

**The Saudi British Bank  
Consolidated Financial Statements**

**For the year ended**

**31 December 2007**

**CONSOLIDATED BALANCE SHEET**

**As at 31 December 2007 and 2006**

	Notes	2007 SAR'000	2006 SAR'000
<b>ASSETS</b>			
Cash and balances with SAMA	3	<b>16,643,746</b>	7,795,020
Due from banks and other financial institutions	4	<b>1,723,576</b>	3,137,510
Investments	5	<b>14,858,747</b>	21,702,420
Loans and advances, net	6	<b>62,000,858</b>	42,450,243
Investment in associates	7	<b>110,447</b>	72,209
Property and equipment, net	8	<b>551,840</b>	541,235
Other assets	9	<b>2,323,696</b>	1,490,741
<b>Total assets</b>		<b>98,212,910</b>	77,189,378
<b>LIABILITIES AND SHAREHOLDERS' EQUITY</b>			
<b>Liabilities</b>			
Due to banks and other financial institutions	11	<b>8,045,047</b>	2,171,835
Customers' deposits	12	<b>71,847,852</b>	59,257,642
Debt securities in issue	13	<b>4,038,367</b>	3,853,194
Borrowings	14	<b>187,500</b>	187,500
Other liabilities	15	<b>3,669,211</b>	2,314,608
<b>Total liabilities</b>		<b>87,787,977</b>	67,784,779
<b>Shareholders' equity</b>			
Share capital	16	<b>3,750,000</b>	3,750,000
Statutory reserve	17	<b>3,750,000</b>	3,750,000
Other reserves		<b>(16,220)</b>	70,385
Retained earnings		<b>2,050,528</b>	943,589
Proposed dividend	25	<b>890,625</b>	890,625
<b>Total shareholders' equity</b>		<b>10,424,933</b>	9,404,599
<b>Total liabilities and shareholders' equity</b>		<b>98,212,910</b>	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
<b>Net special commission income</b>		<b>3,058,697</b>	<b>2,583,822</b>
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
<b>Operating income</b>		<b>4,373,952</b>	<b>4,616,690</b>
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
<b>Operating expenses</b>		<b>1,824,960</b>	<b>1,628,619</b>
<b>Income from operating activities</b>		<b>2,548,992</b>	<b>2,988,071</b>
Share in earnings of associates, net	7	57,947	52,209
<b>Net income for the year</b>		<b>2,606,939</b>	<b>3,040,280</b>
<b>Basic and fully diluted earnings per share (in SAR)</b>	24	<b>6.95</b>	<b>8.11</b>

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**

		Share capital	Statutory reserve	Other reserves	Retained earnings	Proposed dividend	Total
	Notes	SAR '000	SAR '000	SAR '000	SAR '000	SAR '000	SAR '000
<b>2007</b>							
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 (note10)		-	-	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		3,750,000	3,750,000	(16,220)	2,050,528	890,625	10,424,933
<b>2006</b>							
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 (note10)		-	-	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		3,750,000	3,750,000	70,385	943,589	890,625	9,404,599

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

**The Saudi British Bank**
**CONSOLIDATED STATEMENT OF CASH FLOWS**
**For the years ended 31 December 2007 and 2006**

	Notes	2007 SAR'000	2006 SAR'000
<b>OPERATING ACTIVITIES</b>			
<b>Net income for the year</b>		<b>2,606,939</b>	3,040,280
<b>Adjustments to reconcile net income to net cash from operating activities:</b>			
(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)
		<b>3,209,276</b>	3,113,852
<b>Net (increase) decrease in operating assets:</b>			
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)
<b>Net increase (decrease) in operating liabilities:</b>			
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)
<b>Net cash from operating activities</b>		<b>1,374,992</b>	8,041,263
<b>INVESTING ACTIVITIES</b>			
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
<b>Net cash from (used in) investing activities</b>		<b>6,572,703</b>	(5,572,624)
<b>FINANCING ACTIVITIES</b>			
Debt securities in issue		-	1,604,480
Dividends paid		(1,484,751)	(878,097)
<b>Net cash (used in) from financing activities</b>		<b>(1,484,751)</b>	726,383
<b>Increase in cash and cash equivalents</b>		<b>6,462,944</b>	3,195,022
Cash and cash equivalents at the beginning of the year		8,583,113	5,388,091
<b>Cash and cash equivalents at the end of the year</b>	26	<b>15,046,057</b>	8,583,113
Special commission received during the year		5,201,815	4,380,737
Special commission paid during the year		2,137,319	1,841,861
<b>Supplemental non cash information</b>			
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.

**The Saudi British Bank**  
**NOTES TO THE CONSOLIDATED 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 Kingdom of Saudi Arabia). Activities of 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 that are 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 recognized 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.

**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 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, judgment by management is required in the estimation of the amount and timing of future cash flows when determining the level of provision required. Such estimates are based on assumptions about a number of factors and actual results may differ, resulting in future changes to the specific provision.

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.

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 recognized 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, recognized 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.

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 remeasuring 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 unamortized 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 on 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 recognized in the consolidated statement of income on the effective yield basis including premiums amortized 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 financial asset or liability.

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

Fees and commission are recognized 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 recognized as an adjustment to the effective yield on the loan. Portfolio and other management advisory and service fees are recognized based on the applicable service contract, usually on a time proportionate basis. Fee received on the asset management, wealth management, financial planning, custody services and other similar services that are provided in extended period of time are recognized rateably over the period when the service is being provided.

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 counter-party 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 as 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

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 recognized when the Bank enters into the contractual provisions of the arrangements with counterparties on trade date and derecognized 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 recognized in shareholders' equity is included in the consolidated statement of income for the period.

Equity investments classified under available-for-sale investments whose fair value cannot be reliably measured are carried at cost.

**(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 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 amortized 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 effective yield method.

**h) Investment in associates**

Investment in associate is accounted for using the equity method in accordance with International Accounting Standard 28 – Investment in Associates. An associate is an entity in which the Bank has significant influence and which is neither a subsidiary nor a joint venture.

Under the equity method, investment in associate is carried in the balance sheet at cost plus post investment changes in the Bank's share of net assets of the associate. The investments in associates are carried in balance sheet at the lower of equity accounted or recoverable amount.

The reporting dates of the associate and the Bank are identical and the associate's accounting policies conform to those used by the Bank for like transactions and events in similar circumstances.

Unrealised profits and losses resulting from transactions between the Bank and its associate are eliminated to the extent of the Bank's interest in the associate.

**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 is not ordinarily permissible.

The Banks 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 uncollectible, 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 recognized (such as an improvement in the debtor's credit rating), the previously recognized impairment loss is reversed by adjusting the allowance account. The amount of the reversal is recognized in the consolidated income statement in impairment charge for credit losses.

**i) Impairment of financial assets held at amortized 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.

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 uncollectible. 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 uncollectible, 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.

**l) 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.

**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 amortized 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.



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**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 expires.

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.

**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 shareholders 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**

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

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**

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

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**5. Investments**

**a) Investment securities are classified as follows:**

	<b>Domestic</b>		<b>International</b>		<b>Total</b>	
	<b>2007</b>	<b>2006</b>	<b>2007</b>	<b>2006</b>	<b>2007</b>	<b>2006</b>
	<b>SAR'000</b>	<b>SAR'000</b>	<b>SAR'000</b>	<b>SAR'000</b>	<b>SAR'000</b>	<b>SAR'000</b>
<b>i) Held as FVIS</b>						
Fixed rate securities	<b>80,914</b>	69,956	<b>18,637</b>	18,804	<b>99,551</b>	88,760
Floating rate securities	<b>82,716</b>	239,054	<b>194,396</b>	1,788,807	<b>277,112</b>	2,027,861
<b>Held as FVIS</b>	<b>163,630</b>	309,010	<b>213,033</b>	1,807,611	<b>376,663</b>	2,116,621

FVIS investments above includes investments 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	<b>973,925</b>	5,638,206	<b>2,586,360</b>	2,118,901	<b>3,560,285</b>	7,757,107
Floating rate securities	<b>2,014,750</b>	3,144,204	<b>2,553,873</b>	1,597,372	<b>4,568,623</b>	4,741,576
Equities	<b>99,798</b>	146,170	<b>31,249</b>	18,836	<b>131,047</b>	165,006
Other	-	45,826	-	-	-	45,826
<b>Available for sale investments</b>	<b>3,088,473</b>	8,974,406	<b>5,171,482</b>	3,735,109	<b>8,259,955</b>	12,709,515

**iii) Held at amortised cost**

Fixed rate securities	<b>4,492,077</b>	5,142,585	-	-	<b>4,492,077</b>	5,142,585
Floating rate securities	<b>1,221,000</b>	1,221,000	-	-	<b>1,221,000</b>	1,221,000
<b>Held at amortised cost</b>	<b>5,713,077</b>	6,363,585	-	-	<b>5,713,077</b>	6,363,585

**iv) Held to maturity**

Fixed rate securities	<b>509,052</b>	512,699	-	-	<b>509,052</b>	512,699
<b>Held to maturity investments</b>	<b>509,052</b>	512,699	-	-	<b>509,052</b>	512,699
<b>Investments</b>	<b>9,474,232</b>	16,159,700	<b>5,384,515</b>	5,542,720	<b>14,858,747</b>	21,702,420

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

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



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- 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 SAR'000				2006 SAR'000			
	Carrying value	Gross unrecognised gain	Gross unrecognised loss	Fair value	Carrying value	Gross unrecognised gain	Gross unrecognised loss	Fair value
<b>i) Held at amortised cost</b>								
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
<b>Total</b>	<b>5,713,077</b>	<b>154,545</b>		<b>5,867,622</b>	<b>6,363,585</b>	<b>97,146</b>	<b>(65,669)</b>	<b>6,395,062</b>
<b>(ii) Held to maturity</b>								
Fixed rate securities	509,052	22,077	-	531,129	512,699	12,433	(3,425)	521,707
<b>Total</b>	<b>509,052</b>	<b>22,077</b>		<b>531,129</b>	<b>512,699</b>	<b>12,433</b>	<b>(3,425)</b>	<b>521,707</b>

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

	2007 SAR'000	2006 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
<b>Total</b>	<b>14,858,747</b>	<b>21,702,420</b>

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 SAR'000	2006 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
<b>Total</b>	<b>14,858,747</b>	<b>21,702,420</b>

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

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

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

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**6. Loans and advances, net**

**a) Loans and advances are classified as follows:**

	<b>2007</b>			<b>SAR ' 000</b>
	<b>Credit Cards</b>	<b>Consumer Loans</b>	<b>Commercial Loans and Overdrafts</b>	<b>Total</b>
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
<b>Total loans and advances</b>	<b>1,852,463</b>	<b>11,084,908</b>	<b>49,634,535</b>	<b>62,571,906</b>
Allowance for impairment of credit losses (specific and collective)	(98,881)	(131,702)	(340,465)	(571,048)
<b>Loans and advances, net</b>	<b>1,753,582</b>	<b>10,953,206</b>	<b>49,294,070</b>	<b>62,000,858</b>

  

	<b>2006</b>			<b>SAR ' 000</b>
	<b>Credit Cards</b>	<b>Consumer Loans</b>	<b>Commercial Loans and Overdrafts</b>	<b>Total</b>
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
<b>Total loans and advances</b>	<b>1,372,877</b>	<b>9,882,376</b>	<b>31,692,670</b>	<b>42,947,923</b>
Allowance for impairment of credit losses (specific and collective)	(100,068)	(94,873)	(302,739)	(497,680)
<b>Loans and advances, net</b>	<b>1,272,809</b>	<b>9,787,503</b>	<b>31,389,931</b>	<b>42,450,243</b>

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**

	<b>2007</b>			<b>SAR, 000</b>
	<b>Credit Cards</b>	<b>Consumer Loans</b>	<b>Commercial Loans and Overdrafts</b>	<b>Total</b>
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)
<b>Balance at the end of the year</b>	<b>98,881</b>	<b>131,702</b>	<b>340,465</b>	<b>571,048</b>

  

	<b>2006</b>			<b>SAR, 000</b>
	<b>Credit Cards</b>	<b>Consumer Loans</b>	<b>Commercial Loans and Overdrafts</b>	<b>Total</b>
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)
<b>Balance at the end of the year</b>	<b>100,068</b>	<b>94,873</b>	<b>302,739</b>	<b>497,680</b>

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.

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

  

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

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

2007 SAR'000	Performing	Non performing, net	Credit loss provision	Loans and advances, net
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)
<b>TOTAL</b>	<b>62,374,816</b>	<b>197,090</b>	<b>(571,048)</b>	<b>62,000,858</b>

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

2006 SAR'000	Performing	Non performing, net	Credit loss provision	Loans and advances, net
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)
<b>TOTAL</b>	<b>42,782,825</b>	<b>165,098</b>	<b>(497,680)</b>	<b>42,450,243</b>

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 hold 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.

**e) Neither past due nor impaired loans**

	2007			SAR,000
	Credit Cards	Consumer Loans	Commercial Loans	Total
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
<b>Total</b>	<b>1,772,219</b>	<b>10,916,582</b>	<b>49,686,015</b>	<b>62,374,816</b>

  

	2006			SAR,000
	Credit Cards	Consumer Loans	Commercial Loans	Total
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
<b>Total</b>	<b>1,372,877</b>	<b>9,862,385</b>	<b>31,547,563</b>	<b>42,782,825</b>

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**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		
	HSBC Saudi Arabia Limited	SABB Takaful	Total	HSBC Saudi Arabia Limited	SABB Takaful	Total
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
<b>Total</b>	<b>90,411</b>	<b>20,036</b>	<b>110,447</b>	<b>72,209</b>	<b>-</b>	<b>72,209</b>

	2007		2006	
Share of the associate's financial statements:	HSBC Saudi Arabia Limited	SABB Takaful	HSBC Saudi Arabia Limited	SABB Takaful
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	-

**8. Property and equipment, net**

	Land and Buildings SAR'000	Leasehold improvements SAR'000	Equipment, furniture and vehicles SAR'000	2007 Total SAR'000	2006 Total SAR'000
<b>Cost</b>					
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)
<b>As at 31 December</b>	<b>586,331</b>	<b>253,276</b>	<b>540,896</b>	<b>1,380,503</b>	<b>1,339,250</b>
<b>Accumulated depreciation</b>					
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)
<b>As at 31 December</b>	<b>258,556</b>	<b>179,307</b>	<b>390,800</b>	<b>828,663</b>	<b>798,015</b>
<b>Net book value</b>					
<b>As at 31 December 2007</b>	<b>327,775</b>	<b>73,969</b>	<b>150,096</b>	<b>551,840</b>	
As at 31 December 2006	347,567	60,121	133,547		541,235

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 55.8million), SAR 29.0 million (2006: SAR 10.8 million) and SAR nil million (2006 SAR 6.7 million), respectively.

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**9. Other assets**

	<b>2007</b>	2006
	<b>SAR'000</b>	SAR'000
Accrued special commission receivable – banks and other financial institutions	<b>1,477</b>	3,225
– investments	<b>220,787</b>	221,359
– loans and advances	<b>579,998</b>	469,432
Total accrued special commission receivable	<b>802,262</b>	694,016
Accounts receivable	<b>198,186</b>	128,306
Other real estate	<b>12,929</b>	13,449
Positive fair value of derivatives (note10)	<b>983,432</b>	337,704
Advance tax	<b>184,451</b>	153,422
Other	<b>142,436</b>	163,844
<b>Total</b>	<b>2,323,696</b>	1,490,741

**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.

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**

<b>2007</b>	<b>Positive</b>	<b>Negative</b>	<b>Notional</b>	<b>Within 3</b>	<b>3-12</b>	<b>1-5</b>	<b>Over 5</b>	<b>Monthly</b>
<b>SAR'000</b>	<b>fair</b>	<b>fair</b>	<b>amount</b>	<b>months</b>	<b>months</b>	<b>years</b>	<b>years</b>	<b>average</b>
	<b>value</b>	<b>value</b>	<b>total</b>					
<b>Derivatives held for trading:</b>								
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
<b>Derivatives held as fair value hedges:</b>								
Special commission rate swaps	17,696	(13,278)	1,524,591	224,000	74,327	743,014	483,250	2,153,311
<b>Derivatives held as cash flow hedges:</b>								
Special commission rate swaps	10,231	(2,990)	1,021,250	100,000	190,000	731,250	-	749,896
<b>Total</b>	<b>983,432</b>	<b>(608,278)</b>	<b>52,772,788</b>	<b>8,497,840</b>	<b>6,713,365</b>	<b>10,466,185</b>	<b>27,095,398</b>	

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	Positive fair value	Negative fair value	Notional amount total	Within 3 months	3-12 months	1-5 years	Over 5 years	Monthly average
2006 SAR'000								
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.

2007 (SAR'000)	Fair value	Hedge inception value	Risk	Hedging instrument	Positive fair value	Negative fair value
<b>Description of the hedged items:</b>						
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)

2006 (SAR'000)	Fair value	Hedge inception value	Risk	Hedging instrument	Positive fair value	Negative fair value
<b>Description of the hedged items:</b>						
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 item 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 SAR' 000	2006 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	-
<b>Balance at end of the year</b>	<b>7,752</b>	<b>2,159</b>

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



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**11. Due to banks and other financial institutions**

	<b>2007</b>	2006
	<b>SAR'000</b>	SAR'000
Current accounts	<b>2,161,736</b>	965,132
Money market deposits	<b>5,883,311</b>	1,206,703
<b>Total</b>	<b>8,045,047</b>	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**

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

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:

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

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**13. Debt securities in issue**

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

**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 US\$ 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.

**15. Other liabilities**

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

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**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	<b>60%</b>	60%
HSBC Holdings BV (a wholly owned subsidiary of HSBC Holdings plc)	<b>40%</b>	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 capitalization 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 million (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 (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 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 the 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.

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

<b>2007 SAR'000</b>	<b>Within 3 months</b>	<b>3-12 months</b>	<b>1-5 years</b>	<b>Over 5 years</b>	<b>Total</b>
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
<b>Total</b>	<b>12,362,174</b>	<b>10,134,612</b>	<b>7,119,204</b>	<b>23,302</b>	<b>29,639,292</b>

  

<b>2006 SAR'000</b>	<b>Within 3 months</b>	<b>3-12 months</b>	<b>1-5 years</b>	<b>Over 5 years</b>	<b>Total</b>
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
<b>Total</b>	<b>8,900,375</b>	<b>6,887,173</b>	<b>3,267,804</b>	<b>44,572</b>	<b>19,099,924</b>

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:

	<b>2007 SAR'000</b>	<b>2006 SAR'000</b>
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
<b>Total</b>	<b>29,639,292</b>	<b>19,099,924</b>

- f) **Operating lease commitments**

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

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

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**19. Net special commission income**

	2007 SAR'000	2006 SAR'000
<b>Special commission income</b>		
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
	<u>854,810</u>	<u>782,991</u>
Due from banks and other financial institutions	620,209	556,308
Loans and advances	<u>3,744,936</u>	<u>3,097,422</u>
<b>Total</b>	<u>5,219,955</u>	<u>4,436,721</u>
<b>Special commission expense</b>		
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
<b>Total</b>	<u>2,161,258</u>	<u>1,852,899</u>
<b>Net special commission income</b>	<u>3,058,697</u>	<u>2,583,822</u>

**20. Fees from banking services, net**

	2007 SAR'000	2006 SAR'000
<b>Fees income:</b>		
- 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
<b>Total fees income</b>	<u>968,563</u>	<u>1,703,754</u>
<b>Fees expense:</b>		
- Cards	(28,008)	(17,478)
- Custodial services	(840)	(712)
- Other banking services	(77,791)	(35,081)
<b>Total fees expense</b>	<u>(106,639)</u>	<u>(53,271)</u>
<b>Fees from banking services, net</b>	<u>861,924</u>	<u>1,650,483</u>

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**21. Income from FVIS financial instruments, net**

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

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**

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

**23. Gains on non-trading investments, net**

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

**24. Basic and fully diluted earnings per share**

Basic earnings per share for the year 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.

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**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:

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

**27. Business segments**

The Bank's primary segment reporting format is determined to be 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 banks primary business is conducted in 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.

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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:

<b>2007</b> <b>SAR'000</b>	<b>Retail</b> <b>Banking</b>	<b>Corporate</b> <b>Banking</b>	<b>Treasury</b>	<b>Others</b>	<b>Total</b>
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

<b>2006</b> <b>SAR'000</b>	<b>Retail</b> <b>Banking</b>	<b>Corporate</b> <b>Banking</b>	<b>Treasury</b>	<b>Others</b>	<b>Total</b>
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:**

<b>2007</b> <b>SAR'000</b>	<b>Retail</b> <b>Banking</b>	<b>Corporate</b> <b>Banking</b>	<b>Treasury</b>	<b>Total</b>
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
<b>Total</b>	<b>20,731,575</b>	<b>51,986,176</b>	<b>34,959,623</b>	<b>107,677,374</b>

<b>2006</b> <b>SAR'000</b>	<b>Retail</b> <b>Banking</b>	<b>Corporate</b> <b>Banking</b>	<b>Treasury</b>	<b>Total</b>
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
<b>Total</b>	<b>16,037,695</b>	<b>33,289,711</b>	<b>33,407,823</b>	<b>82,735,229</b>

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.



## **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 to 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 fulfill 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. The information on Banks maximum credit exposure by business segment is given in note 27. The information on maximum credit risk exposure and their relative risk weights is also provided in 36.

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

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

<b>2007 SAR'000</b>	<b>Kingdom of Saudi Arabia</b>	<b>GCC and Middle East</b>	<b>Europe</b>	<b>North America</b>	<b>Other countries</b>	<b>Total</b>
<b>Assets</b>						
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
<b>Total</b>	<b>88,474,556</b>	<b>1,374,425</b>	<b>2,582,180</b>	<b>2,639,751</b>	<b>266,462</b>	<b>95,337,374</b>
<b>Liabilities</b>						
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
<b>Total</b>	<b>75,058,729</b>	<b>2,333,385</b>	<b>5,601,119</b>	<b>1,034,235</b>	<b>91,298</b>	<b>84,118,766</b>
<b>Commitments and contingencies</b>	<b>28,167,099</b>	<b>370,946</b>	<b>347,001</b>	<b>27,662</b>	<b>726,584</b>	<b>29,639,292</b>
<b>Credit exposure (stated at credit equivalent amounts)</b>						
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
<b>Total credit exposure</b>	<b>99,241,245</b>	<b>1,476,698</b>	<b>3,484,892</b>	<b>2,961,757</b>	<b>512,782</b>	<b>107,677,374</b>

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2006 SAR'000	Kingdom of Saudi Arabia	GCC and Middle East	Europe	North America	Other countries	Total
<b>Assets</b>						
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
<b>Total</b>	<b>66,841,483</b>	<b>714,865</b>	<b>3,487,579</b>	<b>3,815,163</b>	<b>298,312</b>	<b>75,157,402</b>
<b>Liabilities</b>						
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
<b>Total</b>	<b>60,061,916</b>	<b>226,605</b>	<b>4,217,327</b>	<b>720,035</b>	<b>244,288</b>	<b>65,470,171</b>
Commitments and contingencies	17,990,187	257,425	335,115	46,149	471,048	19,099,924
<b>Credit exposure (stated at credit equivalent amounts)</b>						
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
<b>Total credit exposure</b>	<b>73,060,906</b>	<b>806,513</b>	<b>4,341,581</b>	<b>4,023,338</b>	<b>502,891</b>	<b>82,735,229</b>

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.

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 VAR figure should occur, on average, not more than once every hundred days.

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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 Banks ALCO committee for their review.

The Bank's VaR related information is as under.

	2007		SAR'000
	Foreign Exchange	Special commission Rate	Total
VAR as at 31December 2007	649	405	694
Average VAR for 2007	486	514	791
	2006		SAR'000
	Foreign Exchange	Special commission Rate	Total
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 December 31, 2007 for the effect of assumed changes in commission rates. The sensitivity of equity is analyzed by maturity of the asset or swap.

Currency	Increase in basis	Sensitivity of Income	2007				SAR' 000
			Sensitivity of Equity				Total
			6months or less	1 year or less	1-5 years or less	Over 5 years	
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	-	-	-	-	-

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		2007		SAR '000			
Currency	Decrease in basis	Sensitivity of Income	Sensitivity of Equity				Total
			6months or less	1 year or less	1-5 years or less	Over 5 years	
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		SAR '000			
Currency	Increase in basis	Sensitivity of Income	Sensitivity of Equity				Total
			6months or less	1 year or less	1-5 years or less	Over 5 years	
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		SAR, 000			
Currency	Decrease in basis	Sensitivity of Income	Sensitivity of Equity				Total
			6months or less	1 year or less	1-5 years or less	Over 5 years	
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 SAR'000 Long (short)	2006 SAR'000 Long (short)
US Dollar	135,444	(681,345)
Euro	6,154	(600)
Sterling Pounds	(728)	176
Other	14,751	8,419

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**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.

<b>2007 SAR'000</b>	<b>Within 3 months</b>	<b>3-12 months</b>	<b>1-5 years</b>	<b>Over 5 years</b>	<b>Non special commission bearing</b>	<b>Total</b>	<b>Effective Commission rate %</b>
<b>Assets</b>							
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	
<b>Total assets</b>	<b>53,808,917</b>	<b>11,725,353</b>	<b>22,302,938</b>	<b>1,735,138</b>	<b>8,640,564</b>	<b>98,212,910</b>	
<b>Liabilities and shareholders' equity</b>							
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	
<b>Total liabilities and shareholders' equity</b>	<b>39,194,140</b>	<b>8,010,676</b>	<b>3,889,928</b>	<b>187,500</b>	<b>46,930,666</b>	<b>98,212,910</b>	
<b>On balance sheet gap</b>	<b>14,614,777</b>	<b>3,714,677</b>	<b>18,413,010</b>	<b>1,547,638</b>	<b>(38,290,102)</b>	<b>-</b>	
<b>Off balance sheet gap</b>	<b>111,333</b>	<b>1,356,569</b>	<b>(238,478)</b>	<b>(1,229,424)</b>	<b>-</b>	<b>-</b>	
<b>Total special commission rate sensitivity gap</b>	<b>14,726,110</b>	<b>5,071,246</b>	<b>18,174,532</b>	<b>318,214</b>	<b>(38,290,102)</b>	<b>-</b>	
<b>Cumulative special commission rate sensitivity gap</b>	<b>14,726,110</b>	<b>19,797,356</b>	<b>37,971,888</b>	<b>38,290,102</b>	<b>-</b>	<b>-</b>	

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2006 SAR'000	Within 3 months	3-12 months	1-5 years	Over 5 years	Non special commission bearing	Total	Effective commission rate %
<b>Assets</b>							
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	-
<b>Total assets</b>	<b>34,700,847</b>	<b>14,327,607</b>	<b>19,575,016</b>	<b>2,093,948</b>	<b>6,491,960</b>	<b>77,189,378</b>	<b>-</b>
<b>Liabilities and shareholders' equity</b>							
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	-
<b>Total liabilities and shareholders' equity</b>	<b>37,179,512</b>	<b>5,130,735</b>	<b>813,748</b>	<b>187,500</b>	<b>33,877,883</b>	<b>77,189,378</b>	<b>-</b>
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, maintaining 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.

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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 :**

<b>2007 SAR'000</b>	<b>Within 3 months</b>	<b>3-12 months</b>	<b>1-5 years</b>	<b>Over 5 years</b>	<b>Total</b>
<b>Financial Liabilities</b>					
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
<u>Derivatives :</u>					
- 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)
<b>Total undiscounted financial liabilities</b>	<b>67,980,359</b>	<b>9,210,757</b>	<b>7,789,308</b>	<b>152,167</b>	<b>85,132,591</b>
<hr/>					
<b>2006 SAR'000</b>	<b>Within 3 months</b>	<b>3-12 months</b>	<b>1-5 years</b>	<b>Over 5 years</b>	<b>Total</b>
<b>Financial Liabilities</b>					
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)
<b>Total undiscounted financial liabilities</b>	<b>55,539,627</b>	<b>6,299,252</b>	<b>4,837,404</b>	<b>198,961</b>	<b>66,875,244</b>

**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.



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<b>2007 SAR'000</b>	<b>Within 3 months</b>	<b>3-12 months</b>	<b>1-5 Years</b>	<b>Over 5 years</b>	<b>No fixed maturity</b>	<b>Total</b>
<b>Assets</b>						
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
<b>Total assets</b>	<b>45,253,545</b>	<b>12,305,697</b>	<b>22,614,879</b>	<b>11,488,108</b>	<b>6,550,681</b>	<b>98,212,910</b>
<b>Liabilities and shareholders' equity</b>						
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
<b>Total liabilities and shareholders' equity</b>	<b>67,633,430</b>	<b>8,720,057</b>	<b>5,782,027</b>	<b>1,983,252</b>	<b>14,094,144</b>	<b>98,212,910</b>
<b>2006 SAR'000</b>						
	<b>Within 3 months</b>	<b>3-12 months</b>	<b>1-5 Years</b>	<b>Over 5 years</b>	<b>No fixed maturity</b>	<b>Total</b>
<b>Assets</b>						
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
<b>Total assets</b>	<b>28,524,246</b>	<b>17,687,165</b>	<b>22,177,882</b>	<b>4,135,651</b>	<b>4,664,434</b>	<b>77,189,378</b>
<b>Liabilities and shareholders' equity</b>						
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
<b>Total liabilities and shareholders' equity</b>	<b>55,230,141</b>	<b>5,905,272</b>	<b>4,147,258</b>	<b>187,500</b>	<b>11,719,207</b>	<b>77,189,378</b>

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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 valuation technique, is SAR 39.4 million (2006: SAR 7.3 million).

**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:

	<b>2007</b>	<b>2006</b>
	<b>SAR'000</b>	<b>SAR'000</b>
<b>The HSBC Group:</b>		
Due from banks and other financial institutions	<b>744,086</b>	2,433,918
Investments	<b>733,238</b>	622,635
Other assets	-	22,076
Derivatives (at fair value)	<b>313,133</b>	179,021
Due to banks and other financial institutions	<b>3,792,098</b>	986,599
Other liabilities	<b>20,659</b>	7,656
Commitments and contingencies	<b>846,789</b>	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	<b>2,356,137</b>	1,345,568
Customers' deposits	<b>3,714,385</b>	3,474,176
Derivatives (at fair value)	<b>4,990</b>	2,247
Commitments and contingencies	<b>213,524</b>	195,675

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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	<b>43,494</b>	10,701
Customers' deposits	<b>607,314</b>	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:

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

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

	<b>2007</b> <b>SAR'000</b>	2006 SAR'000
Short-term employee benefits (Salaries and allowances)	<b>35,935</b>	29,182
Employment termination benefits (End of service indemnity and social security)	<b>5,130</b>	6,460

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 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 to hold the minimum level of the regulatory capital of 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 notional amount of derivatives at a weighted amount to reflect their relative risk.

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

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	<u>Risk weighted assets</u>					
	2007 SAR'000			2006 SAR'000		
	Carrying value/ notional amount	Credit equivalent	Risk weighted assets	Carrying value/ notional amount	Credit equivalent	Risk weighted assets
<b>Balance sheet assets</b>						
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
<b>Total</b>	<b>98,212,910</b>		<b>67,297,369</b>	<b>77,189,378</b>		<b>46,403,145</b>
<b>Commitments and contingencies</b>						
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
<b>Total</b>	<b>29,639,292</b>	<b>10,606,444</b>	<b>9,281,092</b>	<b>19,099,924</b>	<b>6,804,953</b>	<b>5,574,358</b>
<b>Derivatives</b>						
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
<b>Total</b>	<b>52,772,788</b>	<b>2,481,164</b>	<b>790,967</b>	<b>41,624,718</b>	<b>1,406,449</b>	<b>421,109</b>
<b>Total risk weighted assets</b>			<b>77,369,428</b>			<b>52,398,612</b>

**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 this 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.

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**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 22 January 2008).