14 Muharram 1429H (corresponding to 22 January 2008).

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Published by Corporate
Communications,
The Saudi British Bank, Riyadh.

Cover designed by Addison Corporate
Marketing Limited, London;
text pages designed by Group
Communications (Asia), The
Hong Kong and Shanghai Banking
Corporation Limited, Hong Kong.

Printed by
Al-Nasher Al-Arabi Printing Press
Riyadh, Saudi Arabia