The Saudi British Bank

Annual Report and Accounts 2011

SABB ساب

Table of Contents

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

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بسم الله الرحمن الرحيم

Custodian of The Two Holy Mosques

King Abdullah Bin Abdulaziz Al Saud

His Royal Highness

Prince Naif bin Abdulaziz Al Saud,

Crown Prince, Deputy Prime Minister and Minister of Interior

Board of Directors

Chairman
Khaled Suliman Olayan

Fouad Abdulwahab Bahrawi

Sulaiman Abdulkader Al Muhaidib

Zarir J. Cama

Mohammed Omran Al Omran

Simon Cooper

Khalid Abdullah Al Molhem

David Dew

Mohammed Abdulrehman Al Samhan

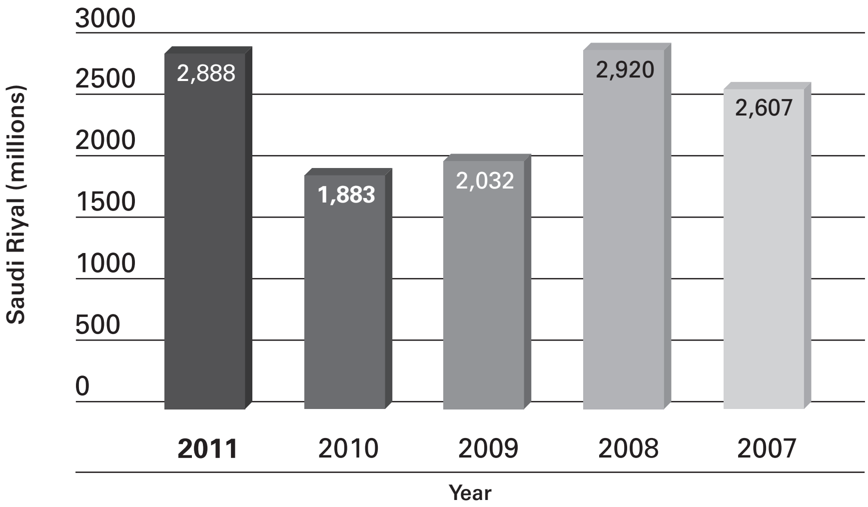
Mohammad Mazyed Al Tuwaijri

Financial Highlights

Five-year financial highlights

	Year				
Saudi Riyal (millions)	**2011**	2010	2009	2008	2007
Customer Deposits	**105,577**	94,673	89,187	92,678	71,848
Shareholders' Equity	**17,166**	15,172	13,045	11,634	10,425
Investments, Net	**22,200**	24,972	23,818	29,604	14,859
Loans and Advances, Net	**84,811**	74,248	76,382	80,237	62,001
Total Assets	**138,658**	125,373	126,838	131,661	98,213
Net Income	**2,888**	1,883	2,032	2,920	2,607
Gross Dividend	**563**	563	660	660	1,500

Net income



Chairman's Statement

On behalf of the Board of Directors it gives me great pleasure to present the Annual Report of SABB for the financial year ending 31December 2011.

In 2011, SABB raised its net profits by 53.4 per cent from SAR1,883 million to SAR2,888 million. Such an achievement reflects the Bank's strong income streams and its on-going efforts to reduce operational and administrative expenditure allied to a decreased level of provision for credit losses. As successful as SABB has been in 2010, sustained efforts continue to be exerted to further strengthen the Bank's core business by continuing to develop and introduce new products and services supported by the latest banking technology. This led us to recommend to the Shareholders General Meeting, to increase the Bank's capital from SAR7.5 billion, to SAR10 billion.

On the basis of the declared results the Board of Directors proposes a total dividend of 75 halalah per share, which equates to a total of SAR562.5 million, for the financial year 2011 and a net dividend of 65 halalah per share after the deduction of Zakat payable by local shareholders. Shareholders' approval for the dividend will be sought at the Extra-ordinary General Meeting.

Generally, the Bank succeeded in achieving its results through concerted efforts by all areas of the Bank and its commitment to the implementation of its strategic and operational plans.

Corporate and Commercial Banking have both seen their business grow in 2011, further strengthening their position in the local marketplace. A prime element in this has been the leveraging of SABB's relationship with HSBC in support of Saudi companies in overseas markets and international companies fulfilling assignments in the Kingdom.

Retail Banking and Wealth Management remains strong, especially under the Amanah banner. The Bank's distinctive product offerings to high net worth individuals continue to be successful, especially given expansion of its "Amanah" propositions that provides larger segments of customers with quality banking services in Saudi market.

Treasury and Private Banking also made good contributions to the Bank's overall results, as did Income from Associates, primarily from HSBC Saudi Arabia.

In an effort to emphasize the principles of good governance and adopt professional and ethical standards in all the Bank's transactions, and deepen the elements of transparency and disclosure, the Board of Directors during 2011, approved the "Corporate Governance Policy" in accordance with the requirements contained in the "Corporate Governance List" issued by the Capital Market Authority and the draft principles of corporate governance issued by the Saudi Arabian Monetary Agency. The Bank is also committed in letter and spirit to all applicable mandatory rules and guidelines, included in the list of corporate governance issued by the Capital Market Authority.

Also during the year, SABB has implemented numerous initiatives under the banner of "SABB in the Community", specifically in the fields of education, environment, health and community services, thus emphasising the Bank's corporate social responsibility. The Bank participated in the "Leave No Trace" programme that seeks to raise awareness of eco-tourism; assisted in the rehabilitation of houses damaged by the floods in Jeddah; and co-operated with a number of charitable associations supporting the deaf, the disabled and the disadvantaged. SABB also sponsored scientific research and activities conducted by the Faculty of Geology in King Fahd University of Petroleum and Mineral (KFUPM).

Finally, on behalf of the Board of Directors, it is my pleasure to extend our sincere thanks to the Bank's shareholders for their loyalty; our deep appreciation to all members of the Bank's staff, whose efforts have been wholly integral to the successful pursuit of business over the past twelve months; and to voice immense gratitude to all the Bank's customers for their confidence and support. Considerable thanks are due also to the Saudi government, specifically the Ministries of Finance, Commerce and Industry, as well as the Saudi Arabian Monetary Agency, and to the Capital Market Authority, for their continued guidance and assistance to the Saudi banking and financial communities. On behalf of SABB as a leading member of that community, I confirm our commitment to the ongoing growth and development of Saudi Arabia under the leadership of the Custodian of the Two Holy Mosques and the Crown Prince.

Khaled Suliman Olayan

Directors' Report

The Board of Directors is pleased to submit to shareholders the Annual Report of SABB for the financial year ending 31st December 2011.

Introduction

The Saudi British Bank (the 'Bank'), a Saudi Joint Stock Company, was established by Royal Decree No. M/4 dated 12 Safar 1398H (21 January 1978G) and is an associate of the HSBC Group. The objectives of the Bank are to provide a complete range of banking products and services to both retail and corporate sectors Kingdom-wide, including traditional banking products such as current and saving accounts, time deposits, finances and personal and housing loans, trade finance, cash management, treasury and card business. The Bank also provides non-interest bearing products, which are approved and supervised by an independent Shariah Board.

SABB has a 100% (2010 : 100%) ownership interest amounting to SAR 250 Million in the capital of a subsidiary, SABB Securities Limited, a Limited Liability Company formed in accordance with the Capital Market Authority's Resolution No. 2007-35-7 dated 10 Jumada II 1428H (25 June 2007) and was registered and operates in the Kingdom of Saudi Arabia under commercial registration No. 1010235982 dated 8 Rajab 1428H (22 July 2007). SABB has a 98% direct and a 2% indirect ownership interest in its subsidiary (the indirect ownership is held via a Limited Liability Company registered in the Kingdom of Saudi Arabia). The principal activities of the subsidiary are to engage in the business of custody and dealing as an agent excluding underwriting. However, effective 1 July 2011 the assets and liabilities of the Company have been transferred to HSBC Saudi Arabia Limited, an associate company of SABB in lieu of additional shares. The Company will be liquidated once the legal formalities for transfer of the business have been completed.

SABB has a 100% (2010 : 100%) ownership interest amounting to SAR 500,000 in the capital of a subsidiary, SABB Insurance Agency Company Limited, a Limited Liability Company registered in the Kingdom of Saudi Arabia under commercial registration No. 1010235187 dated 18 Jumada II 1428H (3 July 2007). SABB has a 98% direct and a 2% indirect ownership interest in its subsidiary (the indirect ownership is held via a Limited Liability Company that was registered and operates in the Kingdom of Saudi Arabia). The principal activity of the subsidiary is to act as a sole insurance agent for SABB Takaful Company within the Kingdom of Saudi Arabia as per the agreement between them. However, the articles of association do not restrict the Company from acting as an agent to any other insurance company in the Kingdom of Saudi Arabia.

SABB has a 51% (2010 : 51%) ownership interest amounting to SAR 3 Million in the capital of a subsidiary, SABB Insurance Services Limited, a Limited Liability Company that was registered and operates in the Kingdom of Saudi Arabia under commercial registration number 1010241209 dated 24 Dhul Qadah 1428H (4 December 2007). The principal activity of the subsidiary is to act as insurance brokers and consultants to consumers operating within the Kingdom of Saudi Arabia. The Company commenced operations on 24 Dhul Qadah 1428H (4 December 2007). SABB is in the process of selling its entire investment in SABB Insurance Services Limited to Marsh Saudi Arabia. The transaction is expected to be completed in the first quarter of 2012.

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

Five-year financial highlights

	Year				
Saudi Riyal (millions)	**2011**	2010	2009	2008	2007
Customer Deposits	**105,577**	94,673	89,187	92,678	71,848
Shareholders' Equity	**17,166**	15,172	13,045	11,634	10,425
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Net Income	**2,888**	1,883	2,032	2,920	2,607
Gross Dividend	**563**	563	660	660	1,500

Five-year financial highlights *(continued)*

Geographical Analysis of Income

The Bank generates the majority of its operating income from its activities in the Kingdom of Saudi Arabia and has no branches, subsidiaries or associates outside the Kingdom of Saudi Arabia. The following table shows the distribution of operating income in accordance with the geographical classification of the Kingdom's regions.

Saudi Riyal millions

Year	Central Province	Western Province	Eastern Province
2011	3,166	957	776

Main Business Segments/Sectors

The Bank is organized into the following main business Segments/Sectors:

Retail Banking and Wealth Management - which caters mainly to the banking requirements of personal and private banking customers including deposits, current and savings accounts, personal finances and credit cards.

Corporate Banking - which caters mainly to the banking requirements of commercial and corporate banking customers including deposits, current accounts, loans, finances and other credit facilities.

Treasury - which caters mainly to capital markets, foreign currency transactions and trading in financial derivatives. This section also caters to management of 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 statement of financial position.

Others - includes activities of SABB Securities Limited and investment in associates.

Transactions between the business segments and sectors are reported as recorded by the Bank's transfer pricing system. The Bank's total operating income and expenses and the results for the year ended 31 December 2011, by business segments, are as follows:

2011 **SAR '000**	Retail Banking and Wealth Management	Corporate Banking	Treasury	Other	Total
Total Operating Income	**1,396,914**	**2,370,371**	**1,029,286**	**102,020**	**4,898,591**
Total Operating Expenses	**937,036**	**987,132**	**94,331**	**55,822**	**2,074,321**
Share in Earnings of Associates, Net	**-**	**-**	**-**	**64,165**	**64,165**
Net Income	**459,878**	**1,383,239**	**934,955**	**110,363**	**2,888,435**

The bank's share in earnings of associates represents shares in the profits of the following companies:

HSBC Saudi Arabia Limited

HSBC Saudi Arabia Limited is involved in investment banking services in addition to being engaged in the business of custody and dealing as an agent excluding underwriting in the Kingdom of Saudi Arabia. During the year the assets and liabilities of SABB Securities Limited, a wholly owned subsidiary of SABB, have been transferred to HSBC Saudi Arabia Limited effective 1 July 2011, resulting in an increased shareholding of SABB in HSBC Saudi Arabia Limited from 40% to 51%. However, the share transfer will only take place when the legal formalities are completed. The Bank is not consolidating HSBC Saudi Arabia Limited as it does not have the power to govern the financial and operating policies of HSBC Saudi Arabia Limited.

Directors' Report (continued)

Five-year financial highlights *(continued)*

SABB Securities Limited

SABB has 100% (2010: 100%) ownership interest in a subsidiary, SABB Securities Limited, a Saudi limited liability company formed in accordance with Capital Market Authority's Resolution No. 2007-35-7 dated 10 Jumada II 1428H (25 June 2007) and registered in the Kingdom of Saudi Arabia under Commercial Registration No. 1010235982 dated 8 Rajab 1428H (22 July 2007). SABB has 98% direct and 2% indirect ownership interest in its subsidiary (the indirect ownership is held via a limited liability company registered in the Kingdom of Saudi Arabia). The principal activities of the subsidiary were to engage in the business of custody and dealing as an agent excluding underwriting. However, effective 1 July 2011 the assets and liabilities of the Company have been transferred to HSBC Saudi Arabia Limited, an associate company of SABB in lieu of additional shares (see note 7 of the notes to the consolidated financial statement). The Company will be liquidated once the legal formalities for transfer of business have been completed.

SABB Takaful

A Saudi joint-stock company listed on the Saudi Capital Market (Tadawul). The Bank owns 32.5% of the company's capital which amounts to SAR 340 Million and comprises 34 million shares of SAR 10 each. The company offers Shariah-compliant insurance services including family and general Takaful products.

Profits

The Bank's profit increased in the year 2011 to SAR 2,888 million, up SAR 1,005 million or 53.4 per cent compared with SAR 1,883 million for the same period in 2010. This was mainly due to a decrease in the provision for credit losses of SAR 758 million and a decrease in other general and administrative expenses of SAR 163 million. Earnings per share amounted to SAR 3.85 compared with SAR 2.51 per share in 2010. Total assets during 2011 increased to SAR138.7 billion, an increase of SAR13.3 billion or 10.6 per cent, compared with SAR125.4 billion at the end of the previous year. Customer deposits increased to SAR105.6 billion, an increase of SAR 10.9 billion or 11.5 per cent compared with SAR94.7 billion at the end of 2010. Loans and advances to customers as at 31 December 2011 of SAR84.8 billion as compared to SAR74.2 billion in 2010 were SAR10.6 billion or 14.3 per cent higher. Investments decreased by 11.2 per cent or SAR2.8 billion to SAR22.2 billion as at 31 December 2011 from SAR25.0 billion at the end of 2010.

Cash Dividends and Bonus Share Issue

In accordance with the Bank's Articles of Association, the Bank's dividend distribution policy is in compliance with the provisions of the Banking Control Law. The annual net income of the Bank is distributed as follows:

1. Amounts for payment of Zakat payable by Saudi shareholders and the tax payable by the non-Saudi partner, will be calculated and allocated in line with the rules and regulations in force in the Kingdom of Saudi Arabia. The Bank will pay such amounts from the net income distributed to these parties.
2. 25% of the net income is transferred to statutory reserves until this reserve equals at least the paid up share capital of the Bank.
3. Based on the recommendation of the Board of Directors dividends will be paid to shareholders in accordance with the number of shares held.
4. Undistributed net income is carried forward as retained earnings or transferred to statutory reserve.

The distributable profits proposed for 2011 amounting to 65 halalas per share after deduction of Zakat for local shareholders will be presented at the Extra-Ordinary General Meeting, scheduled for 13 March 2012, for endorsement and approval. However, the Board of Directors have recommended the distribution of profits as follows:

	SAR '000
Net Income 2011	2,888,435
Retained earnings from the previous year	1,544,613
Total	4,433,048
Distributed as follows:	
Transferred to statutory reserves	722,109
Zakat and Income Tax	272,300
Proposed dividend, net	290,200
Retained earnings for 2011	3,148,439

Profits *(continued)*

Other than the cash dividend proposed to be paid to shareholders for the year 2011, and whereas the Bank is in the process of increasing its capital from SAR 7.5 billion to SAR 10 billion, the Board of Directors have recommended to the Extra-Ordinary General Meeting scheduled for 13 March 2012, the approval of the Bank's capital increase and to grant the shareholders registered in the Bank's register as of the end of trading on the General Meeting Day, a bonus share issue of 1 share for each 3 shares held.

Statutory Payments

Statutory payments payable by the Bank during 2011 consist of Zakat payable by Saudi Shareholders, tax payable by the foreign partner, and the amounts payable to GOSI which represent staff insurance contributions.

The statutory payments for the year were as follows:

	SAR '000
■ Zakat attributable to the Saudi Shareholders for the year 2011	**41,900**
■ Income tax attributable to the share of the non-Saudi shareholders	**230,400**
■ GOSI payments	**75,548**
■ Other payments	**3,015**

Fines, Penalties and Regulatory Restrictions

The Bank practices its business in line with the banking systems and organizational rules as per the regulatory requirements issued by the supervisory and regulatory authorities in the Kingdom of Saudi Arabia and has not been subject to any fines or penalty of significant effect on its business. However, in 2011 SAMA inflicted fines of an operational nature totaling of SAR 78,500 which were handled and rectified. The details of such fines were as follows:

Serial	Reasons for imposition of fine	Fine Amount (SAR)
1.	Comments of operational nature relating to response to inquiries on a customer's account with the Bank	**23,500**
2.	Comments of operational nature relating to response to inquiries on a customer's account with the Bank	**20,000**
2.	Comments relating to a returned late paid cheque	**5,000**
4.	Comments relating to rules for opening of bank accounts	**30,000**
	Total	**78,500**

Arrangements for Directors waiver of salaries or remuneration:

The Bank is not aware of any information on any arrangements or agreements for the waiver by any director of the Board or any senior executive of any salaries, awards or remuneration.

Arrangements for Shareholders waiver of rights to dividends

The Bank is not aware of any information on any arrangements or agreements for the waiver by any shareholder of the Bank of any of their rights to dividends.

Notification Relating to Substantial Shareholdings:

During the year, the Bank did not receive any notification from shareholders or relevant persons with regard to the change in the ownership of the Bank's shares in accordance with the Disclosure requirements of the Listing Rules issued by the Capital Market Authority. Below are schedules of share ownership of major shareholders, directors of the Board and senior executives or their spouses and minor children in shares or equity:

1) Description of any interest, option rights and subscription rights of major shareholders:

Major Shareholders:

Name of stakeholder	No. of shares at the beginning of the year 01/01/2011	No. of shares at year-end 31/12/2011	Net change during the year No. of Shares	%
HSBC Holding BV	300,000,000	300,000,000	-	0%
Olayan Saudi Investment Company Ltd.	127,496,250	127,496,250	-	0%
General Organization for Social Insurance	71,493,750	71,493,750	-	0%

Directors' Report (continued)

Profits *(continued)*

2) Description of any interest, option rights and subscription rights of Directors of the Board and their wives and minor children:

Directors of the Board and their wives and minor children: Name of stakeholder	No. of shares at the beginning of the year 01/01/2011	No. of shares at year-end 31/12/2011	Net change during the year No. of Shares	%
Khaled Suliman Saleh Al-Olayan	3,750	3,750	0	0%
Fouad Abdulwahab Mohammed Ali Bahrawi	171,000	176,000	5,000	0.003%
Khalid Abdullah Abdulaziz Al-Molhem	26,560	26,560	0	0%
Sulaiman Abdulkader Abdulmohsen Al-Muhaidib and family members	61,870	61,870	0	0%
Mohammed Omran Mohammed Al Omran and family members	7,030,270	7,030,270	0	0%
David Robert Dew	12,000	12,000	0	0%
Mohammed Abdulrahman Sulaiman (Al-Samhan representing GOSI)	0	0	0	0%
Zarir J. Cama (representing the foreign partner HSBC)	0	0	0	0%
Simon Nigel Cooper (representing the foreign partner HSBC)	0	0	0	0%
Mohammad Mazyed Mohammad Al-Tuwaijri [1] (representing the foreign partner HSBC)	0	0	0	0%

[1] On 21st March 2011 Mr. Mohammad Mazyed Mohammad Al-Tuwaijri, was appointed non-executieve board member representing the foreign partner HSBC Group replacing Mr. Robin D. Jones.

3) Description of any interest, option rights and subscription rights of senior executives and their wives and minor children:

Bank's Senior Executives, their Spouses and Minor Children: Name of stakeholder	No. of shares at the beginning of the year 01/01/2011	No. of shares at year-end 31/12/2011	Net change during the year No. of Shares	%
Mansour Abdulaziz Rashid Al-Bosaily	13,714	23,924	10,210	0.0014%
David Robert Dew	12,000	12,000	0	0%
Rehan Ahmed Khan	0	0	0	0%

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 2007G 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. Such 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:

Related Party Transactions *(continued)*

The HSBC Group	As at 31 December 2011 SAR'000
Due from banks and other financial institutions	**2,230,796**
Investments	**845,806**
Other assets	**3,410**
Derivatives (at fair value)	**(557,228)**
Due to banks and other financial institutions	**4,165,841**
Commitments and contingencies	**2,068,672**
Directors, Audit Committee, Other Major Shareholders and their Affiliates	
Loans and advances	**3,463,838**
Customers' deposits	**8,922,735**
Derivatives (at fair value)	**776**
Commitments and contingencies	**273,596**

Note: Shareholders holding more than 5% of the Bank's capital are classified as major shareholders.

Bank's Mutual Funds	As at 31 December 2011 SAR'000
Loans and advances	**31,064**
Customers' deposits	**1,406,178**

Following is the analysis of income and expenditure pertaining to transactions with related parties included in the consolidated financial statements:

	As at 31 December 2011 SAR'000
Special commission income	**50,932**
Special commission expense	**(197,639)**
Fees and commission income	**64,503**
Profit share arrangement relating to investment banking activitie	**(6,099)**
Share in earnings of associates	**64,165**
Directors' remuneration	**2,720**

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

	As at 31 December 2011 SAR'000
Short-term employee benefits (Salaries and allowances)	**48,089**
Employment termination benefits	**8,709**

Senior management staff 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 was one such scheme outstanding at 31 December 2011.

Directors' Report (continued)

Borrowings and Debt Securities in Issue

	As at 31 December 2011 SAR'000
USD 600 million 5 year fixed rate notes	**2,273,660**
SAR 1,705 million 5 year floating rate notes	**1,705,000**
Borrowings	**171,875**
Total	**4,150,535**

USD 600 million 5 year fixed rate notes

These notes were issued during the year 2010 at a fixed rate of 3% and are due to mature on 12 November 2015. The notes are unsecured and carry an effective yield of 3.148% which includes a credit spread of 170 bps. The notes are non-convertible, unsecured and are listed on the London Stock Exchange.

The special commission rate exposure on these notes has been hedged by a fixed to floating special commission rate swap. The special commission rate swap forms part of a designated and effective hedging relationship and is accounted for as a fair value hedge in these financial statements. The negative mark to market on these notes pertaining to the hedged portion is SAR 35.5 million as at the end of 31 December 2011.

SAR 1,705 million 5 year floating rate notes

These notes were issued during 2008 and are due to mature on 21 July 2013. The notes carry effective special commission at three months SIBOR plus 80 bps payable quarterly. The notes are unsecured, non convertible and are listed on the Saudi Stock Exchange (Tadawul).

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 SAR 1,250 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 SABB's financial statements.

Floating rate 5 year notes of Euro 325 million maturing on 13 April 2011 were paid in 2011.

Borrowing

This represents a 12 year amortising fixed rate loan that carries special commission at the rate of 5.11% payable semi annually. The loan was taken on 7 July 2005 and is repayable by 15 June 2017. An amount of SAR 10.3 million has been paid as commission during the year.

Directors' and Senior Executives' Remuneration

Directors' fees during 2011 amounted to SAR 2,563,500 including SAR 283,500 in attendance fees at Board of Directors', Executive Committee and Audit Committee meetings as well as at the Nomination and Remuneration Committee. The following table shows details of remuneration paid to Board and Committee members and senior executives of the Bank during the year:

2011 **SAR'000**	*Executive Board Members*	*Non-Executive/ Independent Board Members*	*Detailed remuneration elements for the seven executives who have received the highest compensation from the company. The MGD and CFO are included as required*
Salaries and Remuneration	**2,504**	**2,720**	**7,432**
Allowances	**103**	-	**1,930**
Annual and Periodic Bonuses*	**1,689**	-	**11,571**
Incentive Schemes**	-	-	-
Any Remuneration or other benefits in kind paid monthly or annually	**1,025**	-	**579**

Note: values calculated on cost to bank during 2011-excluding bonuses and shares where they are based on value delivered to employees within 2011.

*Bonuses received in 2011
**Current board members

Staff Benefits and Schemes

According to the Labour Law of The Kingdom of Saudi Arabia and the Bank's internal policies, staff end of service benefit is due for payment at the end of an employee's period of service. The end of service benefit outstanding at the end of December 2011 amounted to SAR 291 million.

The Bank operates (1) equity scheme for certain employees. The book value for this scheme amounted to SAR 18.3 million at the end of 2011.

During 2011, the Bank undertook an independent review of its compensation structures to ascertain its compliance with SAMA's Regulations on Compensation for Banks and was found to be largely compliant. The Bank has submitted a report to SAMA with an action plan on the areas requiring changes. During 2011 an action plan has been implemented to comply with these supervisory requirements.

Board of Directors' Assurance

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

- The Bank's books of account were properly prepared
- The Bank's internal control system is effective
- It has no evidence that suggest the Bank's inability to continue as a going concern
- There is no contract the Bank is part of, where or when there were substantial interests for one of the Board Members, Managing Director, Chief Financial Officer or any person who has a relationship with them, except for that which was mentioned in the Related Party Transactions in this report

As indicated in their audit report, the Bank's auditors, for the purpose of their review of the financial statements, have considered internal controls relevant to the Bank's preparation and fair presentation of the financial statements in order to enable them to design audit procedures which are appropriate, but not for the purpose of expressing an opinion on the effectiveness of the Bank's internal controls. The auditors have reported to the Board certain deficiencies or recommendations arising from this exercise. In the management's opinion these items do not constitute material weaknesses. The auditors have issued an unqualified audit report on the financial statements of the Bank.

Accounting Standards

The consolidated financial statements have been prepared in accordance with the accounting standards for financial institutions issued by the Saudi Arabian Monetary Agency (SAMA), International Financial Reporting Standards (IFRS) and also comply with the Banking Control Law, the Regulations for Companies in the Kingdom of Saudi Arabia and the Bank's Articles of Association. There has been no major deviation in the accounting standards being applied at SABB against SOCPA's accounting standards applied during the financial year ended 31 December 2011, except in the application of the international standards mentioned in the notes to the financial statements in which regard SABB has applied the subject standard with retroactive effect without an impact on the Bank's financial position or performance.

Directors' Report (continued)

Basel II

Basel II is an international business standard and is intended to strengthen risk management practices and processes within financial institutions stipulating a minimum regulatory capital requirement given the risk profile of the institution. The standards have been adopted by SAMA.

The Basel II framework consists of three mutually reinforcing pillars which, acting together, are intended to contribute to enforcing soundness in the financial systems:

- **Pillar 1:** refers to Minimum Capital Requirements relating to Credit risk, Operational risk and Market risk
- **Pillar 2:** refers to SAMA's supervisory review of SABB's Internal Capital Adequacy Assessment Process (ICAAP)
- **Pillar 3:** refers to Market discipline through public disclosures

ICAAP is designed to capture capital requirements under stressed scenarios as well as capital for Pillar 2 risks. Pillar 2 risks refer to risks not captured under Pillar 1, for example, Concentration risk.

SABB's ICAAP is a comprehensive document designed to evaluate the Bank's risk profile, the processes for identifying, measuring and controlling risk, and its capital requirements and resources. It reflects a conservative and realistic approach to the assessment of SABB's current and planned capital requirements on a fully consolidated basis, based on the Basel II Pillar 2 framework and the expected profile of the Bank.

SABB's ICAAP is in line with guidance issued by SAMA and is updated on an annual basis.

The Basel II disclosures have been prepared in accordance with the Basel II rules issued by SAMA in March 2008.

Basel III

Much progress was made in 2011 in finalising the details of the Basel III capital requirements along with an implementation timetable stretching out to 2019 to allow time for the global financial industry to adjust progressively.

A minimum common equity Tier 1 ratio of 7%, including a capital conservation buffer, has been agreed. SABB already meets this threshold requirement.

During 2012, SABB will continue participating in SAMA working groups on the various aspects of Basel III aimed at finalising the implementation of the rules within Saudi Arabia. An observation period will commence during 2012 where reporting will be undertaken to assist in the calibration of minimum requirements.

Board of Directors and Subsidiary Committees

Directors

The Board of Directors of The Saudi British Bank comprises of ten members, six of whom represent Saudi interests whom are elected and appointed by the General Meeting of the Bank for three years with the possibility of re-election, and four other members appointed by the foreign partner.

On 14 December 2010 the following Saudi Directors were elected and appointed by the General Meeting for three years commencing 1 January 2011.

- Mr. Khaled Suliman Olayan, Director of the Board - Independent
- Mr. Fouad Abdulwahab Bahrawi, Director of the Board - Independent
- Engr. Khalid Abdullah Al-Molhem, Director of the Board - Independent
- Mr. Suliman Abdulkader Al-Muhaidib, Director of the Board - Non-executive, representing Abdul Qadir Al Muhaidib & Sons Co.
- Mr. Mohammed Omran Al-Omran, Director of the Board - Independent
- Mr. Mohammed Abdul Rahman Al-Samhan, Director of the Board - Non-executive, representing GOSI

The SABB Board of Directors selected unanimously Mr. Khaled Suliman Olayan as Chairman for 3 Gregorian years commencing 1 January 2011G.

On 21 March 2011 Mr. Mohammad Mazyed Mohammad Al-Tuwaijri was appointed a non-executive member of the Board and representative of the foreign partner HSBC in succession to and as a replacement for Mr. Robin D Jones whose secondment period has expired.

In light of these changes the Board of Directors as at 31 December 2011 comprised:

Board of Directors and Subsidiary Committees *(continued)*

Mr. Khaled Suliman Olayan, CHAIRMAN, INDEPENDENT (SAUDI)
Board Member, Al-Zamil Industrial Investment Company

Mr. Fouad Abdulwahab Bahrawi, BOARD MEMBER, INDEPENDENT (SAUDI)
Board Member, SABB Takaful Co.

Engr. Khalid Abdullah Al Molhem, BOARD MEMBER, INDEPENDENT (SAUDI)
Board Member, Economic City
Board Member, Riyadh Cement Co.
Board Member, Amlak Real-Estate Company
Board Member, Saudia Airlines Catering

Mr. Mohammed Omran Al Omran, BOARD MEMBER, INDEPENDENT (SAUDI)
Board Member, Saudi Credit Swiss Co.
Board Member, Saudi Telecommunication Co.
Board Member, Saudi Orex Lease Finance Company
Board Member, Al-Rajhi Cooperative Insurance Co.

Mr. Sulaiman Abdulkader Al Muhaidib, BOARD MEMBER, NON-INDEPENDENT (SAUDI)
Chairman, A. K. Al-Muhaidib & Sons Group of Companies
Chairman, Secorp Co.
Board Member, Arabian Pipes Co.
Board Member, First Real Estate Development Company (representing Abdul Qadir Al Muhaidib & Sons Co.)
Board Member, Yamama Steel Industries Co. (representing Abdul Qadir Al Muhaidib & Sons Co.)
Board Member, Safola Group (representing Abdul Qadir Al Muhaidib & Sons Co.)
Board Member, National Industries Company (representing Abdul Qadir Al Muhaidib & Sons Co.)
Board Member, Al-Marai Company (representing Abdul Qadir Al Muhaidib & Sons Co.)

Mr. Mohammed Abdulrahman Al Samhan, BOARD MEMBER, NON-INDEPENDENT (SAUDI)
Board Member, Representing GOSI

Mr. Zarir Cama, BOARD MEMBER, NON-INDEPENDENT (BRITISH)
Board Member, Representing the foreign partner HSBC

Mr. Simon Cooper, BOARD MEMBER, NON-INDEPENDENT (BRITISH)
Board Member, Representing the foreign partner HSBC

Mr. Mohammad Mazyed Mohammad Al Tuwaijri, BOARD MEMBER, NON-INDEPENDENT (SAUDI)
Board Member, Representing the foreign partner HSBC

Mr. David Dew, MANAGING DIRECTOR, BOARD MEMBER, NON-INDEPENDENT (BRITISH)
Board Member, SABB Takaful Company

Directors' Report (continued)

Board Meetings

In 2011G, the Board of Directors of the Saudi British Bank ("SABB") held 5 meetings. The following table shows details of those meetings and record of attendance of directors in the year:

No.	*Name*	*15 March 2011*	*24 May 2011*	*18 July 2011*	*11 September 2011*	*13 December 2011*
1.	Mr. Khaled Suliman Olayan	-	✓	✓	✓	✓
2.	Mr. Fouad Abdulwahab Bahrawi	✓	✓	✓	✓	✓
3.	Mr. Khalid Abdullah Al Molhem	✓	✓	✓	-	✓
4.	Mr. Sulaiman Abdulkader Al Muhaidib	✓	✓	✓	✓	✓
5.	Mr. Mohammed Abdulrahman Al Samhan	✓	✓	✓	✓	✓
6.	Mr. Mohammed Omran Al Omran	✓	✓	✓	✓	✓
7.	Mr. Zarir Cama	✓	✓	✓	✓	✓
8.	Mr. Robin D. Jones	✓	-	-	-	-
9.	Mr. Simon Cooper	✓	✓	✓	✓	✓
10.	Mr. David Dew	✓	✓	✓	✓	✓
11.	Mr. Mohammad Al Tuwaijri	-	✓	✓	✓	✓
	Number of Attendees	9	10	10	9	9
	Percentage of Attendees	90%	100%	100%	90%	90%

The following table shows attendance of the Board of Directors and Board Committees in the year 2011:

No.	*Name*	*Audit*	*EXCOM*	*Board*	*Nomination & Remuneration*
1.	Mr. Khaled Suliman Olayan	-	-	4	3
2.	Mr. Fouad Abdulwahab Bahrawi	4	11	5	2
3.	Mr. Khalid Abdullah Al Molhem	-	9	4	4
4.	Mr. Sulaiman Abdulkader Al Muhaidib	-	-	5	-
5.	Mr. Mohammed Abdulrahman Al Samhan	4	-	5	-
6.	Mr. Mohammed Omran Al Omran	-	11	5	5
7.	Mr. Zarir Cama	-	-	5	-
8.	Mr. Robin D Jones (*1)	-	2	1	-
9.	Mr. Simon Cooper	-	-	4	-
10.	Mr. David Dew	-	11	5	-
11.	Mr. Mohammed Al Tuwaijri (*1)	-	8	4	-
12.	Mr. Mohamed M Al Ammaj (*2)	4	-	-	-
13.	Mr. James Madsen (*2)	4	-	-	-
14.	Mr. Talal Al Zamel (*2)	4	-	-	-

(*1) On 21.03.2011G, Mr. Mohammed Mazyad Al-Tuwaijri was appointed Non-Executive member of the Board and representative of the foreign partner HSBC in succession to Mr. Robin D. Jones.

(*2) The Audit Committee, as per formation rules, consists of 3 Non-Board members.

Executive Committee

The Executive Committee is appointed by the Board in accordance with Article 26 of the Bank's Articles of Association and consists of the Managing Director (Chairman) and four other members selected from among the Directors. The main task is to assist the Managing Director (MGD) within the powers determined by the Board to deal with matters referred by the MGD or by the Board. The Executive Committee reviews and considers all monthly reports submitted by different functional heads and business segments of the Bank and meets twelve times during the year. The Board in its meeting held on 14 December 2010, has appointed the following as members of the Executive Committee with effect from 1 January 2011. Mr. David Dew (Chairman); Mr. Fouad Abdulwahab Bahrawi; Mr. Khalid Abdullah Al Molhem; Mr. Mohamed Omran Al Omran; and Mr. Mohammad Al Tuwaijri who was appointed as member of the Executive Committee in succession to and replacement for Mr. Robin D Jones.

The above members remained without any changes as at 31 December 2011.

The Executive Committee held 11 meetings during 2011G.

Audit Committee

SABB's Audit Committee was formed in 1992G and as per formation rules consists of 3 – 5 members from within and out of the Board. The Committee reports directly to the Board of Directors, and meets four times during the year. The Committee monitors the Bank's internal and external audit functions and reviews control weaknesses and system deficiencies. It is also responsible for review of financial statements to ensure that all financial information is of the highest quality, concentrating on critical business issues, which enable the Bank's external auditors and management to focus on those areas of greatest risk to the business. The Committee also recommends to the Board the appointment of Bank's auditors, fixing their fees and review of the audit plan, follow up on the auditors work and review the bank's auditors comments. The Board in its meeting held on 14 December 2010, has appointed the following as members of the Audit Committee with effect from 1 January 2011:

Mr. Fouad Abdulwahab Bahrawi, Board member – Independent, (Chairman) and Mr. Mohammed Abdul Rahman Al Samhan, Board member – Non-Executive; Mr. Ian Stewart Martin (who was replaced by Mr. James Madsen effective 01 March 2011): Mr. Mohammed Mutlaq Al Ammaj; and Mr. Talal Ahmed Al Zamel, who are Non-Board members.

The above members remained without any changes as at 31 December 2011.

The Audit Committee held 4 meetings during 2011G. As the Board of Directors wished the terms of reference of the committee to be in line with the regulatory guidelines, the organizational rules and terms of reference of the committee were amended and shall be submitted to the General Meeting scheduled for 13.03.2012 for approval.

Property Committee

The Property Committee, which is a Board Committee, comprises 3 – 5 members with a brief to consider and approve the Bank's expenditure and liabilities in respect of properties including rentals, project costs and related support expenditure in areas such as safety and security. Subjects referred to the Property Committee are considered by circulation unless the Chairman of the Committee requires a meeting. The Board in its meeting held on 14 December 2010, has appointed the following as members of the Property Committee with effect from 1 January 2011. Mr. Khaled Suliman Olayan (Chairman); Mr. Sulaiman Abdulkhader Al Muhaidib; Mr. David Dew; Mr. Robin D Jones; Mr. Mohammed Abdulrahman Al Samhan.

No member was appointed in replacement of Mr. Robin D. Jones after his departure.

With that exception the above members remained in place as at 31 December 2011.

The Committee did not hold any meetings in 2011G.

Directors' Report (continued)

Nomination and Remuneration Committee

The Nomination and Remuneration Committee was formed by the Board and its organizational rules and terms of reference were approved by the General Meeting held on 15 March 2011 to be in line with the regulatory guidelines, and shall meet at least twice during the year. The committee consists of three independent members of the Board appointed by the Board and reports directly to the Board.

The committee recommends to the Board of Directors nominations for Board membership, annually reviews the skills and capabilities required of those suitable for Board membership including the time needed by a Board member for Board business, reviews the structure of the Board and submits the necessary recommendations and establishment of performance related remuneration policies for the Board members and senior executives.

The Board in its meeting held on 14 December 2010, has appointed the following as members of the Nomination and Remuneration Committee: Mr. Khaled Suliman AlOlayan (Chairman); Mr. Mohamed Omran AlOmran; Mr. Khalid Abdullah AlMolhem.

In line with the regulatory guidelines issued by SAMA, the Committee was re-formed to be in line with such requirements, as follows: Mr. Mohammed Omran AlOmran (Chairman); Mr. Khaled Suliman Olayan; and Mr. Khalid Abdullah Al Molhem. CMA was advised of such change on 26.11.2011G.

The Nomination and Remuneration Committee held 5 meetings during 2011.

Corporate Governance

The Saudi British Bank (SABB) is aware of the immense effects associated with the adoption of Prudent Governance Principles and Standards and that such adoption will lead to observance of professional and ethical standards in all the Bank's dealings as well as transparency and disclosure which will contribute to the furthering and improvement of the Company's efficiency and its relations with all interested parties, be they staff, depositors or others. The Bank also believes that the adoption will enhance investors' confidence in the Bank on one side and in the Saudi banking industry on the other, which in turn will reflect positively on the security, integrity and stability of the Banking Sector in the Kingdom of Saudi Arabia.

In its endeavour to meet the regulatory requirements stated in the corporate governance rules, and to ensure fulfilment of such requirements in a documented frame and approach, the Bank has laid down its own "SABB Governance Policy" which was endorsed by the Board of Directors on 13.12.2011 and which included the principal provisions and principles of prudent governance. The Bank will review this document regularly to ensure compliance with the principles of governance to be issued by SAMA.

SABB complies in form and content with all Corporate Governance guidelines included in the Corporate Governance Rules issued by the Capital Market Authority. This commitment has resulted in the inclusion of the compulsory requirements in the Bank's Articles of Association and the Terms of Reference of Board Committees as well as in the Internal Policies and Guidelines organizing the works of the different Bank sectors. These include establishment of the rights of shareholders to the shares and to their participation in General Meetings; the provision of all information that ensures shareholders can exercise their rights; the disclosure of financial and non-financial information and the complete observance of transparency requirements in line with the regulatory limits; and the definition of the liabilities of the Board of Directors and formation of its various committees under terms of reference that are in line with the regulatory guidelines.

In addition, the Bank is committed to observe the majority of guidelines included in the Corporate Governance Rules with the exception of the following:

Corporate Governance *(continued)*

Article	*Requirement*	*Reasons for Non-Compliance by the Bank*
Article 3	This Article provides for a number of requirements relating to shareholders' rights including the right to a share of the distributable profits and the right to a share of the company's assets upon liquidation.	There is no explicit text in the Bank's Articles of Association which provides for this requirement; however Article (52) of the Articles of Association handles matters relating to the liquidation of the company and the procedures as provided for in the Companies Act. In addition, the Governance Policy approved by the Board of Directors in December 2011 provides for the right of shareholders to a part of the Bank's assets upon liquidation.
Item (b) of Article 6	In voting in the General Meeting for the nomination to the Board, the accumulative voting method shell be applied.	As the Bank's Articles of Association provides for the ordinary voting right as per the Saudi Companies Act, the accumulative voting requirement has not yet been complied with on the basis that it falls within the guiding principles' requirements provided for in the Corporate Governance Rules, particularly that adoption of these requirements entails the amendment of the Bank's Articles of Association. However, in the recent past the Bank has communicated with the supervisory authorities in this respect, and the Bank's Articles of Association will be amended at the General Meeting scheduled for 13.03.2012 to fulfil this requirement.
Item (d) of Article 6	Investors who are judicial persons and who act on behalf of others - e.g. investment funds – shall disclose in their annual reports their voting policies, actual voting, and ways of dealing with any material conflict of interests that may affect the practice of fundamental rights in relation to their investments.	The Bank is not entitled under any provisions for the ordinary voting right as per capacity to oblige any judicial investors who act on behalf of others to disclose their voting policies.
Article 8	The company shall lay down in writing the policies, procedures and supervisory rules related to disclosure, pursuant to law.	The disclosure policies complied with by the bank are included in the Bank's internal policies and processes. The Governance document as approved by the Board of Directors on 13.12.2011 was included in a supplement including the policies and procedures followed by the Bank in disclosure and which reviews its aspects mechanisms and scope of liabilities fixed.
Item (d) of Article 10	Laying down of specific and explicit policies, standards and procedures, for the membership of the Board of Directors and implementing them after they have been approved by the General Meeting.	The Bank has laid down written policies and Board membership standards and procedures which were approved by the Board of Directors on 20.10.2009G. However such policies and standards have not yet been presented to the General Meeting. Nevertheless, these policies and standards will be presented to the General Meeting in the first quarter of 2012G.
Item (b) of Article 13	The Board shall approve the by-laws and terms of reference of all committees of the Board.	The terms of reference of the permanent committees of the Board are all approved by the Board of Directors. The General Meeting has also approved the terms of reference of the Audit and Remuneration and Nomination Committees. As an exception, the terms of reference of the Property Committee, which is liable for approval of costs and liabilities of the Bank relating to real-estate affairs including rents, project costs and support expenses, will be approved by the Board in the first quarter of 2012.

Directors' Report (continued)

Compliance with Regulatory and International Requirements

SABB is in compliance with all regulatory instructions and guidelines issued by SAMA in respect of all banking activities. SABB also continues to be in compliance with Basel II requirements in respect of measurement of risks, capital adequacy and disclosure. The Risk committee formed by the Bank's management continues to ensure the continuous compliance with all guidelines and instructions made in accordance with best international practices. SABB has established its own internal policies in line with the different regulatory requirements.

Retail Banking and Wealth Management

2011 has again seen SABB as a leading provider in Saudi Arabia of Retail Banking and Wealth Management products and services.

Two new branches were opened during the year thereby increasing SABB's retail outlets to 105 (80 branches and 25 dedicated ladies sections). Out of the total 82 are Amanah (Islamic) while 23 outlets remain conventional.

The new branch locations were selected after considering their convenience for the Bank's valued customers.

Amanah Retail Banking assets now amount to 86% of the Bank's total Retail Banking assets and 74% of total Retail banking deposits. SABB Amanah Retail Banking revenues now account for 76% of total SABB Retail Banking revenues for 2011.

Over the course of the year further attention was given to internal restructuring and reorganization to the benefit of high net worth customers, with specific focus on increasing the number of Premier Centres within the Kingdom, which now total 12 centres Kingdom-wide. These exclusive Centres provide Premier customers with specially developed products and services as well as addressing their local and international needs through HSBC's global network.

Building on the success of the existing Premier offering through dedicated Premier Relationship Managers, SABB continues to expand its Amanah Advance proposition which is available in 33 other markets across the globe. This service, which serves as a second tier Premier proposition, allows the Bank's customers access to a high quality banking service in the Kingdom that has the added advantage of being available worldwide. SABB and HSBC Advance customers have access to a wider range of the very best international retail banking products allied to priority service. The service is provided by well-trained Advance Business Officers who are able to offer individual customers financial management solutions best suited to their specific needs. In addition, SABB Amanah Advance harnesses new and multi-channel platforms so customers can manage their finances anytime, anywhere and in a manner that suits them best: provides access to knowledge and counsel that enables them to explore and broaden their financial horizons so as to achieve tomorrow's life goals; and acts as a facilitator for those who are internationally minded and informed.

To widen the availability of its wealth management offerings, SABB has further increased its sales capability across the branch network by ensuring all Advance Business Officers and Premier Relationship Managers attain Wealth Management certification, which allows them to sell selected SABB Takaful Family products.

Such expansion and increased activity, coupled with focused marketing and sales initiatives, contributed to a year-on year increase of 19% in the SABB Premier Customer base.

SABB installed a further 32 ATMs in 2011 increasing its network to 522. To enhance security the bank has introduced chip and pin technology for SABB credit card customers following its successful introduction for debit cards in 2010.

During 2011 SABB's credit card business maintained its leadership position in terms of retail spend. Meanwhile, Amanah credit cards continued to see considerable growth in sales transacted and now constitute 98% of the sales executed each month.

SABB continued to evaluate customer needs and introduce solutions during 2011. The issue of security codes and alerts by SMS has been complemented with the introduction of a "Token" security code option. This has helped SABB improve customer service as well as reduce losses resulting from fraud.

SABB continues to roll out E-statements providing clients with quick and secure access to their financial data while improving efficiency and reducing paper usage.

Private Banking

SABB Private Banking achieved a year on year increase in profitability despite the challenging investment climate.

Activity continued to focus on delivering bespoke banking and investment solutions to wealthy individuals and families in close co-ordination with the investment advisory and portfolio management capabilities of HSBC Saudi Arabia.

SABB Private Banking clients were among the main subscribers to new investment products originated during the year by HSBC Saudi Arabia.

Improved segmentation focus also saw an increase in overall cross-referral activity with other SABB business units.

In September, the Riyadh team relocated to newly refurbished premises at the Super Branch building in Olaya.

Corporate Banking

Global Banking
SABB Global Banking (GBB) was established during the first quarter of 2011 as a stand-alone, centrally-managed business segment within SABB. The basic aim of GBB is to be fully responsible for the relationship management of larger Saudi-registered companies that are globally managed by SABB; multinational businesses operating in Saudi Arabia and globally managed by HSBC; and institutional clients within government and its ministries, agencies and departments as well as institutions in the financial sector or elsewhere.

Increased spending during the year by the Saudi government on infrastructure, utilities, transportation and oil, gas and petrochemicals, as well as on hospitals and housing, resulted in a number of Engineering Procurement and Construction and Lump Sum Turnkey projects and contracts being awarded, mainly to Korean, Chinese, French and Indian multinationals. Most of the international companies have been long-standing HSBC Group clients, with several of them being Fortune 500 companies, whilst the underlying project owners are Saudi corporates or their joint ventures, who have been long-term SABB clients.

Overall development of the Saudi economy has been a key element of SABB's, and specifically GBB's, role over the 12 months under review. The strategy employed leveraged the HSBC Group relationship with SABB Group companies, such as HSBC Saudi Arabia and SABB Takaful, in support of Saudi companies that are also pursuing, both directly and indirectly, the same aim. Such support has included assistance in ensuring timely and quality execution of projects in the Kingdom whilst helping Saudi corporates internationally with their ambitious expansion and acquisition plans or in tapping-in to liquidity through non-Saudi financial institutions through ECA Finance and international bonds.

By the year end GBB's activities resulted in facilities totalling in excess of SAR 15,000 million. Such facilities included the provision of export finance and syndications, comprising non-recourse long-term loans, equity bridge loans, treasury solutions and Sukuks, the latter especially for Saudi clients; guarantees, working capital and treasury solutions for international companies implementing specific contracts; and the confirmation and discounting of export letters of credit specifically in support of oil exports. A complete range of Shariah-compliant financial solutions are wholly integral to the range of facilities offered.

GBB attained funded and off-balance sheet assets to the tune of SAR 30.6 billion against total liabilities valued at SAR 21.8 billion at the year end. Such achievements are a direct result of the core pursuit of customer loyalty and satisfaction through the provision of innovative solutions developed in close cooperation with other segments of SABB and the HSBC Group.

Directors' Report (continued)

Commercial Banking

With over 26,000 customers, loans of over SAR 53 billion, and revenue of SAR 1.8 billion, SABB Commercial Banking (CMB) is a strong player in the commercial banking market in Saudi Arabia. SABB CMB has a total operating income market share of 12.7%, and is now considered to be the third largest bank in Saudi Arabia in the commercial banking segment.

As a full-service bank, SABB offers both conventional and Islamic banking solutions to meet the needs of commercial customers. A dedicated relationship and support team of 210 staff covers customers' corporate banking requirements and provides access to specialist teams in Treasury, Cash Management, Trade and Investment Banking. SABB is both a strong local partner for its customers in Saudi Arabia and the gateway to global financial markets and services through the HSBC Group.

SABB CMB operates an "Amanah First" approach in providing financial services to its clients but maintains the flexibility of offering conventional products according to their requirements and needs. All of SABB's Islamic products are fully Shariah-compliant and segregated from its conventional banking activities. SABB is an Islamic product leader especially in the provision of international products and is the only bank in the Kingdom to offer Shariah-compliant treasury products such as forex forward, options and interest rate swaps. Additionally, SABB was the first bank to introduce an Islamic solution for overdrafts and is also a market leader on Shariah documentation and turnaround times. SABB is also one of only three banks that offer international commodities supporting Tawarruq Products.

In-house technology development combined with access to HSBC systems ensures that SABB offers state of the art banking channels to its clients including various payments and cash management solutions to meet the complex and structured needs of customers. Vigorous business continuity arrangements ensure that SABB's clients have reliable access to their finances. The Bank's corporate online banking strategy focuses on providing a single multi-faceted platform to customers across all business lines, covering a wide variety of services in ways that can be packaged or personalized to suit their unique needs. Cross product integration is offered through a single window that serves diverse customers through one unified portal. A one stop shop for payments, receivables, financing, markets and foreign exchange functionality, SABB's online channels aim to provide a globally consistent client experience with robust local functionality. The Bank currently has two online banking systems serving the overall needs of business customers. HSBCnet is a global system, mainly targeting corporates, mid-to-large commercial customers and financial institutions with a variety of financial needs, whilst Business SABBnet is an easy-to-use solution for small and medium enterprises with local in-country banking needs.

In pursuit of its strategic direction to deliver market-leading propositions, international connectivity and exceptional services to customers, SABB CMB has launched a number of new initiatives and achieved important landmarks during 2011. These include the leveraging of cross-border relationships with the HSBC Group in the 85 countries in which it operates, the net result of which has been the mutual referral of substantial levels of business, and the strengthening of SABB's links with China through the establishment of a China Desk, the first by a Saudi bank, to encourage bilateral trade flows.

A prime focus of SABB CMB has been on Small and Medium Enterprises (SMEs).

SABB has a history of commitment to the small business customer and was the first bank in Saudi Arabia to participate in the Kafalah Program, a government Guarantee program to encourage banks to lend to small businesses. Throughout a year of heightened economic uncertainty, SABB has significantly strengthened its commitment to supporting small businesses. Business Banking was relaunched as an independent, functionally-managed segment within CMB, to ensure increased focus on SMEs by separating its management from that of the Bank's large corporate customers. SABB Business Banking, with a team of 46 staff, now manages relationships with over 23,000 businesses, each of whose annual turnover is lower than SAR100 million.

SABB believes in delivering best in class customer experience to its small business customers. Customers have free access to direct channels 24/7, and dedicated business centers operate in each region to meet any customer requirement. SABB has also launched the Business Banking Academy to upgrade staff skills, and looks to grow the business banking segment while working on providing tailored customer solutions. In the near future, SABB Business Banking intends to launch business product packages to support the segment in all of its different life cycles.

Amanah

Amanah has seen continued growth in all Shariah-compliant activities in 2011, whilst the number of Amanah branches operating at the year end had risen to 82 out of a total of 105 SABB outlets Kingdom-wide. In doing so Amanah contributed increasingly to the results achieved by the Bank during the year.

The provision of housing finance has been an important feature of Amanah's activity this year, with various options being made available to personal customers including rental of ready-to-occupy properties, land or under-construction buildings as well as sale and lease-back of property, with the commitment to customers to own the property at the end of the lease for all options.

Considerable attention has been paid also to the needs of corporate customers with the development of attractive Amanah corporate and commercial banking services. As the first bank in the Kingdom, SABB introduced the new Amanah cash line accounts, a Shariah-compliant alternative to conventional overdrafts based on Tawarruq financing and Mudarabah investment. Specialised Shariah-compliant hedging products are offered also to protect corporate customers against interest and currency exchange rate fluctuations.

Prime elements of Amanah's success have been the provision of appropriate Shariah training to SABB staff, where 300 staff were trained in 25 training programmes organized during the year, and the recruitment of well-qualified and experienced Saudi staff to the Shariah and product development team. Such activities have ensured the provision of quality financial solutions and services to all customers. As new services are launched and the Amanah branch network continues to grow, further business growth is forseen for Amanah in the Kingdom in the coming year.

Treasury

Treasury has enjoyed another strong and profitable year despite the challenging combination of a low interest rate environment and increased credit volatility. The market liquidity premiums presented various challenges in managing liquidity but nevertheless the Balance Sheet maintained healthy and robust liquidity levels. Active interest rate risk management, as well as leading positions in foreign exchange, made a significant contribution to the Bank's operating income.

Treasury continued to increase its market share of hedging and investment activities, by providing increasingly bespoke onshore and cross-border solutions to both Shariah-compliant and conventional customers. The model of specialised coverage for the central, western and eastern provinces combined with diversified products has continued to enhance SABB's relationships.

Future Plans

SABB is a diversified financial services institution with a range of business activities and income streams. This has been achieved through continued investment in the core business infrastructure together with capital deployment into various strategic businesses. SABB's principal lines of business are Retail Banking & Wealth Management, Global Banking, Corporate Banking, Private Banking and Treasury Services. SABB offers Islamic (Shariah) compliant products across all principal business lines, under the "Amanah" brand-name. SABB is continually evaluating new business opportunities to expand the range of banking and finance products and services which it offers customers. These offerings are complimented by our associate companies who offer Takaful, Investment Banking, Asset Management, Brokerage and Securities Services.

A new strategic plan (Medium Term Outlook – MTO) for the period 2011 – 2013 was approved by the SABB Board in December, 2010 which focuses on our strategic goal to remain a leading player in the financial services industry in Saudi Arabia by offering a comprehensive suite of banking propositions. In 2011, significant progress has been achieved against this plan.

Directors' Report (continued)

Future Plans *(continued)*

Key deliverables of the plan included the following aspects:

1. Investment in People – Robust Talent Management & Succession Plan with a structured Learning & Development proposition.
2. Increased investment in Global Transaction Banking.
3. Transformation from a trading driven to a sales led Treasury function with greater emphasis on Non-Fund Income.
4. Consolidated Corporate/Commercial business focused on four key segments: Corporate, Middle Market, Business Banking and Institutional Banking.
5. Moves to a segment based strategy in Retail Banking with the Premier & Advance segments being a priority.
6. Development of a robust Wealth Management proposition working closely with associate companies.
7. Continued focus on Islamic Banking propositions across all customer groups with percentage of income derived from the business increasing during the plan period.
8. Business Transformation - Continuous focus on operational efficiencies.
9. Introduction of a new Marketing Strategy to improve the Brand Health Index.
10. Development of alternative channels and the reviewing of current branch network.
11. Restructuring of the Risk Management function closely aligned to the customer groups.

Credit and Risk

All SABB's activities involve, to varying degrees, the measurement, evaluation, acceptance and management of risks or combinations of risks. The most important categories of risk that the Bank is exposed to are Credit risk (including counterparty and cross-border country risk), Market risk (including foreign exchange, interest rate and equity price risks), Operational risks in various forms, Liquidity risk, Reputational risk and Sustainability (environmental and social) risks.

A well-established risk governance and ownership structure ensures oversight of, and accountability for, the effective management of risk. The Board approves the Bank's risk framework, plans and performance targets, which include the establishment of risk appetite statements, the appointment of senior officers, the delegation of authorities for credit and other risks and the establishment of effective control procedures.

SABB's risk appetite framework was enhanced during the year and describes the quantum and types of risk that SABB is prepared to take in executing its strategy. It is central to an integrated approach to risk, capital and business management and supports the Bank in achieving its return on equity objectives, as well as being a key element in meeting the Bank's obligations under Pillar 2 of Basel II.

The Bank continued to operate an independent Credit risk function which provides high-level oversight and management of Credit and Market risk for SABB. Its responsibilities include: formulating SABB's credit policy in compliance with local regulations; guiding business segments on the Bank's appetite for Credit and Market risk exposure to specified market sectors, activities and banking products; controlling exposures to sovereign entities, banks and other financial institutions; and undertaking an independent review and objective assessment of risk.

The Operational risk management framework covers identification and assessment of material risks, identification and monitoring of key controls and identification and management of the Bank's major risks. In order to increase Operational risk awareness SABB has developed a risk-based approach comprising increased integration between all functions and businesses and the development of appropriate training.

Looking ahead, key enhancements of the framework will include up-grading of the Operational risk management system to ensure that it supports businesses; managing and controlling their material risks whilst also encouraging a forward looking approach to operational risk by identifying areas of potential risk.

SABB has adapted its robust liquidity and funding risk management framework in response to changes in the mix of business that it undertakes and the impact of global events on its liquidity positions. The liquidity and funding risk management framework will continue to evolve as the Bank assimilates knowledge from market events, and recent regulatory proposals covering liquidity risk outlined within the Basel III framework.

Annual Review of the Effectiveness of Internal Control Procedures

SABB's management is responsible for implementing and reviewing the effectiveness of the Bank's internal control framework as approved by the Board of Directors.

SABB has established clear standards that should be met by employees, departments and the Bank as a whole.

Systems and procedures are in place within SABB to identify any deviation of control and report on major risks including credit, changes in the market prices of financial instruments, liquidity, operational error, breaches of law or regulations, unauthorised activities and fraud. In addition to an on-going management review, exposure to these risks is subject to monitoring through various management committees that were established to ensure the effectiveness of the Bank's control framework and to maintain specific oversight of key risks such as credit, asset and liability management, compliance and fraud.

Periodically, strategic plans are prepared for key customer and product groups and support functions. These are implemented and monitored through annual operating plans that are prepared and adopted by all business and support functions and that set out the key business initiatives and their likely financial effects.

Centralised functional control is exercised over all computer system developments and operations. Common systems are employed for similar business processes wherever practicable. Credit and market risks are measured and analysed, reported and aggregated for review of risk concentration on a Bank-wide basis.

Authorities to enter into credit exposures and market risk exposures are delegated, with limits, to line management. In addition, functional management is responsible for setting policies, procedures and standards across all areas of risk, including credit, market, liquidity, operational, accounting, information, legal and regulatory compliance, human resources and reputational and purchasing risks. A detailed exercise to review the policy framework for all key functions has been completed during the year.

The Risk Management function serves as a secondary control maintaining oversight of credit, market and operational risks, as well as other functions such as business continuity, security and fraud risks. Risk aspects are analysed in general, while operational risks are analysed by quantitative methods which are measured and reported through internal committees, such as Risk Committee, Operational Risks Committee, Financial Crimes Fighting Committee and Compliance Committee. Results are communicated for the information of the directors by means of periodical reports which are provided to Audit Committee members. The Compliance function maintains oversight of business operations and management action to ensure conformity with regulatory requirements, particularly the Rules for Opening of Bank Accounts, Anti-Money Laundering and Terrorism Finance Fighting Rules and CMA Rules and Regulations. This department operates in collaboration with all Bank segments and departments to ensure compliance of the Bank's policies and work processes with the regulatory requirements through an annual Compliance programme to be prepared by the Internal Compliance Department and approved by the Audit Committee. Plans, achievements and progress are tracked in quarterly reports and an annual comprehensive report addressed to SAMA and submitted to the Board.

The risk management process is fully integrated with the strategic planning, annual operating plan and capital planning cycle. Furthermore, each employee is expected to be accountable for and to manage the risk within his or her assigned responsibilities based on the governance principles adopted by the Bank and addressed during training programmes.

The systems and procedures for the ongoing identification, evaluation and management of the significant risks faced by SABB were in place throughout the year. These procedures enabled SABB to discharge its obligations under the rules and regulations issued by SAMA.

Internal Audit (INA), together with the Risk Management and Compliance function, forms an integral part of the control environment of SABB. These functions operated in 2011 each within the frame and limits of liability. To this effect, they have performed numerous audits and inspection activities which covered many aspects of the Bank's activities with the objective of measuring aspects of compliance with the rules, regulations and procedures adopted. Such functions have also handled all audit and inspection processes adopted by the regulatory authorities in 2011G under which all comments covered by supervisory prudential returns were handled in line with the action plan prepared in coordination with those authorities.

Positioned as an independent, tertiary line of control, INA provides management and, through the Audit Committee, the Board with an independent and objective assessment on whether the framework of risk management, control and governance processes, as designed and represented by management, are adequate and functioning effectively.

Internal Audit accomplishes this by independently reviewing, through a risk-based approach, the design effectiveness and operating efficiency of internal control systems and policies prepared and implemented by Business management. Internal Audit also reviews and reports on the adequacy and effectiveness of oversight maintained by support functions such as internal control, compliance and risk management departments, to ensure that the Bank is operating within its stated risk appetite and in compliance with the regulatory framework.

Directors' Report (continued)

Human Resources

2011 was a transformational year for HR with all HR strategic goals being developed in alignment with the Bank's strategy. To meet the challenging business objectives, detailed attention was given to up-grading all HR tools and solutions to ensure enhancement of the overall knowledge and capability of SABB staff.

In line with SABB's efforts of pursuing a sustainable growth strategy, a robust talent assessment exercise was completed for all executives to assist in the identification of high potential staff capable of executing the current and future business strategies of the Bank. This activity complements the Bank's objective of building Saudi successors with high skills and capabilities and are able to fill critical leadership roles of the Bank in the years to come.

The learning and development approach of SABB was transformed in alignment with the overall People Strategy and "Best-in-Class" global learning models and practices. In this regard SABB has the added advantage of being able to leverage the best practices offered by the HSBC Group. As part of the new developmental approach, various solutions were designed and implemented to enhance the leadership capabilities, knowledge and service delivery of all staff thereby providing them with a platform on which to build their overall career progression. As part of the new model, SABB invested in the implementation of a state of the art e-learning platform (MyLearning) which consists of a vast array of e-learning modules. During the year, a total of 13,433 training days were attended by SABB staff and an additional 3,660 e-learning modules were completed.

SABB continued to invest in a robust performance management system to ensure the delivery of desired business results by inter-relating business objectives with individual performance plans. This included the implementation of a bank-wide Performance Calibration exercise. SABB pursued a performance-based, market-driven rewards strategy that included participation in annual compensation and benefits surveys in the Kingdom that enabled the Bank to keep abreast of on-going market trends. Additionally, following SAMA and FSB guidelines, the Bank revamped its compensation structures to be fully aligned with prudent risk management.

SABB embarked on several strategic Saudisation initiatives that included the taking of a number of local and overseas recruitment initiatives during the year. These included participation in major career day events in Saudi Arabia, the United Kingdom and the United States of America to enable identification of young high-potential Saudi graduates well able to join SABB Development Programmes. In addition, the offering of attachments for quality undergraduates in co-operative programmes and the provision of summer internships ensured our commitment towards supporting the development of Saudi undergraduates.

At year end, SABB's total staff amounted to 3,123 of which 422 were ladies. The Saudisation ratio at 31st December 2011 was 85.6%.

Business Support

In line with the "Total Operating Model" recommendations, five departments were united under the one umbrella of "Business Support" during the year, namely Corporate Real Estate, Administration Affairs, Purchasing, Security, Safety and Government Relations and Crisis Management and Business Continuity.

Corporate Real Estate carried out an extensive capacity planning exercise to ensure both freehold and leasehold property portfolios were optimally utilised. As a result two main buildings were vacated, namely NSC and BDH, and another, CPM, was partially vacated and converted into a hot contingency site for business continuity. The NSC building has been sold whilst BDH remained on the market as at 31 December. The Head Office and Area Management buildings have been restructured to house those functions moved out of vacated buildings and to meet co-location preferences required for better work synergy. As a result the Vacancy Ratio has dropped from 18.5% to 7.9%, the Density Ratio has fallen from 12.1 to 8.5 square metres per staff member and the total operating cost (TOC) of the freehold premises has reduced to 10% a year thereby ensuring maintenance of SABB's forefront position amongst its peer group in terms of TOC/Capital (2.57%) and TOC/Assets (0.15%).

Given the current economic environment, the branch network expansion programme has been slowed down and as a result just two new branch premises were built in 2011. These were Sulaimaniah new branch in Jeddah and Buraidah branch's new premises. Both branches are purpose-built, stand-alone premises incorporating ladies sections and D/U ATM facilities with ample surface car parking. Additionally, 32 new ATM were installed and 8 branches and 3 buildings across the Kingdom were renovated and re-branded, some with shaded parking facilities, to the ultimate convenience of customers and staff.

Business Support *(continued)*

The “CRE Gold Suite Project”, consisting of the supply, installation and commissioning of new electromechanical equipment (generators, UPS, transformers, A/Cs and Main Distribution Boards) was initiated and completed during the year to provide sufficient back-up power and cooling capacity for the Primary and Recovery Data Centers in Riyadh and Jeddah. Furthermore, power saving panels have been installed in 64 branches Kingdom-wide resulting in a 12.9% saving in electricity consumption compared with last year. Additional back-up power systems were installed in 4 more branches, making a total of 46 branches having this facility, which provides back-up power in case of commercial power failures.

Health, Safety and Environment launched several programmes, events and campaigns during the year, including the Anti-Smoking Campaign, whilst the Bank also participated in World Water Day and World Environment Day. Further, several “working environment” tests have been carried out including those for indoor air/water quality, noise levels and light intensity to ensure a healthy working environment is provided and maintained at all times.

Purchasing department during 2011 executed 69 different types of contracts related to in excess of 530 negotiated deals. This resulted in approximate one-off savings of SAR 14 million and sustainable saving of SAR 8.5 million per annum.

Throughout the year Administration department has provided considerable administrative support to the business to enable more effective customer service whilst managing to improve efficiency, reduce cost and information risk breaches; helping protect the environment by reducing the amount and cost of mail sent and returned; and limiting archiving, shredding and recycling paper, particularly confidential documents. The SABB car fleet has also been reduced during the year, by 23%, and is subject to close monitoring going forward.

Security and Fire Safety management remained vigilant and has employed all physical and electronic security measures to ensure the provision of a safe and secure working environment, with the excellent result of zero accidents during the year. The new state-of-the-art Central Monitoring Station (CMS) is now in place and functioning 24/7, covering all branches and off-branch ATMs Kingdom-wide. Fire drills have been conducted twice during the year for all SABB main buildings in collaboration with the Civil Defence, Red Crescent and Local Police.

Crisis Management and Business Continuity received greater attention during the year. A major exercise in improving readiness to deal with major incidents that may cause disruption to normal business operations was completed and a full “Impact Analysis” exercise was carried out on all main functions, buildings and systems. A dedicated 300 seat, plug and play, hot Contingency Site was established in the CPM building and, in December, was full-load tested, moving all transactions via Jeddah IT back-up centre whilst assuming non-availability of HQ. The Business Recovery (BRP) test was logistically successful and has provided comfort to management that a dedicated facility does now exist for all SABB functions to use in case of crisis. IT has immediately started addressing the outcome of the test and future rehearsals will be carried out regularly to ensure full readiness in the unlikely event of crises.

Operations and Processing

Operations and Processing maintained its prominent role in implementing all those automation projects so vital to enhancement of efficiency, reducing operational costs and manual processing and enhancing staff performance whilst also contributing to the live green environmental initiative.

Information Technology

In 2011, the focus of Information Technology was on compliance with the regulatory requirement which stipulates that all Saudi Banks must host systems and support services within the Kingdom. Accordingly several key projects to host systems locally were in progress at the year end such as SWIFT Alliance Hosting and GLEAM Localization (FERMAT), which are expected to be rolled out during 2012. Some of the key systems hosted locally this year included GSI replacement of message broker, replacement of the fraud monitoring system of credit cards and the local hosting of the Moody’s Risk Advisory server.

Throughout the year, Information Technology continued to support and advance innovative technical solutions for all SABB financial group entities, thus enabling them to provide their customers with an enhanced service across all electronic delivery channels. Additionally, major infrastructure improvement initiatives were implemented which resulted in a significant increase in systems availability to 99.5%.

Information Technology has also spearheaded the automation to eliminate manual intensive processes and to improve the “Straight Thru Process” (STP) initiatives, which has resulted in significant cost savings and reduction in manual effort. Some of the many key systems rolled out during 2011 have been the SABB KANA electronic messaging system between the Bank and its customers; the ANDIS System up-grade for instant issuance of cards; the SMS Gateway up-grade; the ATM event monitoring system; the Tadawul Oracle application up-grade and the introduction of a new, operationally-stable Treasury telephony system.

Directors’ Report (continued)

Community Service and Sustainability

SABB is an active and responsible corporate citizen. In 2011 the Bank planned and implemented many initiatives under the umbrella of “SABB in the Community Programmes” focusing on education, environment, health and community service.

During the year, SABB sponsored the KFUPM Chapter of the American Association of Petroleum Geology Society (AAPG) in Saudi Arabia. The exclusive initiative is to support AAPG in fostering scientific research, to advance the science of geology, to promote technology and to inspire high professional conduct through various activities such as field trips and workshops for the faculty and students.

In supporting arts and culture, SABB sponsored the “Painting & Patronage” programme, a social and cultural initiative for the encouragement and promotion of artistic expression to enrich the diverse cultures and traditions prevalent amongst the indigenous people of Saudi Arabia.

Contributing to sustainable environmental and development programmes, SABB sponsored the ‘’Leave No Trace” programme, a national initiative by the Saudi Commission for Tourism and Antiquities to raise awareness of the concept of eco-tourism, which is becoming an important economic resource for local communities in the Kingdom. The project included training in the application of the principles of “Leave No Trace” and calls for the protection of the environment and nature in visited areas by tourists and the general public.

As a good citizen with a true sense of altruism for a community in a state of disaster, a group of SABB employees in the Western Province participated in the rehabilitation of houses damaged by the Jeddah floods, an initiative that was implemented in collaboration with the Society of Majid Bin Abdulaziz for Development and Social Services. Various necessities including new furniture, electrical appliances and other items were provided to flood-stricken homes. The initiatives were highly appreciated by both citizens and residents in Jeddah.

The Bank also cooperated with The Saudi Deaf Association and sponsored a vocational training programme for deaf male and female Saudis that enabled them to enhance their writing and reading skills. They learned the use and commands of sign language used by the deaf and were informed about how to understand and negotiate job offers that will help them to integrate and lead a normal life in Saudi society. The Bank also trained a large number of its customer relations employees on the use of sign language to enable them to assist deaf and hearing impaired customers.

In health and rehabilitation, SABB sponsored a diagnostic technology unit in the Prince Sultan Rehabilitation Complex in the Eastern Province by providing the unit with the latest state-of-the-art equipment used in the diagnosis of various types of disabilities.

In programmes relating to health and welfare of the disabled, SABB supported the Philanthropic Waqf of HRH Prince Salman Bin Abdulaziz in Makkah. The landmark 12 storey, 90-apartment tower with commercial plaza is a non-profit Waqf investment built to generate income that will finance The Disabled Children Association’s future activities. SABB’s contribution to this Waqf reflects the Bank’s role in sustainable Community Service.

International Recognition for SABB

During the year, SABB won a number of major awards from world renowned magazines and international organisations. The awards are testimony to the quality services SABB provides to its clients in Saudi Arabia, enhancing customer experience and facilitating cross-border business.

The bank received the awards in Saudi Arabia in 2011 for being:

- Global Finance Best Trade Finance Provider
- Global Finance Best Sub-Custodian Bank
- Global Finance Best Islamic Project Finance Provider
- Global Finance Best Corporate and Institutional Internet Bank
- Euromoney Best Cash Management Bank
- Euromoney Best Private Bank
- Arabian Business Magazine Bank of the Year
- Global Trade Review Best Trade Finance Bank in Saudi Arabia
- Banker Middle East Best Customer Loyalty Programme
- IFC Most Active GTFP Confirming Bank in MENA and Supporter of SME Trade

SABB Takaful Company

SABB Takaful is a leading provider of Takaful products in Saudi Arabia.

Capitalized at SAR 340 million, the Company was one of the first Takaful companies in the Kingdom to be listed on the Saudi Stock Exchange and is 32.5% owned by SABB Bank and 32.5% by HSBC Group and its subsidiaries, with the balance being held by the general public following an Initial Public Offering in July 2007.

SABB Takaful Company offers a wide range of Takaful products in the Kingdom that focus on the individual and commercial markets with a range of wealth management and protection propositions. The SABB Takaful wealth management proposition for individuals is aimed at meeting their financial needs for education, savings, retirement and investment. These plans are savings wrapped in a protection fund for dependents of the plan-holder in the unfortunate event of death or permanent disability. The SABB Takaful protection proposition for individuals offers a selection of products for travel, Schengen, personal accident and home and contents. The commercial proposition provides protection under marine cargo, fire, property all risks, business interruption and public liability, as well as a business banking package designed for small and medium enterprises. Employee benefits are also made available to commercial customers via group protection plans for employers who are keen to provide coverage benefits for their most valuable assets, their employees, in the regrettable event of death or permanent disability. SABB Takaful has also launched the Hajj and Umrah plan, an innovative product to provide coverage including emergency medical assistance for individuals and groups. The new plan is expected to be the solution of choice for Hajj Pilgrims and Umrah Performers who are looking for Shariah-compliant special coverage.

In June, SABB Takaful introduced the “Straight Thru Processing” system to enhance its distribution capabilities and capacity. This is a portal dedicated to enhancing the efficiency of issuing Family Takaful plans at the point of sale in order to improve customer experience when buying a SABB Takaful product.

As one of the first licensed Takaful companies in Saudi Arabia, SABB Takaful has experienced strong growth over the four years since commencement of operations and is poised to continue to capitalise on the favorable long-term prospects of the local insurance industry. With increasing growth in the market and growing awareness of Shariah-compliant Takaful solutions, the Company is very well placed to benefit from its competitive advantages of increasing market presence and expansion of the business.

As of 31 December 2011, SABB Takaful was considered the most profitable bancassurance company in the country, with gross written contribution amounting to SAR 268 Million, of which SAR 233 Million was Family Takaful business.

SABB Takaful, having developed a compelling proposition, a comprehensive product range and a powerful brand position all allied to the practical use of technology, follows a successful bancTakaful model focusing on customer service, innovative marketing strategies and high quality human capital.

HSBC Saudi Arabia Limited

Investment Banking

Investment Banking Advisory

HSBC Saudi Arabia maintained its prominent position as the leading investment bank in Saudi Arabia in both Equity Capital Markets and Mergers and Acquisitions. During the year, the Division advised on the landmark SAR 7.5 billion (USD 2.0 billion) restructuring of Al-Ittefaq Steel Products Company, representing the first successful corporate restructuring of its size and complexity in Saudi Arabia. In addition, HSBC Saudi Arabia acted as Financial Advisor, Lead Manager and Lead Underwriter to the SAR 396 million (USD 105.6 million) IPO of United Electronics Company (eXtra), one of two premium offerings to have taken place in the Kingdom during 2011. Since the IPO market commenced in Saudi Arabia in 2003, HSBC Saudi Arabia has dominated issuance, through both IPOs and follow-on rights issues, with 20 equity issuances to date and an offering value in excess of SAR 24 billion (USD 6.4 billion), more than any other financial adviser.

Directors' Report (continued)

Investment Banking Finance – Debt Capital Markets and Syndicated Finance

HSBC Saudi Arabia continued to dominate the Debt Capital Markets and Syndicated Finance space in Saudi Arabia, since inception continuously ranking number one for both local and international issuances by Saudi issuers. During the year the Division successfully led four debt capital market issuances for key clients, helping them issue SAR 6,000 million of debt securities in the local market. In addition, it actively distributed international offerings into Saudi Arabia, helping issuer and investor clients locally and internationally. These issuances included Bank Al Jazirah's subordinated Sukuk offering (the first subordinated Sukuk for a Saudi Islamic bank), as well as Saudi Binladin Group's innovative short-term Sukuk. The foregoing were in addition to a lead level involvement in all significant syndicated loans in the Kingdom during the year, including book runner positions (for both HSBC Saudi Arabia and SABB) in syndicated loans for Chemanol, Jabal Omar, National Shipping and an STC subsidiary (Axis telecom in Indonesia). The Division's professionalism was highlighted when The Banker – a leading global financial publication - again selected HSBC Saudi Arabia's Debt Capital Markets team as the global "team of the month" for its work on the USD 1.2 billion financing of STC's Indonesian subsidiary, quoting "the deal is significant not only because of the size but also because, for many of the players involved, it was the first dealing with Shariah principles, presenting HSBC and its Saudi affiliate a complex task".

Project and Export Finance

HSBC Saudi Arabia Limited continued its leadership in Project and Export Finance business in the Kingdom, across both advisory and arranging activities. The year continued the remarkable success of the Division on the advisory side such that by the year end it was advising on seven key mandates across several sectors and a spectrum of blue-chip clients, including Saudi Aramco, SABIC, Ma'aden, Tasnee, Sipchem, Sahara and Mohamed Al Rajhi & Sons. On the arranging side, HSBC and SABB acted as Mandated Lead Arranger on the USD 2,100 million project financing for Saudi Electricity Company's Qurayyah IPP as well on Ma'aden Aluminium's Mine and Refinery USD 2,100 million project financing. In addition, HSBC Saudi Arabia and SABB played leading roles in bridge facilities extended to projects on certain key transactions. Furthermore, the Division concluded two significant Export Financing transactions for key clients, thereby establishing a clear lead in this area of business: a USD 435 million financing for SABIC by SACE (the Italian export credit agency) and a USD 990 million financing for Saudi Electricity Company by Coface (the French export credit agency) in relation to the Shoaiba 3 project.

Asset Management

The Asset Management Division of HSBC Saudi Arabia maintained its position as one of the leading asset management companies in the Kingdom as global capital markets remained volatile. The division offers clients a diverse and full range of investment products including equity, fixed income, liquidity and alternative strategies. The division continued to manage focused investment strategies that are responsive to client needs while delivering long-term value. With a large suite of mutual funds and managed portfolios, the division had assets under management of over US$ 4 billion as at 31 December 2011. In its efforts to provide investors with diversification opportunities as well as inflation hedging, the Division launched a Shariah-compliant commodity fund in October 2011 as well as a locally listed Exchange Traded Fund (ETF), the first such fund from HSBC in the region. Furthermore, in the managed portfolio space, the firm expanded its coverage to GCC markets whilst also appointing investment advisory staff to provide investment advice to Private and HNWI clients.

Equity Brokerage

During the year, the Bank's securities business offered by SABB Securities was merged with HSBC Saudi Arabia in an effort to offer a full and integrated platform for capital markets solutions to clients. The brokerage division offers a comprehensive range of services including cash equity and equity financing through different delivery channels, including fifteen Investment Centres across the Kingdom, on-line services such as SABB Tadawul and SABB Mubasher and phone services via the Brokerage Call Centre. These services are supported by a dedicated research team that provides timely and comprehensive sector and company research.

HSBC also continues to be one of the top providers of Access products to international institutional investors. HSBC's swaps offering enables international institutional investors to participate in the growth of Saudi single listed stocks indirectly, an offering in which HSBC enjoys a pre-eminent position.

Equity Research

In less than three years, HSBC Saudi Arabia has established a significant local presence and now provides research on companies that account for about 80% of the total market capitalisation on Tadawul. The research provided is best in class and is setting the standard for the region.

Securities Services

HSBC Securities Services maintained its market dominating position in the Kingdom and remained service provider of choice for foreign institutional investors and Saudi government, semi-government and family houses. The company's focus remained on product development and the active marketing of such products whilst successfully launching a business module to support ETF, DPM and Amanah custody. Global and SWAP custody and Agency Services witnessed remarkable growth in terms of client base and a constant increase in assets under custody as well as in revenues. Furthermore, a number of major deals were signed which will have a significant impact on revenues. HSBC Securities Services has a compelling product range with a powerful brand position, coupled with a strong team to support the business. It is anticipated that the impending opening of the Saudi market to foreign investors will provide a major boost to the custody business.

International Recognition for HSBC Saudi Arabia

The year has seen HSBC Saudi Arabia receive an array of awards from leading financial journals including Best Investment Bank in Saudi Arabia; Best Global Infrastructure and Project Finance House; Most Innovative Investment Bank for Infrastructure and Project Finance; MENA Fund Manager: Fund of Funds of the Year (HSBC Amanah Multi Assets Growth Fund) and Sector Fund of the Year (HSBC Amanah Saudi Industrial Companies Fund); and Best Custodian Bank in Saudi Arabia.

INDEPENDENT AUDITORS' REPORT

To the Shareholders of The Saudi British Bank (a Saudi Joint Stock Company)

We have audited the accompanying consolidated financial statements of The Saudi British Bank (the "Bank") and its subsidiary, which comprise the consolidated statement of financial positions as at 31 December 2011, and the consolidated statements of income, comprehensive income, changes in shareholders' equity and cash flows for the year then ended, and a summary of significant accounting policies and other explanatory notes from 1 to 41. We have not audited note 38, nor the information related to "Basel II Pillar 3 disclosures" cross referenced therein, which is not required to be within the scope of our audit.

Management's Responsibility for the Consolidated Financial Statements

Management is responsible for the preparation and fair presentation of these consolidated financial statements in accordance with Accounting Standards for Financial Institutions issued by the Saudi Arabia Monetary Agency ("SAMA"), International Financial Reporting Standards, the provisions of the Regulations of Companies, the Banking Control Law in the Kingdom of Saudi Arabia and the Bank's Articles of Association. In addition, management is responsible for such internal controls as management determines is necessary to enable the preparation of consolidated financial statements that are free from material misstatement, whether due to fraud or error.

Auditors' Responsibility

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

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

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

Opinion

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

- present fairly, in all material respects, the financial position of the Bank and its subsidiary as at 31 December 2011, and their financial performance and cash flows for the year then ended in accordance with Accounting Standards for Financial Institutions in the Kingdom of Saudi Arabia issued by SAMA and with International Financial Reporting Standards; and
- comply with the requirements of the Regulations for Companies, the Banking Control Law in the Kingdom of Saudi Arabia and the Bank's Articles of Association in so far as they affect the preparation and presentation of the consolidated financial statements.

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20 Rabi Awal 1433H
(12 February 2012)

Consolidated Statement of Financial Position

As at 31 December

	Notes	2011 SAR'000	2010 SAR'000
ASSETS			
Cash and balances with SAMA	*3*	**22,380,625**	15,144,088
Due from banks and other financial institutions	*4*	**4,347,018**	7,042,310
Investments, net	*5*	**22,200,122**	24,972,442
Loans and advances, net	*6*	**84,811,287**	74,248,486
Investment in associates	*7*	**565,191**	221,532
Property and equipment, net	*8*	**536,922**	558,609
Other assets	*9*	**3,816,340**	3,185,399
Total assets		**138,657,505**	125,372,866
LIABILITIES AND SHAREHOLDERS' EQUITY			
LIABILITIES			
Due to banks and other financial institutions	*11*	**5,894,056**	4,661,178
Customers' deposits	*12*	**105,576,542**	94,672,855
Debt securities in issue	*13*	**3,978,660**	5,475,754
Borrowings	*14*	**171,875**	187,500
Other liabilities	*15*	**5,870,171**	5,203,632
Total liabilities		**121,491,304**	110,200,919
SHAREHOLDERS' EQUITY			
Share capital	*16*	**7,500,000**	7,500,000
Statutory reserve	*17*	**6,180,972**	5,458,863
Other reserves	*18*	**(225,710)**	105,971
Retained earnings		**3,148,439**	1,544,613
Proposed dividends	*26*	**562,500**	562,500
Total shareholders' equity		**17,166,201**	15,171,947
Total liabilities and shareholders' equity		**138,657,505**	125,372,866

The accompanying notes 1 to 41 form an integral part of these consolidated financial statements.

Consolidated Statement of Income

For the years ended 31 December

	Notes	2011 SAR'000	2010 SAR'000
Special commission income	*20*	**3,515,880**	3,724,908
Special commission expense	*20*	**493,905**	481,865
Net special commission income		**3,021,975**	3,243,043
Fees and commission income, net	*21*	**1,215,004**	1,181,322
Exchange income, net		**265,095**	126,677
Trading income, net	*22*	**307,860**	258,279
Dividend income		**51,474**	3,707
Gains on non-trading investments, net	*23*	**4,192**	-
Other operating income		**32,991**	26,393
Total operating income		**4,898,591**	4,839,421
Salaries and employee related expenses	*24*	**996,169**	969,583
Rent and premises related expenses		**96,246**	90,840
Depreciation	*8*	**94,995**	113,114
General and administrative expenses		**417,762**	580,633
Provision for credit losses, net	*6*	**475,530**	1,233,526
Impairment of other financial assets	*5*	**(6,742)**	9,553
Other operating expenses		**361**	94
Total operating expenses		**2,074,321**	2,997,343
Income from operating activities		**2,824,270**	1,842,078
Share in earnings of associates, net	*7*	**64,165**	41,074
Net income for the year		**2,888,435**	1,883,152
Basic and diluted earnings per share (in SAR)	*25*	**3.85**	2.51

The accompanying notes 1 to 41 form an integral part of these consolidated financial statements.

Consolidated Statement of Comprehensive Income

For the years ended 31 December

	Notes	2011 SAR'000	2010 SAR'000
Net income for the year		**2,888,435**	1,883,152
Other comprehensive income:			
Available for sale financial assets			
- Net change in fair value	*18*	**(315,714)**	281,568
- Transfer to consolidated statement of income	*18*	**(4,192)**	-
Cash flow hedges			
- Net change in fair value	*18*	**(3,190)**	(33,452)
- Transfer to consolidated statement of income	*18*	**(8,585)**	(4,610)
		(331,681)	243,506
Total comprehensive income for the year		**2,556,754**	2,126,658

The accompanying notes 1 to 41 form an integral part of these consolidated financial statements.

Consolidated Statement of Changes in Shareholders' Equity

For the years ended 31 December

2011	Notes	*Share capital* SAR'000	*Statutory reserve* SAR'000	*Other reserves* SAR'000	*Retained earnings* SAR'000	*Proposed dividend* SAR'000	*Total* SAR'000
Balance at beginning of the year		**7,500,000**	**5,458,863**	**105,971**	**1,544,613**	**562,500**	**15,171,947**
Total comprehensive income for the year							
- Net income for the year		**-**	**-**	**-**	**2,888,435**	**-**	**2,888,435**
- Other comprehensive income		**-**	**-**	**(331,681)**	**-**	**-**	**(331,681)**
Transfer to statutory reserve	*17*	**-**	**722,109**	**-**	**(722,109)**	**-**	**-**
2010 final proposed dividend paid		**-**	**-**	**-**	**-**	**(562,500)**	**(562,500)**
2011 final proposed dividend	*26*	**-**	**-**	**-**	**(562,500)**	**562,500**	**-**
Balance at end of the year		**7,500,000**	**6,180,972**	**(225,710)**	**3,148,439**	**562,500**	**17,166,201**
2010							
Balance at beginning of the year		7,500,000	4,988,075	(137,535)	694,749	-	13,045,289
Total comprehensive income for the year							
- Net income for the year		-	-	-	1,883,152	-	1,883,152
- Other comprehensive income		-	-	243,506	-	-	243,506
Transfer to statutory reserve	*17*	-	470,788	-	(470,788)	-	-
2010 final proposed dividend	*26*	-	-	-	(562,500)	562,500	-
Balance at end of the year		7,500,000	5,458,863	105,971	1,544,613	562,500	15,171,947

The accompanying notes 1 to 41 form an integral part of these consolidated financial statements.

Consolidated Statement of Cash Flows

For the years ended 31 December

	Notes	2011 SAR'000	2010 SAR'000
OPERATING ACTIVITIES			
Net income for the year		**2,888,435**	1,883,152
Adjustments to reconcile net income to net cash from (used in) operating activities:			
Accretion of discount on non-trading investments		**(6,638)**	(7,821)
Gains on non-trading investments, net	*23*	**(4,192)**	-
Depreciation	*8*	**94,995**	113,114
(Gains) losses on disposal of property and equipment, net		**(3,362)**	94
Share in earnings of associates, net	*7*	**(64,165)**	(41,074)
Provision for credit losses, net	*6*	**475,530**	1,233,526
Impairment of other financial assets		**(6,742)**	9,553
Change in carrying value of debt securities in issue		**(21,797)**	(233,733)
		3,352,064	2,956,811
Net (increase) decrease in operating assets:			
Statutory deposit with SAMA	*3*	**(555,871)**	(76,234)
Investments held for trading, net		**18,786**	313,945
Loans and advances		**(11,038,331)**	899,587
Other assets		**(630,941)**	59,436
Net increase (decrease) in operating liabilities:			
Due to banks and other financial institutions		**1,232,878**	(8,944,566)
Customers' deposits		**10,903,687**	5,485,994
Other liabilities		**670,185**	111,250
Net cash from operating activities		**3,952,457**	806,223
INVESTING ACTIVITIES			
Proceeds from sale and maturities of non-trading investments		**24,706,666**	26,753,333
Purchase of non-trading investments		**(22,267,241)**	(27,980,396)
Purchase of property and equipment	*8*	**(79,238)**	(78,438)
Investment in associates	*7*	**(279,494)**	-
Proceeds from disposal of property and equipment		**9,292**	663
Net cash from (used in) investing activities		**2,089,985**	(1,304,838)
FINANCING ACTIVITIES			
Debt securities in issue		**(1,475,297)**	-
Borrowings		**(15,625)**	-
Dividends paid		**(566,146)**	(10,699)
Net cash used in financing activities		**(2,057,068)**	(10,699)
Increase (decrease) in cash and cash equivalents		**3,985,374**	(509,314)
Cash and cash equivalents at the beginning of the year		**16,947,600**	17,456,914
Cash and cash equivalents at the end of the year	*27*	**20,932,974**	16,947,600
Special commission received during the year		**3,637,285**	3,740,263
Special commission paid during the year		**511,660**	568,217
Supplemental non cash information			
Other comprehensive income		**(331,681)**	243,506

The accompanying notes 1 to 41 form an integral part of these consolidated financial statements.

Notes to the Consolidated Financial Statements (31 December 2011)

1. General

The Saudi British Bank (SABB) is a Saudi Joint Stock Company and was established by Royal Decree No. M/4 dated 12 Safar 1398H (21 January 1978). SABB 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. SABB operates under Commercial Registration No. 1010025779 dated 22 Dhul Qadah 1399H (13 October 1979) as a commercial bank through a network of 80 branches (2010: 81 branches) in the Kingdom of Saudi Arabia. SABB employed 3,123 staff as at 31 December 2011 (2010: 3,389). The address of SABB's head office is as follows:

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

The objectives of SABB are to provide a range of banking services. SABB also provides Shariah approved products, which are approved and supervised by an independent Shariah Board established by SABB.

SABB has 100% (2010: 100%) ownership interest in a subsidiary, SABB Securities Limited, a Saudi limited liability company formed in accordance with Capital Market Authority's Resolution No. 2007-35-7 dated 10 Jamada II 1428H (25 June 2007) and registered in the Kingdom of Saudi Arabia under Commercial Registration No. 1010235982 dated 8 Rajab 1428H (22 July 2007). SABB has 98% direct and 2% indirect ownership interest in its subsidiary (the indirect ownership is held via a limited liability company registered in the Kingdom of Saudi Arabia). The principal activities of the subsidiary were to engage in the business of custody and dealing as an agent excluding underwriting. However, effective 1 July 2011 the assets and liabilities of the Company have been transferred to HSBC Saudi Arabia Limited, an associate company of SABB in lieu of additional shares (see note 7). The Company will be liquidated once the legal formalities for transfer of business have been completed.

SABB has 100% (2010 : 100 %) ownership interest in a subsidiary, SABB Insurance Agency Company Limited, a Limited Liability Company registered in the Kingdom of Saudi Arabia under commercial registration No. 1010235187 dated 18 Jumada II 1428H (3 July 2007). SABB has 98% direct and 2% indirect ownership interest in its subsidiary (the indirect ownership is held via a limited liability company registered in the Kingdom of Saudi Arabia). The principal activity of the subsidiary is to act as a sole insurance agent for SABB Takaful Company (an associate company- see note 7) within the Kingdom of Saudi Arabia as per the agreement between them. However, the articles of association do not restrict the Company from acting as an agent to any other insurance company in the Kingdom of Saudi Arabia.

SABB has 51% (2010 : 51 %) ownership interest in a subsidiary, SABB Insurance Services Limited, a Limited Liability Company registered in the Kingdom of Saudi Arabia under commercial registration number 1010241209 dated 24 Dhul Qadah 1428H (4 December 2007). The principal activity of the subsidiary is to act as insurance brokers and consultants to consumers operating within the Kingdom of Saudi Arabia. The Company commenced its operations from 24 Dhul Qadah 1428H (4 December 2007). SABB is in the process of selling its entire investment in SABB Insurance Services Limited to Marsh Saudi Arabia. The transaction is expected to be completed in the first quarter of 2012.

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). SABB prepares its consolidated financial statements to comply with the Banking Control Law, the Regulations for Companies in the Kingdom of Saudi Arabia and SABB's article of association.

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 the risks that are being hedged.

Notes to the Consolidated Financial Statements (31 December 2011) (continued)

1.1. Basis of preparation *(continued)*

c) Functional and presentation currency

These consolidated financial statements are expressed in Saudi Arabian Riyals (SAR), rounded off to the nearest thousands, which is the functional currency of SABB and its subsidiary.

d) Basis of consolidation

The consolidated financial statements comprise the financial statements of SABB and its subsidiary, SABB Securities Limited (collectively referred to as "the Bank"). The financial statements of the subsidiary are prepared for the same reporting year as that of SABB, using consistent accounting policies. The Bank has not consolidated SABB Insurance Agency Limited and SABB Insurance Services Limited as their total assets, liabilities and their income and expenses are not significant to the Bank's overall consolidated financial statements.

A subsidiary is an entity over which SABB 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 SABB and ceases to be consolidated from the date on which the control is transferred from SABB.

Intercompany 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 judgements, 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. Actual results may differ from these estimates. Revisions to accounting estimates are recognised in the period in which the estimate is revised and future periods. Significant areas where management has used estimates, assumptions or exercised judgements are as follows:

i) Impairment losses on loans and advances

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

The Bank reviews its loan portfolios to assess an additional collective impairment 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.

1.1. Basis of preparation *(continued)*

e) Critical accounting judgements and estimates *(continued)*

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.

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.

f) Going concern

The Bank's management has made an assessment of the Bank's ability to continue as a going concern and is satisfied that the Bank has the resources to continue in business for the foreseeable future. Furthermore, the management is not aware of any material uncertainties that may cast significant doubt upon the Bank's ability to continue as a going concern. Therefore, the consolidated financial statements continue to be prepared on the going concern basis.

2. Summary of significant accounting policies

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

a) Changes in accounting policies

The accounting policies adopted are consistent with those of the previous financial year.

Amendments resulting from improvements to IFRSs to the following standards did not have any impact on the accounting policies, financial position or performance of the Bank:

IAS 24 Related Party Disclosures (revised 2009)

The revised IAS 24 Related Party Disclosures amends the definition of a related party and modifies certain related party disclosure requirements for government-related entities.

(Amendments to IFRS 7) Amendments to IFRS 7 – Financial Instruments: Disclosures Transfers of Financial Assets

These amendments introduce new disclosure requirements about transfers of financial assets, including disclosures for:

- Financial assets that are not derecognised in their entirety; and
- Financial assets that are derecognised in their entirety but for which the entity retains continuing involvement

Improvements to IFRSs 2010 – IFRS 7 Financial Instruments: Disclosures

The amendments add an explicit statement that qualitative disclosure should be made in the context of the quantitative disclosures to better enable users to evaluate an entity's exposure to risks arising from financial instruments. In addition, the IASB amended and removed existing disclosure requirements.

Notes to the Consolidated Financial Statements (31 December 2011) (continued)

2. **Summary of significant accounting policies** *(continued)*

Improvements to IFRSs 2010 – IAS 1 Presentation of Financial Statements
IAS 1 is amended to clarify that disaggregation of changes in each component of equity arising from transactions recognised in other comprehensive income also is required to be presented in the financial statements, but is permitted to be presented either in the statement of changes in equity or in the notes.

Other amendments resulting from the improvements to IFRSs relating to the following standards did not have any material impact on the accounting policies, financial position and performance of the Bank:

- IAS 27
- IAS 32

b) 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.

c) Derivative financial instruments and hedge accounting

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 appropriate.

The treatment of changes in their fair value depends on their classification into the following categories:

i) Derivatives held for trading

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

ii) Embedded derivatives

Derivatives embedded in other financial instruments are treated as separate derivatives and recorded at fair value if their economic characteristics and risks are not closely related to those of the host contract, and the host contract is not itself held for trading or designated at fair value through profit or loss. The embedded derivatives separated from the host are carried at fair value in the trading derivatives portfolio with changes in fair value recognised in the consolidated statement of income.

2. Summary of significant accounting policies *(continued)*

c) ***Derivative financial instruments and hedge accounting*** *(continued)*

iii) ***Hedge accounting***

The Bank designates certain derivatives as hedging instruments in qualifying hedging relationships.

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.

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 unamortised fair value adjustment is recognised immediately in the consolidated 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 the consolidated statement of comprehensive income. 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.

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

d) ***Foreign currencies***

Transactions in foreign currencies are translated into Saudi Arabian Riyals at the spot 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 reporting date. The foreign currency gain or loss on monetary items is the difference between amortised cost in the functional currency at the beginning of the year adjusted for effective interest and payments during the year, and the amortised cost in foreign currency translated at the exchange rate at the end of the year. All differences arising on non-trading activities are taken to other non operating income in the statement of income, with the exception of differences on foreign currency borrowings that provide an effective hedge against a net investment in foreign entity. 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 for differences arising on the retranslation of available for sale equity instruments or when deferred in equity as qualifying cash flow hedges and qualifying net investment hedges. Translation gains or losses on non-monetary items carried at fair value are included as part of the fair value adjustment either in the consolidated statement of income or in equity depending on the underlying financial asset.

Notes to the Consolidated Financial Statements (31 December 2011) (continued)

2. Summary of significant accounting policies *(continued)*

e) *Offsetting financial instruments*

Financial assets and liabilities are offset and are reported net in the consolidated statement of financial position 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.

f) *Revenue/expenses recognition*

Special commission income and expense

Special commission income and expense for all commission-bearing financial instruments, except for those classified as held for trading or designated as at fair value through income statement (FVIS), are recognised in the consolidated statement of income on the effective yield basis. The effective commission rate is the rate that exactly discounts the estimated future cash payments and receipts through the expected life of the financial asset or liability (or, where appropriate, a shorter period) to the carrying amount of the financial asset or liability. When calculating the effective commission rate, the Bank estimates future cash flows considering all contractual terms of the financial instrument but not future credit losses.

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 commission rate and the change in carrying amount is recorded as special commission income or expense.

If 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 commission rate applied to the new carrying amount.

The calculation of the effective yield takes into account all contractual terms of the financial instruments (prepayment, options etc.) and includes all fees paid or received related transaction costs, and discounts or premiums that are an integral part of the effective commission rate. Transaction costs are incremental costs that are directly attributable to the acquisition, issue or disposal of financial asset or liability.

When the Bank enters into 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.

Exchange income/loss

Exchange income/loss is recognised when earned/incurred.

Fees and commission income

Fees and commission income are recognised on an accrual basis when the service has been provided. Loan commitment fees for loans that are likely to be drawn down are deferred and, together with the related direct cost are recognised as an adjustment to the effective yield on the loan. Portfolio and other management advisory and service fees are recognised based on the applicable service contract, usually on a time proportionate basis. Fees received on asset management, wealth management, financial planning, custody services and other similar services that are provided over an extended period of time are recognised rateably over the period when the service is being provided. When a loan commitment is not expected to result in the drawdown of a loan, loan commitment fees are recognised on a straight-line basis over the commitment period. Other fees and commission expense relate mainly to transaction and service fees, which is expensed as the service is received.

Dividend income

Dividend income is recognised when the right to receive income is established.

Net trading income

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

2. Summary of significant accounting policies *(continued)*

g) *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 statement of financial position and are measured in accordance with related accounting policies for the underlying financial assets held as FVIS, available for sale, held to maturity and other investments held at amortised cost. The counterparty liability for amounts received under these agreements is included in "due to banks and other financial institutions" or "customers' deposits", as appropriate. The difference between sale and repurchase price is treated as special commission expense and amortised over the life of the repo agreement, using the effective yield method.

Assets purchased with a corresponding commitment to resell at a specified future date (reverse repo) are not recognised in the consolidated statement of financial position, 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.

h) *Investments*

All investment securities are initially recognised at their fair value which represents the consideration given, including acquisition charges associated with the investment (except for investments held as FVIS, where acquisition charges 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 reporting 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 IAS 39. Investments classified as trading are acquired principally for the purpose of selling or repurchasing in the short term. An investment may be designated as FVIS by the management if it satisfies the criteria set out below (except for 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 IAS 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 recognised when the Bank enters into the contractual provisions of the arrangements with counterparties on trade date and derecognised when sold.

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

Notes to the Consolidated Financial Statements (31 December 2011) (continued)

2. Summary of significant accounting policies *(continued)*

h) *Investments (continued)*

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 commission 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 the consolidated statement of comprehensive income. On derecognition, any cumulative gain or loss previously recognised in the consolidated statement of comprehensive income is included in the consolidated statement of income for the period.

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

iii) *Held to maturity*

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

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

iv) *Held at amortised cost*

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

i) *Investment in associates*

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

Under the equity method, investment in associates is carried in the statement of financial position at cost plus post acquisition changes in the Bank’s share of net assets of the associates, less any impairment. The investments in associates are carried in the statement of financial position at the lower of equity accounted or recoverable amount.

The reporting dates of the associates 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 associates are eliminated to the extent of the Bank’s interest in the associates.

2. **Summary of significant accounting policies** *(continued)*

j) Loans and advances

Loans and advances are non-derivative financial assets originated or acquired by the Bank with fixed or determinable payments 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.

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

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

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

l) Impairment of financial assets

An assessment is made at each reporting 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.

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

Notes to the Consolidated Financial Statements (31 December 2011) (continued)

2. Summary of significant accounting policies *(continued)*

l) *Impairment of financial assets* (continued)

i) *Impairment of financial assets held at amortised cost*

A financial asset is classified as impaired when there is 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 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 held at fair value, where a loss has been recognised directly under shareholders' equity, the cumulative net loss recognised in 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 the 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 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 commission rate.

2. Summary of significant accounting policies *(continued)*

m) 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	33 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 the carrying amount. These are included in the consolidated statement of income.

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.

n) 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 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.

o) Provisions

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

p) Guarantees

Financial guarantees are initially recognised in the consolidated financial statements at fair value in other liabilities, being the value of the premium received. Subsequent to the initial recognition, the Bank's liability under each guarantee is measured at the higher of the amortised premium and the best estimate of expenditure required to settle any financial obligations arising as a result of guarantees. Any increase in the liability relating to the financial guarantee is taken to the consolidated statement of income in "provision for credit losses". The premium received is recognised in the consolidated statement of income in "Fees and commission income, net" on a straight-line basis over the life of the guarantee.

q) 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.

r) 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 repos with SAMA excluding the statutory deposit, and due from banks and other financial institutions with an original maturity of ninety days or less from date of acquisition.

Notes to the Consolidated Financial Statements (31 December 2011) (continued)

2. Summary of significant accounting policies *(continued)*

s) 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.

t) 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.

u) 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.

v) Shariah approved banking products

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

All Shariah approved 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

	2011	2010
	SAR'000	SAR'000
Cash in hand	**821,743**	785,487
Statutory deposit	**5,794,669**	5,238,798
Reverse repos	**15,208,895**	9,084,874
Other balances	**555,318**	34,929
Total	**22,380,625**	15,144,088

In accordance with the Banking Control Law and regulations issued by SAMA, the Bank is required to maintain a statutory deposit with SAMA at stipulated percentages of its demand, savings, time and other deposits, calculated at the end of each month. The statutory deposits with SAMA are not available to finance the Bank's day-to-day operations and therefore are not part of cash and cash equivalents.

4. Due from banks and other financial institutions

	2011	2010
	SAR'000	SAR'000
Current accounts	**3,298,863**	6,286,816
Money market placements	**1,048,155**	755,494
Total	**4,347,018**	7,042,310

5. Investments, net

a) Investment securities are classified as follows:

	Domestic		International		Total	
	2011	2010	**2011**	2010	**2011**	2010
	SAR'000	SAR'000	**SAR'000**	SAR'000	**SAR'000**	SAR'000
i) Held as FVIS						
Fixed rate securities	**-**	-	**-**	18,783	**-**	18,783
Floating rate securities	**13,472**	13,475	**-**	-	**13,472**	13,475
Held as FVIS	**13,472**	13,475	**-**	18,783	**13,472**	32,258

Investments classified under FVIS are all held for trading amounting to SAR 13.5 million (2010: SAR 32.3 million).

	Domestic		International		Total	
	2011	2010	**2011**	2010	**2011**	2010
	SAR'000	SAR'000	**SAR'000**	SAR'000	**SAR'000**	SAR'000
ii) Available for sale						
Fixed rate securities	**10,627,077**	12,413,714	**3,975,463**	2,887,871	**14,602,540**	15,301,585
Floating rate securities	**4,221,234**	4,731,526	**758,102**	1,269,258	**4,979,336**	6,000,784
Equities	**984,171**	1,272,024	**55,622**	56,221	**1,039,793**	1,328,245
Available for sale investments, gross	**15,832,482**	18,417,264	**4,789,187**	4,213,350	**20,621,669**	22,630,614
Allowance for impairment	**-**	-	**(24,490)**	(31,232)	**(24,490)**	(31,232)
Available for sale investments, net	**15,832,482**	18,417,264	**4,764,697**	4,182,118	**20,597,179**	22,599,382
iii) Held at amortised cost						
Fixed rate securities	**1,351,172**	2,102,215	**-**	-	**1,351,172**	2,102,215
Floating rate securities	**138,000**	138,000	**9,000**	9,000	**147,000**	147,000
Held at amortised cost, gross	**1,489,172**	2,240,215	**9,000**	9,000	**1,498,172**	2,249,215
Allowance for impairment	**-**	-	**(9,000)**	(9,000)	**(9,000)**	(9,000)
Held at amortised cost, net	**1,489,172**	2,240,215	**-**	-	**1,489,172**	2,240,215
iv) Held to maturity						
Fixed rate securities	**100,299**	100,587	**-**	-	**100,299**	100,587
Held to maturity investments	**100,299**	100,587	**-**	-	**100,299**	100,587
Investments, net	**17,435,425**	20,771,541	**4,764,697**	4,200,901	**22,200,122**	24,972,442

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

	2011			2010		
	Quoted	***Unquoted***	***Total***	*Quoted*	*Unquoted*	*Total*
	SAR'000	**SAR'000**	**SAR'000**	SAR'000	SAR'000	SAR'000
Fixed rate securities	**3,975,462**	**12,078,549**	**16,054,011**	2,984,483	14,538,687	17,523,170
Floating rate securities	**3,709,013**	**1,430,795**	**5,139,808**	4,815,082	1,346,177	6,161,259
Equities	**984,171**	**55,622**	**1,039,793**	1,261,130	67,115	1,328,245
	8,668,646	**13,564,966**	**22,233,612**	9,060,695	15,951,979	25,012,674
Allowance for impairment	**-**	**(33,490)**	**(33,490)**	-	(40,232)	(40,232)
Investments, net	**8,668,646**	**13,531,476**	**22,200,122**	9,060,695	15,911,747	24,972,442

Unquoted investments include securities of SAR 12,195.5 million (2010: SAR 14,968.9 million) issued by the Saudi Arabian Government and its agencies.

Notes to the Consolidated Financial Statements (31 December 2011) (continued)

5. Investments, net *(continued)*

c) *The analysis of unrealised gains and the fair values of held at amortised cost and held to maturity investments, are as follows:*

	2011			2010		
	Carrying value	*Gross unrealised gain*	*Fair value*	*Carrying value*	*Gross unrealised gain*	*Fair value*
	SAR'000	**SAR'000**	**SAR'000**	SAR'000	SAR'000	SAR'000
i) Held at amortised cost						
Fixed rate securities	**1,351,172**	**68,093**	**1,419,265**	2,102,215	109,481	2,211,696
Floating rate securities	**138,000**	**88**	**138,088**	138,000	9,278	147,278
Total	**1,489,172**	**68,181**	**1,557,353**	2,240,215	118,759	2,358,974
ii) Held to maturity						
Fixed rate securities	**100,299**	**4,627**	**104,926**	100,587	7,477	108,064
Total	**100,299**	**4,627**	**104,926**	100,587	7,477	108,064

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

	2011	2010
	SAR'000	SAR'000
Government and quasi government	**17,345,151**	19,871,537
Corporate	**1,902,219**	971,921
Banks and other financial institutions	**2,941,340**	4,117,561
Other	**11,412**	11,423
Total	**22,200,122**	24,972,442

Equities reported under available for sale investments include unquoted shares of SAR 11.4 million (2010: SAR 11.4 million) that are carried at cost, as their fair value cannot be reliably measured.

Investments include SAR nil (2010: SAR 543.3 million) which have been pledged under repurchase agreement with banks and customers. The market value of such investments is SAR nil (2010: SAR 565.4 million).

e) *Credit quality of investments*

	2011	2010
	SAR'000	SAR'000
Saudi government bonds	**12,195,596**	14,698,914
Investment grade	**8,311,319**	8,693,727
Non investment grade	**174,658**	212,745
Unrated	**1,518,549**	1,367,056
Total	**22,200,122**	24,972,442

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

Investment Grade includes those investments having credit exposure equivalent to Standard and Poor's rating of AAA to BBB. Issuer ratings have been used for bonds which have not been rated by any agency amounting to SAR 99.3 million (2010: SAR 609.9 million).

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

f) *Movements of allowance for impairment of investments*

	2011	2010
	SAR'000	SAR'000
Balance at beginning of the year	**40,232**	30,679
Provided during the year	**-**	9,553
Amounts recovered during the year	**(6,742)**	-
Balance at end of the year	**33,490**	40,232

6. Loans and advances, net

a) Loans and advances are classified as follows:

	2011			
	Credit Cards	***Consumer Loans***	***Commercial Loans and Overdrafts***	***Total***
	SAR'000	**SAR'000**	**SAR'000**	**SAR'000**
Performing loans and advances - gross	**1,694,441**	**14,538,498**	**68,981,007**	**85,213,946**
Non performing loans and advances, net	**5,934**	**36,192**	**1,635,938**	**1,678,064**
Total loans and advances	**1,700,375**	**14,574,690**	**70,616,945**	**86,892,010**
Provision for credit losses (specific and collective)	**(52,492)**	**(171,942)**	**(1,856,289)**	**(2,080,723)**
Loans and advances, net	**1,647,883**	**14,402,748**	**68,760,656**	**84,811,287**

	2010			
	Credit Cards	*Consumer Loans*	*Commercial Loans and Overdrafts*	*Total*
	SAR'000	SAR'000	SAR'000	SAR'000
Performing loans and advances - gross	1,921,633	12,877,834	59,449,025	74,248,492
Non performing loans and advances, net	18,685	37,894	2,557,887	2,614,466
Total loans and advances	1,940,318	12,915,728	62,006,912	76,862,958
Provision for credit losses (specific and collective)	(146,817)	(236,370)	(2,231,285)	(2,614,472)
Loans and advances, net	1,793,501	12,679,358	59,775,627	74,248,486

Loans and advances, net include Shariah approved products totalling SAR 55,207 million (2010: SAR 35,024 million) which are stated at cost less provision for credit losses of SAR 839.7 million (2010: SAR 1,317.8 million).

Provision for credit losses charged to the consolidated statement of income related to Shariah approved products is SAR 255.2 million (2010: SAR 786.1 million).

Loans and advances include loans amounting to SAR 1,400 million (2010: SAR 865 million) that have been fair value hedged through a fixed to floating interest rate swap. The positive mark to market on these loans was SAR 1.4 million (2010: SAR 5.3 million) as at the end of the current year.

Non performing loans and advances are disclosed net of accumulated special commission in suspense of SAR 208.2 million (2010: SAR 339.6 million).

Notes to the Consolidated Financial Statements (31 December 2011) (continued)

6. Loans and advances, net *(continued)*

b) Movement in provision for credit losses

	2011			
	Credit Cards	***Consumer Loans***	***Commercial Loans and Overdrafts***	***Total***
	SAR'000	**SAR'000**	**SAR'000**	**SAR'000**
Balance at beginning of the year	**146,817**	**236,370**	**2,231,285**	**2,614,472**
Bad debts written off	**(121,311)**	**(180,315)**	**(820,046)**	**(1,121,672)**
Provided during the year, net of reversals	**26,986**	**115,887**	**472,562**	**615,435**
Recoveries of amounts previously provided	**-**	**-**	**(27,512)**	**(27,512)**
Balance at the end of the year	**52,492**	**171,942**	**1,856,289**	**2,080,723**

	2010			
	Credit Cards	*Consumer Loans*	*Commercial Loans and Overdrafts*	*Total*
	SAR'000	SAR'000	SAR'000	SAR'000
Balance at beginning of the year	127,225	207,177	1,440,942	1,775,344
Bad debts written off	(172,665)	(305,358)	(26,614)	(504,637)
Provided during the year, net of reversals	192,257	334,551	1,154,205	1,681,013
Recoveries of amounts previously provided	-	-	(337,248)	(337,248)
Balance at the end of the year	146,817	236,370	2,231,285	2,614,472

The allowance for credit losses above includes a collective allowance amounting to SAR 1,044.5 million (2010: SAR 505.7 million) related to the performing portfolio.

The net charge to income on account of provision for credit losses is SAR 475.5 million (2010: SAR 1,233.5 million), which is net of recoveries of amounts previously provided as shown above and recoveries of debts previously written off of SAR 112.4 million (2010 : SAR 110.2 million).

6. Loans and advances, net *(continued)*

c) *Credit quality of loans and advances*

i) Neither past due nor impaired loans

	2011			
Grades	***Credit Cards***	***Consumer Loans***	***Commercial Loans and Overdrafts***	***Total***
	SAR'000	**SAR'000**	**SAR'000**	**SAR'000**
Undoubted	**-**	**-**	**84,738**	**84,738**
Good	**-**	**-**	**24,499,148**	**24,499,148**
Satisfactory	**1,544,210**	**13,776,603**	**42,977,162**	**58,297,975**
Total	**1,544,210**	**13,776,603**	**67,561,048**	**82,881,861**

	2010			
Grades	*Credit Cards*	*Consumer Loans*	*Commercial Loans and Overdrafts*	*Total*
	SAR'000	SAR'000	SAR'000	SAR'000
Undoubted	-	-	303,683	303,683
Good	-	-	19,970,516	19,970,516
Satisfactory	1,673,784	11,926,518	36,567,872	50,168,174
Total	1,673,784	11,926,518	56,842,071	70,442,373

Undoubted: The strongest credit risk with a negligible probability of default. Such entities would have an extremely strong capacity to meet long term commitments in adverse market conditions.

Good: A strong credit risk with a low probability of default. These entities have a strong capacity to meet long term commitments but some sensitivity to market events.

Satisfactory: A satisfactory credit risk with a moderate probability of default. These entities have the capacity to meet medium term and short term commitments however there is likely to be a need for periodic monitoring due to a higher sensitivity to market events.

Notes to the Consolidated Financial Statements (31 December 2011) (continued)

6. Loans and advances, net *(continued)*

c) Credit quality of loans and advances *(continued)*

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

	2011			
	Credit Cards	***Consumer Loans***	***Commercial Loans and Overdrafts***	***Total***
	SAR'000	**SAR'000**	**SAR'000**	**SAR'000**
From 1 day to 30 days	**63,453**	**552,934**	**1,260,044**	**1,876,431**
From 31 days to 90 days	**40,884**	**123,108**	**14**	**164,006**
From 91 days to 180 days	**45,894**	**85,853**	**159,901**	**291,648**
Total loans and advances	**150,231**	**761,895**	**1,419,959**	**2,332,085**

	2010			
	Credit Cards	*Consumer Loans*	*Commercial Loans and Overdrafts*	*Total*
	SAR'000	SAR'000	SAR'000	SAR'000
From 1 day to 30 days	107,999	648,823	2,162,854	2,919,676
From 31 days to 90 days	76,403	185,108	130,870	392,381
From 91 days to 180 days	63,447	117,385	313,230	494,062
Total loans and advances	247,849	951,316	2,606,954	3,806,119

6. Loans and advances, net *(continued)*

c) *Credit quality of loans and advances* *(continued)*

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

	2011			
	Performing	***Non performing, net***	***Provision for credit losses***	***Loans and advances, net***
	SAR'000	**SAR'000**	**SAR'000**	**SAR'000**
Government and quasi Government	**2,239,257**	**-**	**-**	**2,239,257**
Agriculture and fishing	**414,810**	**495**	**-**	**415,305**
Manufacturing	**17,870,727**	**164,235**	**(62,262)**	**17,972,700**
Mining and quarrying	**1,447**	**-**	**-**	**1,447**
Electricity, water, gas and health services	**1,293,552**	**-**	**-**	**1,293,552**
Building and construction	**5,860,156**	**436,546**	**(110,661)**	**6,186,041**
Commerce	**19,950,790**	**305,426**	**(277,171)**	**19,979,045**
Transportation and communication	**6,589,376**	**918**	**(602)**	**6,589,692**
Services	**6,964,571**	**26,045**	**(24,502)**	**6,966,114**
Consumer loans and credit cards	**16,232,939**	**42,126**	**(224,434)**	**16,050,631**
Other	**7,796,321**	**702,273**	**(336,635)**	**8,161,959**
Collective impairment provision	**-**	**-**	**(1,044,456)**	**(1,044,456)**
Total	**85,213,946**	**1,678,064**	**(2,080,723)**	**84,811,287**

	2010			
	Performing	*Non performing, net*	*Provision for credit losses*	*Loans and advances, net*
	SAR'000	SAR'000	SAR'000	SAR'000
Government and quasi Government	1,940,204	-	-	1,940,204
Banks and other financial institutions	75,000	-	-	75,000
Agriculture and fishing	861,528	1,695	-	863,223
Manufacturing	14,489,837	145,131	(89,920)	14,545,048
Mining and quarrying	16,363	-	-	16,363
Electricity, water, gas and health services	948,711	7,128	(7,128)	948,711
Building and construction	4,815,904	96,859	(42,828)	4,869,935
Commerce	18,426,539	920,830	(824,835)	18,522,534
Transportation and communication	4,033,293	1,852	(1,083)	4,034,062
Services	6,706,127	13,704	(10,630)	6,709,201
Consumer loans and credit cards	14,724,467	56,579	(383,187)	14,397,859
Other	7,210,519	1,370,688	(749,136)	7,832,071
Collective impairment provision	-	-	(505,725)	(505,725)
Total	74,248,492	2,614,466	(2,614,472)	74,248,486

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

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

d) *Collateral:*

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

Notes to the Consolidated Financial Statements (31 December 2011) (continued)

7. Investment in associates

SABB Securities Limited, a subsidiary of SABB, is in the process of being liquidated by SABB. During the year the assets and liabilities of SABB Securities Limited have been transferred to HSBC Saudi Arabia Limited effective 1 July 2011, resulting in an increased shareholding of SABB in HSBC Saudi Arabia Limited from 40% to 51%. However, the share transfer will only take place when the legal formalities are completed. The Bank is not consolidating HSBC Saudi Arabia Limited as it does not have the power to govern the financial and operating policies of HSBC Saudi Arabia Limited.

HSBC Saudi Arabia Limited is involved in investment banking services in addition to being engaged in the business of custody and dealing as an agent excluding underwriting in the Kingdom of Saudi Arabia.

SABB owns 32.5% of the equity shares of SABB Takaful which carries out Shariah compliant insurance activities and offers family and general takaful products.

	2011			2010		
	HSBC Saudi Arabia Limited	***SABB Takaful***	***Total***	*HSBC Saudi Arabia Limited*	*SABB Takaful*	*Total*
	SAR'000	**SAR'000**	**SAR'000**	SAR'000	SAR'000	SAR'000
Balance at beginning of the year	**113,000**	**108,532**	**221,532**	70,126	110,332	180,458
Additional investment during the year	**279,494**	**-**	**279,494**	-	-	-
Share of undistributed profits (losses)	**61,195**	**2,970**	**64,165**	42,874	(1,800)	41,074
Balance at end of the year	**453,689**	**111,502**	**565,191**	113,000	108,532	221,532

Share of the associates' financial statements:

	2011		2010	
	HSBC Saudi Arabia Limited	***SABB Takaful***	*HSBC Saudi Arabia Limited*	*SABB Takaful*
	SAR' 000	**SAR' 000**	SAR' 000	SAR' 000
Total assets	**458,303**	**320,005**	171,082	315,710
Total liabilities	**93,208**	**208,503**	58,082	207,178
Total equity	**365,095**	**111,502**	113,000	108,532
Total income	**160,370**	**17,074**	98,550	13,128
Total expenses	**99,175**	**14,104**	55,676	14,928

8. Property and equipment, net

	Land and Buildings	*Leasehold improvements*	*Equipment, furniture and vehicles*	**2011** *Total*	2010 *Total*
	SAR'000	**SAR'000**	**SAR'000**	**SAR'000**	SAR'000
Cost					
As at 1 January	**620,457**	**396,210**	**696,960**	**1,713,627**	1,637,988
Additions	**8,015**	**29,523**	**41,700**	**79,238**	78,438
Disposals	**(28,353)**	**(463)**	**(7,292)**	**(36,108)**	(2,799)
As at 31 December	**600,119**	**425,270**	**731,368**	**1,756,757**	1,713,627
Accumulated depreciation					
As at 1 January	**333,231**	**243,806**	**577,981**	**1,155,018**	1,043,946
Charge for the year	**18,496**	**25,803**	**50,696**	**94,995**	113,114
Disposals	**(22,890)**	**(463)**	**(6,825)**	**(30,178)**	(2,042)
As at 31 December	**328,837**	**269,146**	**621,852**	**1,219,835**	1,155,018
Net book value					
As at 31 December 2011	**271,282**	**156,124**	**109,516**	**536,922**	
As at 31 December 2010	287,226	152,404	118,979		558,609

Land and buildings, leasehold improvements and equipment furniture and vehicles include work in progress as at 31 December 2011 amounting to SAR 8.6 million (2010: SAR 5.5 million), SAR 47.3 million (2010: SAR 77.8 million) and SAR 15.4 million (2010 : SAR 4.3 million) respectively.

9. Other assets

	2011	2010
	SAR'000	SAR'000
Accrued special commission receivable		
– banks and other financial institutions	**492**	189
– investments	**94,517**	108,859
– loans and advances	**351,834**	459,200
Total accrued special commission receivable	**446,843**	568,248
Accounts receivable	**48,416**	98,351
Positive fair value of derivatives (note 10)	**1,959,762**	1,790,116
Advance tax	**114,157**	117,140
Other	**1,247,162**	611,544
Total	**3,816,340**	3,185,399

Notes to the Consolidated Financial Statements (31 December 2011) (continued)

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 a 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 purposes

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 purposes

The Bank has adopted a comprehensive system for the measurement and management of risk (see note 29 - credit risk, note 31- market risk and note 34 - 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.

10. Derivatives *(continued)*

Derivatives held for hedging purposes *(continued)*

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 statement of financial position 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.

Cash flow hedges

The Bank is exposed to variability in future special commission cash flows on non-trading assets and liabilities which bear special commission income at a variable rate. The Bank uses commission rate swaps as cash flow hedges of these special commission rate risks. Below is the schedule indicating as at 31 December, the periods when the hedged cash flows are expected to occur and when they are expected to affect profit or loss:

	2011	
	Within 1 year	***1-3 years***
	SAR'000	**SAR'000**
Cash inflows (assets)	**437**	**-**
Cash outflows (liabilities)	**(18,805)**	**(14,065)**
Net cash outflow	**(18,368)**	**(14,065)**

	2010	
	Within 1 year	*1-3 years*
	SAR'000	SAR'000
Cash inflows (assets)	644	323
Cash outflows (liabilities)	(19,407)	(33,976)
Net cash outflow	(18,763)	(33,653)

The schedule reflects special commission income cash flows expected to arise on the hedged items in cash flow hedges based on the repricing profile of the hedged assets and liabilities.

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.

Notes to the Consolidated Financial Statements (31 December 2011) (continued)

10. Derivatives *(continued)*

				Notional amounts by term to maturity				
	Positive fair value	*Negative fair value*	*Notional amount total*	*Within 3 months*	*3-12 months*	*1-5 years*	*Over 5 years*	*Monthly average*
2011	**SAR'000**	**SAR'000**	**SAR'000**	**SAR'000**	**SAR'000**	**SAR'000**	**SAR'000**	**SAR'000**
Derivatives held for trading:								
Special commission rate swaps	**1,199,241**	**(1,110,617)**	**47,494,269**	**3,797,479**	**15,709,125**	**24,416,371**	**3,571,294**	**49,297,807**
Special commission rate futures and options	**38,163**	**(38,163)**	**3,469,552**	**120,000**	**-**	**3,199,552**	**150,000**	**3,303,035**
Spot and forward foreign exchange contracts	**104,779**	**(107,555)**	**33,811,951**	**23,591,975**	**10,143,786**	**76,190**	**-**	**32,215,582**
Currency options	**537,050**	**(537,050)**	**15,417,386**	**1,451,830**	**5,234,052**	**4,590,084**	**4,141,420**	**12,982,737**
Currency swaps	**-**	**-**	**-**	**-**	**-**	**-**	**-**	**368,824**
Others	**35,688**	**(35,688)**	**1,440,000**	**-**	**-**	**1,440,000**	**-**	**1,332,500**
Derivatives held as fair value hedges:								
Special commission rate swaps	**43,266**	**(62,987)**	**4,773,276**	**69,136**	**336,772**	**4,311,168**	**56,250**	**4,248,641**
Derivatives held as cash flow hedges:								
Special commission rate swaps	**1,575**	**(27,564)**	**1,343,750**	**-**	**93,750**	**1,250,000**	**-**	**1,343,750**
Total	**1,959,762**	**(1,919,624)**	**107,750,184**	**29,030,420**	**31,517,435**	**39,283,365**	**7,918,964**	

10. Derivatives *(continued)*

				Notional amounts by term to maturity				
	Positive fair value	*Negative fair value*	*Notional amount total*	*Within 3 months*	*3-12 months*	*1-5 years*	*Over 5 years*	*Monthly average*
2010	SAR'000	SAR'000	SAR'000	SAR'000	SAR'000	SAR'000	SAR'000	SAR'000
Derivatives held for trading:								
Special commission rate swaps	1,336,516	(1,262,996)	49,742,259	1,646,858	6,785,716	37,035,595	4,274,090	55,440,147
Special commission rate futures and options	52,355	(52,355)	2,887,500	-	-	2,887,500	-	2,887,500
Spot and forward foreign exchange contracts	87,661	(106,170)	28,329,060	12,793,040	15,108,630	427,390	-	31,966,804
Currency options	156,008	(156,008)	6,552,879	1,564,873	3,422,006	1,566,000	-	5,592,946
Currency swaps	143,793	-	1,475,297	-	1,475,297	-	-	1,475,297
Others	8,165	(8,165)	780,000	-	-	780,000	-	723,000
Derivatives held as fair value hedges:								
Special commission rate swaps	-	(127,061)	4,058,719	61,370	169,519	3,771,580	56,250	1,966,900
Derivatives held as cash flow hedges:								
Special commission rate swaps	5,618	(28,417)	1,343,750	-	-	1,343,750	-	1,475,000
Total	1,790,116	(1,741,172)	95,169,464	16,066,141	26,961,168	47,811,815	4,330,340	

10. Derivatives *(continued)*

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

	2011					
	Fair value	***Hedge inception value***	***Risk***	***Hedging instrument***	***Positive fair value***	***Negative fair value***
	SAR'000	**SAR'000**			**SAR'000**	**SAR'000**
Description of the hedged items:						
Fixed commission rate investments	**1,178,251**	**1,123,122**	Fair value	Special commission rate swap	**-**	**(55,641)**
Fixed commission rate loans	**1,400,324**	**1,398,900**	Fair value	Special commission rate swap	**5,980**	**(7,346)**
Fixed commission rate debt securities in issue	**2,273,660**	**2,238,177**	Fair value	Special commission rate swap	**37,286**	**-**
Floating commission rate investments	**87,329**	**93,646**	Cash flow	Special commission rate swap	**1,575**	**-**
Floating commission rate debt securities in issue	**1,246,786**	**1,250,000**	Cash flow	Special commission rate swap	**-**	**(27,564)**

	2010					
	Fair value	*Hedge inception value*	*Risk*	*Hedging instrument*	*Positive fair value*	*Negative fair value*
	SAR'000	SAR'000			SAR'000	SAR'000
Description of the hedged items:						
Fixed commission rate investments	991,838	949,049	Fair value	Special commission rate swap	-	(43,228)
Fixed commission rate loans	865,007	859,670	Fair value	Special commission rate swap	-	(5,297)
Fixed commission rate debt securities in issue	2,154,902	2,250,000	Fair value	Special commission rate swap	-	(78,536)
Floating commission rate investments	78,615	93,750	Cash flow	Special commission rate swap	5,618	-
Floating commission rate debt securities in issue	1,255,556	1,250,000	Cash flow	Special commission rate swap	-	(28,417)

The net gains on the hedging instruments for fair value hedges are SAR 97.4 million (2010: net losses of SAR 102.3 million). The net losses on the hedged item attributable to the hedged risk are SAR 97.4 million (2010: net gains of SAR 105.6 million). The net fair value of the derivatives is negative SAR 19.7 million (2010: negative SAR 127.1 million).

Approximately 17% (2010: 33%) of the positive fair value of the Bank's derivatives are entered into with financial institutions and less than 4% (2010: 21%) of the total of the positive fair value contracts are with any individual counterparty at the reporting date.

11. Due to banks and other financial institutions

	2011	2010
	SAR'000	SAR'000
Current accounts	**1,943,322**	672,636
Money market deposits	**3,950,734**	3,988,542
Total	**5,894,056**	4,661,178

Money market deposits also include deposits placed by SAMA of SAR 552.8 million (2010: SAR 290.9 million).

12. Customers' deposits

	2011	2010
	SAR'000	SAR'000
Demand	**50,741,519**	46,625,673
Savings	**5,221,507**	4,452,472
Time	**48,284,323**	42,514,025
Other	**1,329,193**	1,080,685
Total	**105,576,542**	94,672,855

Customers' deposits include SAR 51,422.4 million (2010: SAR 47,218.7 million) deposits taken under Shariah approved product contracts.

Other customers' deposits include SAR 1,328.2 million (2010: SAR 1,078.9 million) of margins held for irrevocable commitments.

The above deposits include the following foreign currency deposits:

	2011	2010
	SAR'000	SAR'000
Demand	**4,944,099**	4,825,657
Savings	**209,996**	186,891
Time	**10,269,408**	4,161,507
Other	**269,040**	247,604
Total	**15,692,543**	9,421,659

Notes to the Consolidated Financial Statements (31 December 2011) (continued)

13. Debt securities in issue

	2011	2010
	SAR'000	SAR'000
USD 600 million 5 year fixed rate notes	**2,273,660**	2,154,902
EUR 325 million 5 year floating rate notes	**-**	1,615,852
SAR 1,705 million 5 year floating rate notes	**1,705,000**	1,705,000
Total	**3,978,660**	5,475,754

USD 600 million 5 year fixed rate notes

These notes were issued during the year 2010 at a fixed rate of 3% and are due to mature on 12 November 2015.The notes are unsecured and carry an effective yield of 3.148% which includes a credit spread of 170 bps. The notes are non-convertible, are unsecured and are listed on the London Stock Exchange.

The special commission rate exposure on these notes has been hedged by a fixed to floating special commission rate swap. The special commission rate swap forms part of a designated and effective hedging relationship and is accounted for as a fair value hedge in these financial statements. The negative mark to market on these notes pertaining to the hedged portion is SAR 35.5 million as at the end of the current year.

Euro 325 million 5 year floating rate notes

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

The bank had converted the foreign currency exposure on these notes into US Dollars by means of a cross currency swap. This swap did not form part of a designated hedging relationship and hence, was carried as a derivative in the trading book. The swap also matured during the current year.

SAR 1,705 million 5 year floating rate notes

These notes were issued during 2008 and are due to mature on 21 July, 2013. The notes carry effective special commission at three months SIBOR plus 80 bps payable quarterly. The notes are unsecured, non convertible and are listed on Saudi Stock Exchange (Tadawul).

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 SAR 1,250 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.

14. Borrowings

This represents a 12 year amortising fixed rate loan that carries special commission at the rate of 5.11% payable semi annually. The loan was taken on 7 July 2005 and is repayable by 15 June 2017.

15. Other liabilities

	2011 SAR'000	2010 SAR'000
Accrued special commission payable		
– banks and other financial institutions	**52,690**	46,586
– customers' deposits	**115,718**	134,867
– debt securities in issue	**14,177**	18,850
– borrowings	**415**	452
Total accrued special commission payable	**183,000**	200,755
Accounts payable	**1,385,444**	1,069,483
Drawings payable	**894,205**	798,443
Negative fair value of derivatives (note 10)	**1,919,624**	1,741,172
Other	**1,487,898**	1,393,779
Total	**5,870,171**	5,203,632

16. Share capital

The authorised, issued and fully paid share capital of SABB consists of 750 million shares of SAR 10 each (2010: 750 million shares of SAR 10 each). The ownership of the SABB's share capital is as follows:

	2011	2010
Saudi shareholders	60%	60%
HSBC Holdings BV	40%	40%
(a wholly owned subsidiary of HSBC Holdings plc)		

The Board of Directors has recommended on 27 Muharram 1433H (22 December 2011) a bonus issue of 250 million shares of nominal value of SAR 10 each to the existing shareholders on the basis of one bonus share for every three shares held through the capitalisation of retained earnings which is subject to approval of shareholders at an 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 SABB. Accordingly, a sum of SAR 722 million (2010: SAR 471 million) was transferred to statutory reserve. The statutory reserve is not currently available for distribution.

Notes to the Consolidated Financial Statements (31 December 2011) (continued)

18. Other reserves

	2011		
	Cash flow hedges	***Available for sale investments***	***Total***
	SAR'000	**SAR'000**	**SAR'000**
Balance at beginning of the year	**(9,604)**	**115,575**	**105,971**
Net change in fair value	**(3,190)**	**(315,714)**	**(318,904)**
Transfer to consolidated statement of income	**(8,585)**	**(4,192)**	**(12,777)**
Net movement during the year	**(11,775)**	**(319,906)**	**(331,681)**
Balance at end of the year	**(21,379)**	**(204,331)**	**(225,710)**

	2010		
	Cash flow hedges	*Available for sale investments*	*Total*
	SAR'000	SAR'000	SAR'000
Balance at beginning of the year	28,458	(165,993)	(137,535)
Net change in fair value	(33,452)	281,568	248,116
Transfer to consolidated statement of income	(4,610)	-	(4,610)
Net movement during the year	(38,062)	281,568	243,506
Balance at end of the year	(9,604)	115,575	105,971

The discontinuation of hedge accounting in prior years resulted in reclassification of the associated cumulative gain of SAR 8.6 million (2010: SAR 4.6 million) from equity to the consolidated statement of income included in the above numbers under cash flow hedges.

19. Commitments and contingencies

a) Legal proceedings

As at 31 December 2011 there are legal proceedings outstanding against the Bank. No material provision has been made as professional advice indicates that it is not probable that any significant loss will eventuate.

b) Capital commitments

As at 31 December 2011 the Bank has capital commitments of SAR 66.6 million (2010: SAR 30.2 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.

19. Commitments and contingencies *(continued)*

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

2011	***Within 3 months*** **SAR'000**	***3-12 months*** **SAR'000**	***1-5 years*** **SAR'000**	***Over 5 years*** **SAR'000**	***Total*** **SAR'000**
Letters of credit	**9,578,429**	**3,642,087**	**515,378**	**-**	**13,735,894**
Guarantees	**17,441,108**	**12,224,176**	**10,835,948**	**34,622**	**40,535,854**
Acceptances	**2,896,049**	**453,430**	**47,126**	**-**	**3,396,605**
Irrevocable commitments to extend credit	**1,849**	**457,909**	**1,495,052**	**-**	**1,954,810**
Total	**29,917,435**	**16,777,602**	**12,893,504**	**34,622**	**59,623,163**

2010	*Within 3 months* SAR'000	*3-12 months* SAR'000	*1-5 years* SAR'000	*Over 5 years* SAR'000	*Total* SAR'000
Letters of credit	5,142,691	4,101,327	911,948	-	10,155,966
Guarantees	11,877,344	11,312,243	9,399,305	38,467	32,627,359
Acceptances	2,369,831	346,632	82,622	-	2,799,085
Irrevocable commitments to extend credit	-	149,408	43,642	-	193,050
Total	19,389,866	15,909,610	10,437,517	38,467	45,775,460

The outstanding unutilised portion of non-firm commitments, which can be revoked unilaterally at any time by the Bank, is SAR 45,536.4 million (2010: SAR 35,173.4 million).

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

	2011 **SAR'000**	2010 SAR'000
Government and quasi government	**947,153**	149,408
Corporate	**47,812,445**	35,834,452
Banks and other financial institutions	**10,639,597**	9,628,199
Other	**223,968**	163,401
Total	**59,623,163**	45,775,460

f) Operating lease commitments

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

	2011 **SAR'000**	2010 SAR'000
Less than 1 year	**55,599**	50,524
1 to 5 years	**163,239**	146,515
Over 5 years	**125,147**	145,594
Total	**343,985**	342,633

Notes to the Consolidated Financial Statements (31 December 2011) (continued)

20. Net special commission income

	2011 SAR'000	2010 SAR'000
Special commission income		
Investments		
– available for sale investments	**282,383**	261,791
– held at amortised cost	**79,781**	151,439
– held to maturity investments	**5,066**	10,717
	367,230	423,947
Due from banks and other financial institutions	**33,771**	40,367
Loans and advances	**3,114,879**	3,260,594
Total	**3,515,880**	3,724,908
Special commission expense		
Due to banks and other financial institutions	**108,696**	52,398
Customers' deposits	**236,630**	358,139
Debt securities in issue	**138,570**	61,045
Borrowing	**10,009**	10,283
Total	**493,905**	481,865
Net special commission income	**3,021,975**	3,243,043

21. Fees and commission income, net

	2011 SAR'000	2010 SAR'000
Fees and commission income:		
– Share trading and fund management	**115,884**	164,737
– Trade finance	**569,725**	505,551
– Corporate finance and advisory	**194,097**	202,407
– Cards	**285,110**	302,311
– Other banking services	**238,047**	130,050
Total fees and commission income	**1,402,863**	1,305,056
Fees and commission expense:		
– Cards	**(99,392)**	(45,392)
– Custodial services	**(719)**	(760)
– Other banking services	**(87,748)**	(77,582)
Total fees and commission expense	**(187,859)**	(123,734)
Fees and commission income, net	**1,215,004**	1,181,322

22. Trading income, net

	2011 SAR'000	2010 SAR'000
Foreign exchange income, net	**254,465**	210,337
Derivatives	**55,721**	36,020
Debt instruments	**162**	8,636
Others	**(2,488)**	3,286
Total	**307,860**	258,279

23. Gains on non-trading investments, net

	2011 SAR'000	2010 SAR'000
Available for sale investments	**4,192**	-

24. Salaries and employee related expenses

i) Quantitative Disclosure

The following table summarizes the Bank's employee categories defined in accordance with SAMA's rules on compensation practices and includes the total amounts of fixed and variable compensation paid to employees during the year ended 31 December 2011, and the forms of such payments.

	Number of employees	*Fixed compensation*	*Variable compensation paid in 2011*		
			Cash	*Shares*	*Total*
	SAR'000	**SAR'000**	**SAR'000**	**SAR'000**	**SAR'000**
Senior executives requiring SAMA no objection	**13**	**22,038**	**14,619**	**350**	**14,969**
Employees engaged in risk taking activities	**228**	**108,377**	**40,711**	**19**	**40,730**
Employees engaged in control functions	**80**	**30,065**	**6,483**	**27**	**6,510**
Other employees	**2,802**	**522,184**	**136,006**	**20**	**136,026**
Outsourced employees	**410**	**34,109**	**3,423**	**-**	**3,423**
Total	**3,533**	**716,773**	**201,242**	**416**	**201,658**

Variable compensation accrued in 2011	**226,242**
Other employee related benefits	**53,154**
Total salaries and employee related expenses	**996,169**

Senior executives (requiring SAMA no objection):

This comprises senior management having responsibility and authority for formulating strategies, directing and controlling the activities of the Bank whose appointment requires no objection from SAMA. This covers the Managing Director and other executives directly reporting to him.

Employees engaged in risk taking activities:

This comprises of management staff within the business lines (Corporate, Trade Services, Private Banking and Treasury), who are responsible for executing and implementing the business strategy on behalf of the Bank. This also includes those involved in recommending and evaluating credit limits and credit worthiness, pricing of loans, undertaking and executing business proposals and treasury dealing activities.

Employees engaged in control functions:

This refers to employees working in divisions that are not involved in risk taking activities but engaged in review functions (Risk Management, Compliance, Internal Audit, Treasury Operation, Finance and Accounting). These functions are fully independent from risk taking units.

Other employees:

This includes all other employees of the Bank, excluding those already reported under categories mentioned above.

Outsourced employees:

Staff employed by various agencies who supply services to the Bank on a full-time basis in non-critical roles. None of these roles require risk undertaking or control.

24. Salaries and employee related expenses *(continued)*

ii) Qualitative Disclosure

Compensation disclosure for the Annual Financial Statements

SAMA being the Banking industry regulator for the Kingdom of Saudi Arabia, has issued its Rules on compensation practices, which is in line with Basel II and FSB Principles. In compliance with the SAMA Rules on compensation practices, a compensation policy endorsed by Nomination and Remuneration Committee and approved by the Board of Directors has been formulated and implemented.

SABB Compensation Policy

a) Policy Objectives

The policy sets the guidelines as to how both fixed and variable pay will be managed at SABB. The scope of policy covers the following: all categories of employees; its subsidiaries; all compensation elements; key determinants of compensation; approval process; reporting processes; bonus deferral process; share retention and relevant stakeholder's roles and responsibilities.

The objectives of the policy are to: align the reward practices with the Bank's strategy & values so as to support the successful execution of the strategy in a risk compliant manner; offer an attractive employee value proposition to attract, retain and motivate competent and committed people ; and ensure the financial sustainability of SABB.

b) Compensation Structure

SABB's compensation operates on a Total Package basis that is benchmarked to market data from peers in the appropriate industry. Total Package comprises of the following blend of fixed and variable compensation elements: salaries, allowances; benefits; annual bonuses; short-term incentives; and long-term incentives.

c) Performance Management System

The performance of all employees is evaluated against agreed targets using a Balanced Scorecard methodology, financial, customer, process and people. A calibration process is applied to ensure fair and equitable performance evaluation. The performance management methodology at SABB focuses on the differentiation of individual performance and drives the variable reward strategy which encourages high performance within a risk compliant manner.

d) Risk-adjustment for Variable Pay schemes

The Bank has reviewed all its variable pay schemes, with the assistance of external remuneration consultants, to ensure that any bonus pay pools have taken into account all relevant risks. The determination of bonus pools is based on appropriate performance factors adjusted for risk.The bonus pool for the Control functions have been ring fenced from short term profits in alignment with SAMA regulations.

e) Bonus Deferral

Bonus deferral in the form of equity applies to all employees who are either subject SAMA "No Objection" and/ or undertake or control significant risk undertaking by the Bank. Bonuses of all these employees will be subject to deferral over a three year vesting period. The vesting will be subject to malus conditions.

f) Nomination and Remuneration Committee

The Nomination and Remuneration Committee has oversight of the remuneration structures and policies for all employees to ensure that: all performance based bonuses are adjusted for risk; compensation structures are regulatory compliant; and effective in achieving its stated objectives.

25. Basic and diluted earnings per share

Basic earnings per share for the year ended 31 December 2011 and 2010 is calculated by dividing the net income for the year attributable to the equity holders by 750 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.

26. Gross dividend, zakat and income tax

The Board of Directors has proposed a gross dividend of SAR 562.5 million for the year 2011 (2010: SAR 562.5 million). Dividends will be 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 41.9 million (2010: SAR 30.0 million).

Non Saudi shareholders
Income tax attributable to the foreign shareholder on its current year's share of income is approximately SAR 230.4 million (2010: SAR 160.0 million).

SABB received the initial Zakat assessment in respect of year 2010. The assessment is primarily due to the disallowance of certain long-term investments from the Zakat base of SABB. SABB filed an appeal before the Preliminary Zakat and Tax Appeal Committee (PZTAC) which is yet to be taken up by the Appeal Committee.

27. Cash and cash equivalents

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

	2011	2010
	SAR'000	SAR'000
Cash and balances with SAMA excluding the statutory deposit (note 3)	**16,585,956**	9,905,290
Due from banks and other financial institutions with an original maturity of ninety days or less from date of the acquisition	**4,347,018**	7,042,310
Total	**20,932,974**	16,947,600

28. Operating segments

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

Transactions between the operating segments are on normal commercial terms and conditions. There are no material items of income or expense between the operating segments. Segment assets and liabilities comprise operating assets and liabilities, being the majority of the balance.

a) ***The Bank's reportable segments under IFRS 8 are as follows:***

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 statement of financial position.

Others – includes activities of SABB Securities Limited and investment in associates.

Notes to the Consolidated Financial Statements (31 December 2011) (continued)

28. Operating segments *(continued)*

Transactions between the operating segments are reported as recorded by the Bank's transfer pricing system. The Bank's total assets and liabilities as at 31 December 2011 and 2010, its total operating income and expenses, and the results for the years then ended, by operating segment, are as follows:

	Retail Banking	***Corporate Banking***	***Treasury***	***Others***	***Total***
2011	**SAR'000**	**SAR'000**	**SAR'000**	**SAR'000**	**SAR'000**
Total assets	**21,521,146**	**65,234,092**	**51,337,076**	**565,191**	**138,657,505**
Total liabilities	**41,418,513**	**53,261,190**	**26,811,601**	**-**	**121,491,304**
Total operating income	**1,396,914**	**2,370,371**	**1,029,286**	**102,020**	**4,898,591**
Total operating expenses	**937,036**	**987,132**	**94,331**	**55,822**	**2,074,321**
Share in earnings of associates, net	**-**	**-**	**-**	**64,165**	**64,165**
Net income for the year	**459,878**	**1,383,239**	**934,955**	**110,363**	**2,888,435**
Fees and commission income, net	**351,231**	**865,744**	**(1,955)**	**(16)**	**1,215,004**
Trading income, net	**886**	**7,341**	**299,633**	**-**	**307,860**
Credit losses and impairment provision, net	**18,798**	**456,732**	**(6,742)**	**-**	**468,788**

	Retail Banking	*Corporate Banking*	*Treasury*	*Others*	*Total*
2010	SAR'000	SAR'000	SAR'000	SAR'000	SAR'000
Total assets	20,513,312	55,952,908	48,677,998	228,648	125,372,866
Total liabilities	37,459,293	47,781,713	24,925,339	34,574	110,200,919
Total operating income	1,544,536	2,265,864	868,887	160,134	4,839,421
Total operating expenses	1,678,297	1,136,886	108,399	73,761	2,997,343
Share in earnings of associates, net	-	-	-	41,074	41,074
Net income for the year	(133,761)	1,128,978	760,488	127,447	1,883,152
Fees and commission income, net	401,813	775,705	4,030	(226)	1,181,322
Trading income, net	91	9,114	249,074	-	258,279
Credit losses and impairment provision, net	654,331	579,195	9,553	-	1,243,079

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

	Retail Banking	***Corporate Banking***	***Treasury***	***Total***
2011	**SAR'000**	**SAR'000**	**SAR'000**	**SAR'000**
Assets	**19,948,476**	**64,862,811**	**47,066,229**	**131,877,516**
Commitments and contingencies	**178,932**	**24,492,900**	**-**	**24,671,832**
Derivatives	**-**	**-**	**3,521,550**	**3,521,550**
Total	**20,127,408**	**89,355,711**	**50,587,779**	**160,070,898**

	Retail Banking	*Corporate Banking*	*Treasury*	*Total*
2010	SAR'000	SAR'000	SAR'000	SAR'000
Assets	18,704,302	55,544,184	45,045,108	119,293,594
Commitments and contingencies	164,850	18,836,365	-	19,001,215
Derivatives	-	-	2,664,413	2,664,413
Total	18,869,152	74,380,549	47,709,521	140,959,222

Credit exposure comprises the carrying value of assets excluding cash, property and equipment, other assets, investment in associates and equity investments, and the credit equivalent value for commitments, contingencies and derivatives is based on the credit conversion factor as prescribed by the SAMA Basel II guidelines.

29. 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 on credit related commitments and contingencies and derivatives.

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 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. 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 and requests additional collateral in accordance with the underlying agreements. It also monitors the market value of collateral obtained during its review of the adequacy of the provision for credit losses.

The Bank regularly reviews its risk management policies and systems to reflect changes in market's products and emerging best practice.

The debt securities included in the investment portfolio are mainly sovereign risk. Analysis of investments by counter-party 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 19. The information on Bank's maximum credit exposure by business segment is given in note 28. The information on maximum credit risk exposure and their relative risk weights is also provided in note 37.

Notes to the Consolidated Financial Statements (31 December 2011) (continued)

30 a). Geographical concentration of assets, liabilities, commitments and contingencies, and credit exposure

	2011					
	Kingdom of Saudi Arabia	*GCC and Middle East*	*Europe*	*North America*	*Other Countries*	*Total*
	SAR'000	SAR'000	SAR'000	SAR'000	SAR'000	SAR'000
ASSETS						
Cash and balances with SAMA	22,380,625	-	-	-	-	22,380,625
Due from banks and other financial institutions	-	109,386	2,021,996	2,023,570	192,066	4,347,018
Investments, net	17,681,334	3,889,345	442,549	-	186,894	22,200,122
Loans and advances, net	83,156,480	605,289	15,728	37,500	996,290	84,811,287
Investment in associates	565,191	-	-	-	-	565,191
Total	123,783,630	4,604,020	2,480,273	2,061,070	1,375,250	134,304,243
LIABILITIES						
Due to banks and other financial institutions	487,414	523,168	4,039,400	826,585	17,489	5,894,056
Customer deposits	104,797,133	195,944	579,846	-	3,619	105,576,542
Debt securities in issue	1,705,000	-	2,273,660	-	-	3,978,660
Borrowings	-	-	171,875	-	-	171,875
Total	106,989,547	719,112	7,064,781	826,585	21,108	115,621,133
Commitments and contingencies	48,680,801	282,454	2,832,665	350,298	7,476,945	59,623,163
CREDIT EXPOSURE (stated at credit equivalent amounts)						
Assets	121,412,525	4,548,398	2,480,273	2,061,070	1,375,250	131,877,516
Commitments and contingencies	20,222,055	101,344	1,401,610	119,669	2,827,154	24,671,832
Derivatives	1,704,914	148,381	1,643,526	9,131	15,598	3,521,550
Total credit exposure	143,339,494	4,798,123	5,525,409	2,189,870	4,218,002	160,070,898

30 a). Geographical concentration of assets, liabilities, commitments and contingencies, and credit exposure *(continued)*

	2010					
	Kingdom of Saudi Arabia	*GCC and Middle East*	*Europe*	*North America*	*Other Countries*	*Total*
	SAR'000	SAR'000	SAR'000	SAR'000	SAR'000	SAR'000
ASSETS						
Cash and balances with SAMA	15,144,088	-	-	-	-	15,144,088
Due from banks and other financial institutions	626,687	142,633	241,966	5,937,201	93,823	7,042,310
Investments, net	20,621,151	3,293,205	908,492	93,773	55,821	24,972,442
Loans and advances, net	73,156,677	1,033,227	21,082	37,500	-	74,248,486
Investment in associates	221,532	-	-	-	-	221,532
Total	109,770,135	4,469,065	1,171,540	6,068,474	149,644	121,628,858
LIABILITIES						
Due to banks and other financial institutions	1,284,453	706,419	2,436,290	224,997	9,019	4,661,178
Customer deposits	94,285,479	358,746	22,286	-	6,344	94,672,855
Debt securities in issue	1,705,000	-	3,770,754	-	-	5,475,754
Borrowings	-	-	187,500	-	-	187,500
Total	97,274,932	1,065,165	6,416,830	224,997	15,363	104,997,287
Commitments and contingencies	37,184,684	428,788	2,534,129	210,790	5,418,069	45,776,460
CREDIT EXPOSURE (stated at credit equivalent amounts)						
Assets	107,491,092	4,412,844	1,171,540	6,068,474	149,644	119,293,594
Commitments and contingencies	15,038,350	119,838	1,241,904	82,885	2,518,238	19,001,215
Derivatives	1,307,891	187,278	1,163,678	5,460	106	2,664,413
Total credit exposure	123,837,333	4,719,960	3,577,122	6,156,819	2,667,988	140,959,222

30 b). The distributions by geographical concentration of impaired loans and advances and impairment for credit losses are as follows:

	2011					
	Kingdom of Saudi Arabia	***GCC and Middle East***	***Europe***	***North America***	***Other Countries***	***Total***
	SAR'000	**SAR'000**	**SAR'000**	**SAR'000**	**SAR'000**	**SAR'000**
Non Performing Loans, net	**1,636,128**	**41,936**	**-**	**-**	**-**	**1,678,064**
Provision for credit losses	**2,037,753**	**42,970**	**-**	**-**	**-**	**2,080,723**

	2010					
	Kingdom of Saudi Arabia	*GCC and Middle East*	*Europe*	*North America*	*Other Countries*	*Total*
	SAR'000	SAR'000	SAR'000	SAR'000	SAR'000	SAR'000
Non Performing Loans, net	2,092,327	522,139	-	-	-	2,614,466
Provision for credit losses	2,216,703	397,769	-	-	-	2,614,472

Notes to the Consolidated Financial Statements (31 December 2011) (continued)

31. Market risk

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

The market risk for the trading book is managed and monitored using Value at Risk (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.

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

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

The Bank's VAR related information is as under.

	Foreign exchange	***Special commission rate***	***Overall risk***
2011	**SAR'000**	**SAR'000**	**SAR'000**
VAR as at 31 December 2011	**547**	**785**	**884**
Average VAR for 2011	**484**	**1,600**	**1,630**

	Foreign exchange	*Special commission rate*	*Overall risk*
2010	SAR'000	SAR'000	SAR'000
VAR as at 31 December 2010	416	661	941
Average VAR for 2010	2,313	2,266	3,428

31. Market risk *(continued)*

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 reasonably 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, based on the floating rate non- trading financial assets and financial liabilities held as at 31 December 2011, 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 31December 2011 for the effect of assumed changes in commission rates. The sensitivity of equity is analysed by maturity period of the asset or swap.

2011

Currency	*Increase in basis points*	*Sensitivity of Special Commission Income*	*Sensitivity of Equity*				
			6 months or less	*1 year or less*	*1-5 years or less*	*Over 5 years*	*Total*
		SAR'000	**SAR'000**	**SAR'000**	**SAR'000**	**SAR'000**	**SAR'000**
SAR	**+ 100**	**59,986**	**(20,563)**	**(9,785)**	**7,123**	**-**	**(23,225)**
USD	**+ 100**	**(185)**	**(13,835)**	**(13,968)**	**(62,610)**	**(2,394)**	**(92,807)**
EUR	**+ 100**	**3,137**	**(362)**	**(383)**	**(697)**	**-**	**(1,442)**
Others	**+ 100**	**1,730**	**-**	**-**	**-**	**-**	**-**

2011

Currency	*Decrease in basis points*	*Sensitivity of Special Commission Income*	*Sensitivity of Equity*				
			6 months or less	*1 year or less*	*1-5 years or less*	*Over 5 years*	*Total*
		SAR'000	**SAR'000**	**SAR'000**	**SAR'000**	**SAR'000**	**SAR'000**
SAR	**– 100**	**(59,986)**	**20,563**	**9,785**	**(7,123)**	**-**	**23,225**
USD	**– 100**	**185**	**13,835**	**13,968**	**62,610**	**2,394**	**92,807**
EUR	**– 100**	**(3,137)**	**362**	**383**	**697**	**-**	**1,442**
Others	**– 100**	**(1,730)**	**-**	**-**	**-**	**-**	**-**

Notes to the Consolidated Financial Statements (31 December 2011) (continued)

31. Market risk *(continued)*

b) Market risk – non trading or banking book *(continued)*

i) Special commission rate risk *(continued)*

2010							
Currency	*Increase in basis points*	*Sensitivity of Special Commission Income*	*Sensitivity of Equity*				
			6 months or less	*1 year or less*	*1-5 years or less*	*Over 5 years*	*Total*
		SAR'000	SAR'000	SAR'000	SAR'000	SAR'000	SAR'000
SAR	+ 100	29,688	(3,034)	(2,348)	(21,001)	-	(26,383)
USD	+ 100	(2,412)	(34,218)	(20,250)	(816)	-	(55,284)
EUR	+ 100	(12,808)	(591)	(628)	(1,455)	-	(2,674)
Others	+ 100	1,547	(402)	(370)	-	-	(772)

2010							
Currency	*Decrease in basis points*	*Sensitivity of Special Commission Income*	*Sensitivity of Equity*				
			6 months or less	*1 year or less*	*1-5 years or less*	*Over 5 years*	*Total*
		SAR'000	SAR'000	SAR'000	SAR'000	SAR'000	SAR'000
SAR	– 100	(29,688)	3,034	2,348	21,001	-	26,383
USD	– 100	2,412	34,218	20,250	816	-	55,284
EUR	– 100	12,808	591	628	1,455	-	2,674
Others	– 100	(1,547)	402	370	-	-	772

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 31(a) reflects the Bank's total exposure to currency risk.

iii) Equity price risk

Equity price risk is the risk that the fair value of equities decreases as the result of changes in the level of equity indices and individual stocks. The non trading equity price risk exposure arises from equity securities classified as available for sale. A 10 per cent increase or decrease in the value of the bank's available for sale equities at 31 December 2011 would have correspondingly increase or decrease equity by SAR 103 million (2010: SAR 132 million).

32. 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:

	2011	2010
	Long (short)	*Long (short)*
	SAR'000	SAR'000
US Dollar	**(22,246)**	471,114
Euro	**4,793**	690
Sterling Pounds	**(1,935)**	(431)
Other	**(5,565)**	4,169

33. Special commission rate risk

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 derivative financial 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.

	2011					
	Within 3 months	*3-12 months*	*1-5 years*	*Over 5 years*	*Non special commission bearing*	*Total*
	SAR'000	**SAR'000**	**SAR'000**	**SAR'000**	**SAR'000**	**SAR'000**
Assets						
Cash and balances with SAMA	**15,208,895**	**-**	**-**	**-**	**7,171,730**	**22,380,625**
Due from banks and other financial institutions	**4,347,018**	**-**	**-**	**-**	**-**	**4,347,018**
Investments, net	**9,832,745**	**6,485,161**	**4,320,683**	**521,742**	**1,039,791**	**22,200,122**
Loans and advances, net	**47,075,996**	**14,124,840**	**23,610,451**	**-**	**-**	**84,811,287**
Investment in associates	**-**	**-**	**-**	**-**	**565,191**	**565,191**
Property and equipment, net	**-**	**-**	**-**	**-**	**536,922**	**536,922**
Other assets	**-**	**-**	**-**	**-**	**3,816,340**	**3,816,340**
Total assets	**76,464,654**	**20,610,001**	**27,931,134**	**521,742**	**13,129,974**	**138,657,505**
Liabilities and shareholders' equity						
Due to banks and other financial institutions	**4,475,430**	**-**	**1,418,626**	**-**	**-**	**5,894,056**
Customer deposits	**45,144,393**	**1,950,793**	**7,721,693**	**18,144**	**50,741,519**	**105,576,542**
Debt securities in issue	**1,705,000**	**-**	**2,273,660**	**-**	**-**	**3,978,660**
Borrowings	**-**	**-**	**-**	**171,875**	**-**	**171,875**
Other liabilities	**-**	**-**	**-**	**-**	**5,870,171**	**5,870,171**
Shareholders' equity	**-**	**-**	**-**	**-**	**17,166,201**	**17,166,201**
Total liabilities and shareholders' equity	**51,324,823**	**1,950,793**	**11,413,979**	**190,019**	**73,777,891**	**138,657,505**
Commission rate sensitivity on assets and liabilities	**25,139,831**	**18,659,208**	**16,517,155**	**331,723**	**(60,647,917)**	
Commission rate sensitivity on derivative financial instruments	**2,459,994**	**805,783**	**(2,929,539)**	**(336,238)**	**-**	
Total special commission rate sensitivity gap	**27,599,825**	**19,464,991**	**13,587,616**	**(4,515)**	**(60,647,917)**	
Cumulative special commission rate sensitivity gap	**27,599,825**	**47,064,816**	**60,652,432**	**60,647,917**	**-**	

Notes to the Consolidated Financial Statements (31 December 2011) (continued)

33. Special commission rate risk *(continued)*

	2010					
	Within 3 months	*3-12 months*	*1-5 years*	*Over 5 years*	*Non special commission bearing*	*Total*
	SAR'000	SAR'000	SAR'000	SAR'000	SAR'000	SAR'000
Assets						
Cash and balances with SAMA	9,119,803	-	-	-	6,024,285	15,144,088
Due from banks and other financial institutions	7,042,310	-	-	-	-	7,042,310
Investments, net	13,002,859	6,579,774	3,997,403	55,544	1,336,862	24,972,442
Loans and advances, net	38,672,590	12,807,097	22,768,799	-	-	74,248,486
Investment in associates	-	-	-	-	221,532	221,532
Property and equipment, net	-	-	-	-	558,609	558,609
Other assets	-	-	-	-	3,185,399	3,185,399
Total assets	67,837,562	19,386,871	26,766,202	55,544	11,326,687	125,372,866
Liabilities and shareholders' equity						
Due to banks and other financial institutions	4,248,695	121,569	290,914	-	-	4,661,178
Customer deposits	39,249,357	1,213,647	7,562,972	21,206	46,625,673	94,672,855
Debt securities in issue	3,320,852	-	2,154,902	-	-	5,475,754
Borrowings	-	-	-	187,500	-	187,500
Other liabilities	-	-	-	-	5,203,632	5,203,632
Shareholders' equity	-	-	-	-	15,171,947	15,171,947
Total liabilities and shareholders' equity	46,818,904	1,335,216	10,008,788	208,706	67,001,252	125,372,866
Commission rate sensitivity on assets and liabilities	21,018,658	18,051,655	16,757,414	(153,162)	(55,674,565)	
Commission rate sensitivity on derivative financial instruments	1,610,219	57,903	(1,840,103)	171,981	-	
Total special commission rate sensitivity gap	22,628,877	18,109,558	14,917,311	18,819	(55,674,565)	
Cumulative special commission rate sensitivity gap	22,628,877	40,738,435	55,655,746	55,674,565	-	

The net gap between derivative financial instruments represents the net notional amounts of derivative financial instruments, which are used to manage the special commission rate risk.

34. 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 7% of total demand deposits and 4% 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 securities.

The table below summarises the maturity profile of the Bank's financial liabilities. The contractual maturities of liabilities have been determined on the basis of the remaining period at the reporting date to the contractual maturity date and does not take account of 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. All derivatives used for hedging purposes are shown by maturity based on their contractual, undiscounted repayment obligations. As the major portion of the derivatives trading book comprises of back to back transactions and consequently the open derivatives trading exposures are small, the management believes that the inclusion of trading derivatives in the contractual maturity table is not relevant for an understanding of the timing of cash flows and hence these have been excluded.

Management monitors the maturity profile to ensure that adequate liquidity is maintained. The weekly 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. A summary report, covering the bank and operating subsidiaries, including any exceptions and remedial action taken, is submitted monthly to ALCO.

a) *Analysis of financial liabilities by remaining contractual maturities:*

	Within 3 months	***3-12 months***	***1-5 years***	***Over 5 years***	***Total***
2011	**SAR'000**	**SAR'000**	**SAR'000**	**SAR'000**	**SAR'000**
Financial liabilities					
Due to banks and other financial institutions	**4,648,772**	**-**	**677,466**	**1,181,842**	**6,508,080**
Customer deposits	**95,711,875**	**2,161,374**	**8,154,907**	**21,641**	**106,049,797**
Debt securities in issue	**6,395**	**86,685**	**4,176,685**	**-**	**4,269,765**
Borrowings	**-**	**39,773**	**142,812**	**16,029**	**198,614**
Derivatives:					
– Contractual amounts payable (receivable)	**12,288**	**15,961**	**(2,253)**	**6,249**	**32,245**
Total undiscounted financial liabilities	**100,379,330**	**2,303,793**	**13,149,617**	**1,225,761**	**117,058,501**

	Within 3 months	*3-12 months*	*1-5 years*	*Over 5 years*	*Total*
2010	SAR'000	SAR'000	SAR'000	SAR'000	SAR'000
Financial liabilities					
Due to banks and other financial institutions	4,250,713	121,995	363,708	-	4,736,416
Customer deposits	85,923,168	1,490,968	7,893,108	21,206	95,328,450
Debt securities in issue	6,884	1,708,848	4,273,102	-	5,988,834
Borrowings	-	25,344	182,585	16,024	223,953
Derivatives:					
– Contractual amounts payable	16,114	33,021	101,287	8,794	159,216
Total undiscounted financial liabilities	90,196,879	3,380,176	12,813,790	46,024	106,436,869

Notes to the Consolidated Financial Statements (31 December 2011) (continued)

34. Liquidity risk *(continued)*

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.

2011	***Within 3 months*** **SAR'000**	***3-12 months*** **SAR'000**	***1-5 years*** **SAR'000**	***Over 5 years*** **SAR'000**	***No fixed maturity*** **SAR'000**	***Total*** **SAR'000**
Assets						
Cash and balances with SAMA	**16,585,956**	**-**	**-**	**-**	**5,794,669**	**22,380,625**
Due from banks and other financial institutions	**4,347,018**	**-**	**-**	**-**	**-**	**4,347,018**
Investments, net	**5,127,226**	**8,373,946**	**6,539,085**	**1,120,073**	**1,039,792**	**22,200,122**
Loans and advances, net	**39,885,669**	**14,903,677**	**21,298,223**	**8,723,718**	**-**	**84,811,287**
Investment in associates	**-**	**-**	**-**	**-**	**565,191**	**565,191**
Property and equipment, net	**-**	**-**	**-**	**-**	**536,922**	**536,922**
Other assets	**-**	**-**	**-**	**-**	**3,816,340**	**3,816,340**
Total assets	**65,945,869**	**23,277,623**	**27,837,308**	**9,843,791**	**11,752,914**	**138,657,505**
Liabilities and shareholders' equity						
Due to banks and other financial institutions	**4,647,305**	**-**	**552,800**	**693,951**	**-**	**5,894,056**
Customer deposits	**95,646,451**	**2,131,522**	**7,780,425**	**18,144**	**-**	**105,576,542**
Debt securities in issue	**-**	**-**	**3,978,660**	**-**	**-**	**3,978,660**
Borrowings	**-**	**-**	**-**	**171,875**	**-**	**171,875**
Other liabilities	**-**	**-**	**-**	**-**	**5,870,171**	**5,870,171**
Shareholders' equity	**-**	**-**	**-**	**-**	**17,166,201**	**17,166,201**
Total liabilities and shareholders' equity	**100,293,756**	**2,131,522**	**12,311,885**	**883,970**	**23,036,372**	**138,657,505**

2010	*Within 3 months* SAR'000	*3-12 months* SAR'000	*1-5 years* SAR'000	*Over 5 years* SAR'000	*No fixed maturity* SAR'000	*Total* SAR'000
Assets						
Cash and balances with SAMA	9,905,290	-	-	-	5,238,798	15,144,088
Due from banks and other financial institutions	7,042,310	-	-	-	-	7,042,310
Investments, net	7,029,983	7,664,806	8,392,234	557,174	1,328,245	24,972,442
Loans and advances, net	32,499,163	12,601,022	22,232,543	6,915,758	-	74,248,486
Investment in associates	-	-	-	-	221,532	221,532
Property and equipment, net	-	-	-	-	558,609	558,609
Other assets	-	-	-	-	3,185,399	3,185,399
Total assets	56,476,746	20,265,828	30,624,777	7,472,932	10,532,583	125,372,866
Liabilities and shareholders' equity						
Due to banks and other financial institutions	4,248,695	121,569	290,914	-	-	4,661,178
Customer deposits	85,810,008	1,482,270	7,359,371	21,206	-	94,672,855
Debt securities in issue	-	1,615,851	3,859,903	-	-	5,475,754
Borrowings	-	-	-	187,500	-	187,500
Other liabilities	-	-	-	-	5,203,632	5,203,632
Shareholders' equity	-	-	-	-	15,171,947	15,171,947
Total liabilities and shareholders' equity	90,058,703	3,219,690	11,510,188	208,706	20,375,579	125,372,866

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 19 (d) of the consolidated financial statements.

35. Fair values of financial instruments

Determination of fair value and fair value hierarchy

The Bank uses the following hierarchy for determining and disclosing the fair value of financial instruments:

Level 1: quoted prices in active markets for the same instrument (i.e., without modification or repacking):

Level 2: quoted prices in active markets for similar assets and liabilities or other valuation techniques for which all significant inputs are based on observable market data: and

Level 3: valuation techniques for which any significant input is not based on observable market data.

	2011			
	Level 1	***Level 2***	***Level 3***	***Total***
	SAR'000	**SAR'000**	**SAR'000**	**SAR'000**
Financial assets				
Derivative financial instruments	**-**	**1,959,762**	**-**	**1,959,762**
Financial assets held as FVIS	**13,472**	**-**	**-**	**13,472**
Financial investments available for sale	**8,644,282**	**11,886,381**	**55,104**	**20,585,767**
Loans and advances – Fair value hedged	**-**	**1,400,324**	**-**	**1,400,324**
Total	**8,657,754**	**15,246,467**	**55,104**	**23,959,325**
Financial Liabilities				
Derivative financial instruments	**-**	**1,919,624**	**-**	**1,919,624**
Debt securities in issue – Fair value hedged	**2,273,660**	**-**	**-**	**2,273,660**
Total	**2,273,660**	**1,919,624**	**-**	**4,193,284**

	2010			
	Level 1	*Level 2*	*Level 3*	*Total*
	SAR'000	SAR'000	SAR'000	SAR'000
Financial assets				
Derivative financial instruments	-	1,790,116	-	1,790,116
Financial assets held as FVIS	13,475	18,783	-	32,258
Financial investments available for sale	9,028,437	13,503,830	55,692	22,285,959
Loans and advances – Fair value hedged	-	865,007	-	865,007
Total	9,041,912	16,177,736	55,692	25,275,340
Financial Liabilities				
Derivative financial instruments	-	1,741,172	-	1,741,172
Debt securities in issue – Fair value hedged	2,154,902	-	-	2,154,902
Total	2,154,902	1,741,172	-	3,896,074

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 recognised 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 except as disclosed above. The fair values of financial instruments that are part of a designated fair value hedge relationship but are not carried at fair value as a class of financial instruments have been disclosed in the note above. These include loans and advances and debt security in issue.

The total amount of the changes in fair value recognised in the statement of income, which was estimated using valuation technique, is positive SAR 163.1 million (2010: SAR negative 66.3 million).

Notes to the Consolidated Financial Statements (31 December 2011) (continued)

36. 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:

	2011	2010
	SAR'000	SAR'000
The HSBC Group:		
Due from banks and other financial institutions	**2,230,796**	5,460,247
Investments	**845,806**	579,210
Other assets	**3,410**	6,561
Derivatives (at fair value)	**(557,228)**	(414,938)
Due to banks and other financial institutions	**4,165,841**	2,175,504
Commitments and contingencies	**2,068,672**	1,865,178

The above investments include investments in associates, amounting to SAR 565.2 million (2010: SAR 221.5 million).

Directors, audit committee, other major shareholders and their affiliates:

	2011	2010
	SAR'000	SAR'000
Loans and advances	**3,463,838**	3,665,336
Customers' deposits	**8,922,735**	7,784,384
Derivatives (at fair value)	**776**	2,623
Commitments and contingencies	**273,596**	281,483
Bank's mutual funds:		
Loans and advances	**31,064**	4,011
Customers' deposits	**1,406,178**	1,249,774

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:

	2011	2010
	SAR'000	SAR'000
Special commission income	**50,932**	45,961
Special commission expense	**(197,639)**	(163,804)
Fees and commission income	**64,503**	70,633
Profit share arrangement relating to investment banking activities	**(6,099)**	(8,670)
Share in earnings of associates	**64,165**	41,074
Directors' remuneration	**2,720**	2,195

36. Related party transactions *(continued)*

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

	2011	2010
	SAR'000	SAR'000
Short-term employee benefits (salaries and allowances)	**48,089**	34,307
Employment termination benefits	**8,709**	5,391

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 was one such scheme outstanding at 31 December 2011. The detail of this scheme has not been separately disclosed in these consolidated financial statements as amounts are not material.

37. 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 regularly by the Bank's management. SAMA requires the Bank to hold the minimum level of the regulatory capital and to maintain a ratio of total regulatory capital to the risk-weighted assets 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 assets, commitments and contingencies, and notional amount of derivatives at a weighted amount to reflect their relative risk.

	2011	2010
	SAR'000	SAR'000
Risk Weighted Assets (RWA)		
Credit Risk RWA	**109,505,348**	98,155,523
Operational Risk RWA	**9,864,886**	9,701,147
Market Risk RWA	**648,400**	1,215,475
Total RWA	**120,018,634**	109,072,145
Tier I Capital	**14,184,649**	12,938,428
Tier II Capital	**3,455,140**	2,512,032
Total I & II Capital	**17,639,789**	15,450,460
Capital Adequacy Ratio%		
Tier I ratio	**11.82%**	11.86%
Tier I + Tier II ratio	**14.70%**	14.17%

Notes to the Consolidated Financial Statements (31 December 2011) (continued)

38. Basel II Pillar 3 Disclosures

Under Basel II pillar 3, quantitative and qualitative disclosures of the Bank's exposures, risk weighted assets and capital are required, and these disclosures will be made available on Bank's website www.sabb.com and the annual report, respectively as required by SAMA.

39. Prospective changes in accounting standards

The Bank has chosen not to early adopt the amendments and the newly issued standards as follows:

- IAS 1 Financial Statement Presentation – Presentation of Items of Other Comprehensive Income effective date 1 July 2012
- IAS 27 Separate Financial Statements (as revised in 2011) effective date 1 January 2013
- IAS 28 Investments in Associates and Joint Ventures (as revised in 2011) effective date 1 January 2013
- IFRS 7 Financial Instruments: Disclosures – Enhanced Derecognition Disclosure Requirements effective date 1 July 2011
- IFRS 9 Financial Instruments: Classification and Measurement effective date 1 January 2015 (tentative)
- IFRS 10 Consolidated Financial Statements effective date 1 January 2013
- IFRS 12 Disclosure of Involvement with Other Entities effective date 1 January 2013
- IFRS 13 Fair Value Measurement effective date 1 January 2013

40. Comparative figures

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

41. Board of Directors' approval

The consolidated financial statements were approved by the Board of Directors on 20 Rabi Awal 1433H (Corresponding 12 February 2012).

The Saudi British Bank
Basel II - Pillar 3
Annual Disclosures
31 December 2011

Basel II – Pillar 3 Annual Disclosures (31 December 2011)

Cautionary statement regarding forward looking statements

These Capital and Risk Management Pillar 3 Disclosures as at 31 December 2011 contain certain forward looking statements with respect to the financial condition, results of operations and business of SABB. These forward looking statements represent SABB expectations or beliefs concerning future events and involve known and unknown risks and uncertainty that could cause actual results, performance or events to differ materially from those expressed or implied in such statements.

Forward-looking statements involve inherent risks and uncertainties. Readers are cautioned that a number of factors could cause actual results to differ, in some instances materially, from those anticipated or implied in any forward-looking statement. Forward-looking statements speak only as of the date they are made, and it should not be assumed that they have been reviewed or updated in the light of new information or future events.

1. Scope of Application

a) **Scope**

These qualitative disclosures set out The Saudi British Bank (SABB) approach to capital assessment and complement the minimum capital requirements and the supervisory review process.

b) **Basis of consolidation**

The basis of consolidation for accounting purposes is described on page 46 of the Annual Report and Accounts 2011.

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

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

Entities that are fully consolidated:
SABB Securities Limited is a wholly owned subsidiary of SABB and its financial statements are consolidated with SABB. The Bank has 98% direct and 2% indirect ownership interest in its subsidiary (the indirect ownership is held via a limited liability company registered in the Kingdom of Saudi Arabia). The principal activities of the subsidiary were to engage in the business of custody and dealing as an agent excluding underwriting. However, effective 1 July 2011 the assets and liabilities of the Company have been transferred to HSBC Saudi Arabia Limited, an associate company of SABB in lieu of additional shares (see note 7 of the SABB Financial Accounts). The Company will be liquidated once the legal formalities for transfer of business have been completed.

Significant Minority Investments:

Following significant minority investments are deducted from the capital:

- The Bank owns 51% of the equity shares of HSBC Saudi Arabia Limited, which is involved in Investment Banking services in the Kingdom of Saudi Arabia. During the year the assets and liabilities of SABB Securities Limited have been transferred to HSBC Saudi Arabia Limited effective 1 July 2011, resulting in an increased shareholding of SABB in HSBC Saudi Arabia Limited from 40% to 51%. However, the share transfer will only take place when the legal formalities are completed
- The Bank owns 32.5% of the equity shares of SABB Takaful. It carries out Shariah-compliant insurance activities and offers Family and General Takaful products

Equity Investments which are risk weighted:

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

1. Scope of Application *(continued)*

c) Capital transferability between legal entities

Restrictions by Memorandum and Articles of Association:

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

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

Statutory restriction:

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

Regulatory restriction:

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

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

2. Capital Structure

The authorized, issued and fully paid share capital of the Bank consists of 750 million shares of SAR 10 each (2010: 750 million shares of SAR 10 each). The ownership of the Bank's share capital is as follows:

	2011	2010
Saudi shareholders	**60%**	60%
HSBC Holdings BV	**40%**	40%
(a wholly owned subsidiary of HSBC Holdings plc)		

The composition of shareholders' equity is available in the annual financial statements.

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

Category	**Definition/meaning/significance**	**Implications for SABB capital management**
Regulatory Capital	Proxy for Risk Capital, particularly under Basel II.	Requirements must be met on a SAMA regulatory rules basis at all times.
Accounting Capital	The capital recognised by accounting standards.	Requirements must be met to achieve audited accounts.
Invested Capital (legal capital)	The equity capital invested in SABB by its shareholders for which SABB is accountable.	SABB must earn a return on its invested capital which is in excess of its cost of capital.
Business Capital	Capital actually held by SABB to bear risk, support growth etc. and upon which an 'economic' return is required.	Allocated to businesses in line with risk appetite given the risks run and acts as basis to set economic profit targets.

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

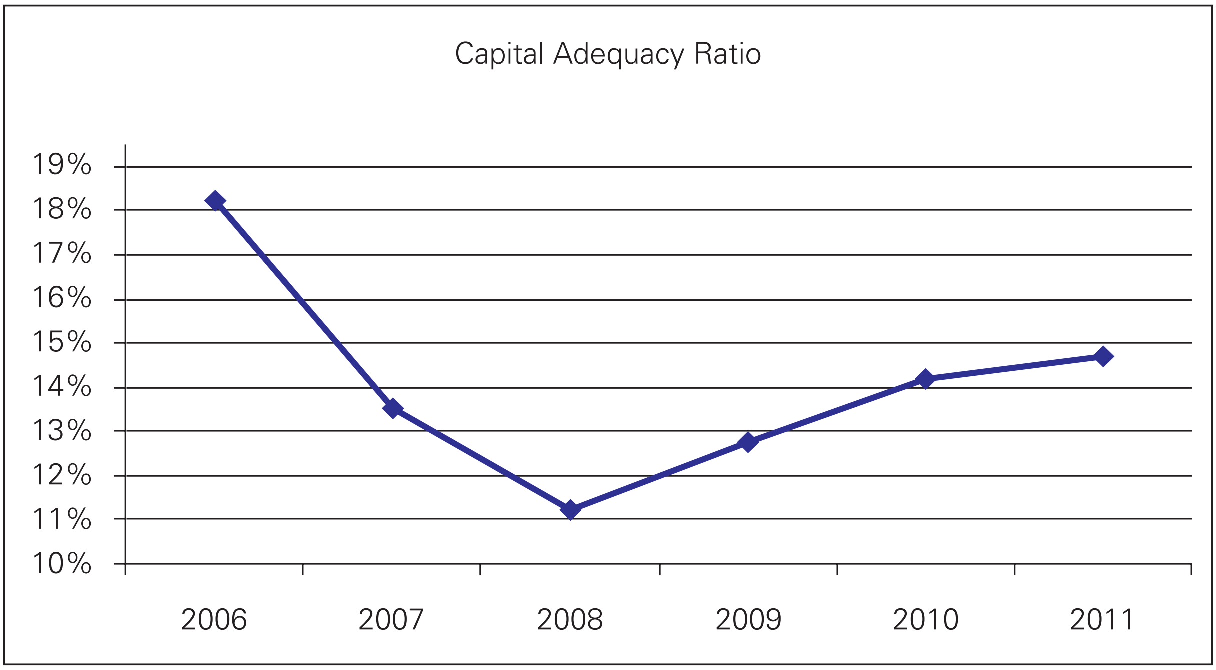
Basel II – Pillar 3 Annual Disclosures (31 December 2011) (continued)

3. Capital Adequacy

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

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

SABB Capital Adequacy Ratio in the last 6 years has been as follows:



2006 - 2007: Capital Adequacy Ratio's are on Basel I basis
2008 - 2011: Capital Adequacy Ratio's are on Basel II basis

Risk Exposure and Assessment

General Qualitative Disclosure Requirements

Credit Risk

Credit risk is the risk of financial loss through the failure of a customer or counterparty to honour their commitments as they fall due. Credit risk arises principally in corporate and personal lending, trade finance, treasury and syndication underwriting. But credit risk also arises from off balance sheet products such as guarantees and derivatives or from SABB's holdings of debt securities.

A culture of prudent and responsible lending is supported by a strong risk policy and control framework which is managed by an independent credit function who both partner and challenge business proposals in line with the Board approved risk appetite levels.

SABB's credit culture is dedicated to achieving sustainable profitability through maintaining high quality risk assets. This is attained through effective control and management of risk, seeking to minimize credit losses while enhancing risk-adjusted returns, thus contributing to the overall success of the Bank.

3. **Capital Adequacy** *(continued)*

Risk Exposure and Assessment *(continued)*

General Qualitative Disclosure Requirements *(continued)*

Credit Risk *(continued)*

A strong risk governance framework has been established under the oversight of the Board designated committee the Risk Management Meeting. A number of sub committees have been established to focus on retail and corporate credit risk, Treasury market risk, Operational risk, security and fraud risk, reputational risk, capital planning, and stress testing.

Credit risk management functions have an appropriate degree of independence and responsibility for key aspects of rating systems, including selection, implementation, performance, and oversight. Approval processes observe high standards of governance, efficiency and facilitate timely decision-making through the use of delegated approval limits.

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

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

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

SABB's association to the HSBC Group promotes the use of standard systems and methodologies for these purposes and employs common measurements of risk throughout the organisation. At SABB, consumer lending decisions are based on credit risk score models developed using internal data and embedded into an automated decision process. Corporate Customers are rated internally and mapped to a 23 point scale based on scorecards with financial and subjective inputs to determine the perceived quality of the company and probability of default (PD). The output is reviewed by expert credit approvers before capital is assigned. Retail customers are rated using a range of behavioural and application quantitative models which segment the customers into different risk bands.

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

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

In order to support and evaluate credit decisions SABB maintains an analytics capability to develop policy and systems, generate performance and management information and undertake stress testing and scenario analysis across SABB's various risk asset portfolios. The outcomes of any analysis are subject to a thorough management challenge to ensure any changes are fit for purpose.

Credit risk consumes the largest proportion of SABB's minimum capital requirement. Within the established principles and parameters SABB ensures that strict capital discipline is maintained through correct pricing and management of credit risks in relation to the regulatory and economic capital requirements.

Information on counterparty credit risk is provided in the table 8 commentary below.

3. Capital Adequacy *(continued)*

Risk Exposure and Assessment *(continued)*

General Qualitative Disclosure Requirements *(continued)*

Market Risk

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

Further information on market risk is provided in the table 10 commentary below.

Operational Risk

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

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

Further information on operational risk capital is provided in the table 12 commentary below.

Investment Risk

Investment risk is the risk of an adverse impact on P&L and capital due to an unexpected loss in value of the investment position held by SABB on a long term (non-trading basis). This can arise out of SABB's investment, private equity or equity investment portfolios.

As a general policy SABB seeks to focus investments around establishing a diversified portfolio of high quality and highly liquid securities. Less liquid or structured investments account for less than 2% of the portfolio.

SABB will continue to review its investment policy in line with market developments and opportunities as they arise. The risk mandate will however always maintain a focus on high quality, liquid investments with a preference for domestically issued debt and securities.

Whilst SABB does hold a nominal position in private equity investments it does not hold any direct equity investments. Further information on equities risk is provided in the table 13 commentary below.

Interest Rate Risk

Interest rate risk in the banking book is defined as the exposure of the non-trading products of the Bank to interest rates. Interest rate risk arises principally from mismatches between the future yield on assets and their funding costs, as a result of changes in interest rates.

Further information on interest risk is provided in the table 14 commentary below.

3. **Capital Adequacy** *(continued)*

Risk Exposure and Assessment *(continued)*

General Qualitative Disclosure Requirements *(continued)*

Foreign Exchange Risk

Currency or foreign exchange risk (FX) arises from an open position, either overbought (long) or oversold (short), in a foreign currency, creating exposure to a change in the relevant exchange rate.

SABB categorises foreign exchange risk as follows:

- ***Trading Book FX risk*** – arises from proprietary currency trading i.e. spot, forwards, futures, swaps and options. Trading exposures are controlled through assigning limits to each currency and aggregate exposure levels as well as through VAR and stress testing measures
- ***Banking Book FX risk*** – arises from a currency mismatch/revaluation between assets and liabilities, including accrued interest and accrued expenses. The mismatch is transferred to Treasury and managed on daily basis through the trading book
- ***Structural FX risk*** – arises due to two reasons a) relates to net investments in subsidiaries, branches or associated capital undertakings. b) Relates to the non-SAR denominated assets. The currencies where structural FX rise arises are those other than the designated reporting currency of the SABB, which is the Saudi Riyal (SAR)

Liquidity Risk

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

Since January 2010, SABB has introduced a new liquidity framework based on projected cashflow scenarios referred to as the Operational Cashflow Projection (OCP). The objective of the OCP is to better reflect the likely behaviour of different customers and manage liquidity during crisis events or a loss in confidence in SABB, resulting in deposit withdrawals by clients. The OCP policy aims to diversify SABB's liability base, and reduce concentration levels to any single customer.

The new framework is compliant with BIS guidelines 'Principles for Sound Liquidity Risk Management and Supervision' issued in September 2008.

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

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

SABB assesses and manages liquidity risk through clearly defined liquidity policies which form part of a boarder Liquidity and Funding framework and funding plan which is reviewed and approved by ALCO and EXCOM. There is a designated Liquidity Management Committee, which monitors the bank's current and projected liquidity position and proposes changes to ALCO on SABB's liquidity ratio limits, funding strategy and liquidity stress testing scenarios.

SABB manages and reports balance sheet liquidity against a range of internal and regulatory ratios which cover the proportion of net liquid assets to customer liabilities, the adequacy of assets to deposits, the proportion of customer deposits held in liquid assets and that Amanah liabilities are only invested in Amanah assets and any excess needs to be invested in Shariah compliant assets.

Basel II – Pillar 3 Annual Disclosures (31 December 2011) (continued)

3. Capital Adequacy *(continued)*

Risk Exposure and Assessment *(continued)*

General Qualitative Disclosure Requirements *(continued)*

Liquidity Risk *(continued)*

The Financial Control Department prepares a bank-wide liquidity report, which is monitored daily against approved limits and regulatory requirements by Senior Management, along with a 1-year rolling forecast balance sheet on a quarterly basis showing expected loan and deposit growth including major currency breakdowns.

SABB seeks to maintain a cushion of unencumbered, high quality, liquid assets that can be liquidated or repoed in times of stressed liquidity. The asset tolerance limit is defined and monitored by ALCO on a monthly basis.

Operational Cashflow Projections are used to stress the liquidity position across a range of maturity bands and through the application of bank specific and market wide scenarios.

Current accounts and savings deposits payable on demand or at short notice form a significant part of SABB's funding and there is considerable focus on maintaining the stability of such deposits. SABB manages and monitors depositor and debt security concentration in order to avoid undue reliance on large individual depositors and ensuring a satisfactory overall funding mix and maturity profile of deposit and debt securities.

A comprehensive Liquidity Contingency Plan is in place and tested on an annual basis. The plan identifies early indicators of stress conditions and describes actions to be taken in the event of difficulties arising from systemic or other crises.

SABB has continued to expand its investor relations programme to ensure that it keeps investors advised of developments and kept itself aware of their changing requirements in readiness for any potential debt or equity issuances.

Concentration Risk

Concentration in credit portfolios has been a cause for bank and banking system distress in the past. As a result, concentration risk forms an integral part of SABB's supervisory review and internal risk assessment process. There can also be benefits where a Banks portfolio can evidence diversification across asset classes, customer groups, industry sectors, business lines and geographic locations.

Concentration risk can manifest itself in three main forms where there is an imperfect diversification of credit risk.

- Single name concentration (Idiosyncratic risk)
- Sector concentration (Systematic risk)
- Contagion (Systemic failure)

It is the Bank's policy to avoid undesired concentration of exposure in any single dimension of the entire credit portfolio (asset class, industry sector, geography, etc.). We aim to ensure that the Bank's exposure is well diversified across a broad mix of business sectors. SABB has established exposure policies and lending risk tolerance limits for individual counterparties, industry sectors, country cross border risk, specific products or advance purposes and portfolio level controls.

SABB retains capital against the granularity of its lending portfolio and reviews the level of concentration within portfolios on a monthly basis through the senior risk management meeting (RMM) and EXCOM.

3. Capital Adequacy *(continued)*

Risk Exposure and Assessment *(continued)*

General Qualitative Disclosure Requirements *(continued)*

Reputational Risk

Reputational risk is the potential negative but unquantifiable current and future impact on profits and capital, which might arise from a changed and adverse perception of SABB's reputation among its various stakeholders in the various facets of its operations.

The safeguarding of SABB's reputation is of paramount importance and critical to its success. SABB's policies and procedures are regularly reviewed to ensure reputational factors covering environmental, social and governance risks are continually updated in light of relevant developments. All new products are reviewed by the reputational risk committee, which reviews key activities that give rise to material reputational risk sensitivities.

The SABB Reputational Risk Committee was established in 2009 to assess and manage reputational risk, at which SABB functions with responsibilities for activities that attract reputational risk are presented.

Actions by employees can have an impact on the reputation of the bank and they are provided with awareness sessions to educate people on reputational risk and their personal responsibilities in upholding and enhancing the image and brand of SABB.

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

Sustainability risk sensitivities are also of high importance in managing reputational risk and SABB seeks to uphold the highest sustainability risk standards, including the equator principles for project finance lending, sector based sustainability guidelines covering sectors with high environmental, ethical or social impacts.

The unique structure of Islamic financial products (Shariah Compliant Products) is quite distinct and places increased requirements on the Bank to ensure that not only do they meet customer suitability standard but that the internal Shariah compliance process if robust. The impact of Shariah compliance failures would impact SABB's reputation and as a result SABB operates a dedicated Amanah banking team who control Islamic product develop and monitor ongoing compliance with Shariah requirements.

3. Capital Adequacy *(continued)*

Risk Exposure and Assessment *(continued)*

General Qualitative Disclosure Requirements *(continued)*

Macro Economic and Business Cycle Risk

Macroeconomic and Business Cycle Risks are seen as the potential negative impacts on profits and capital as a result of SABB not meeting its goals and objectives caused by unforeseen changes in the business and regulatory environment, exposure to economic cycles and technological changes.

SABB assesses and manages macroeconomic and business cycle risk through clearly defined policies and procedures.

As an intrinsic part of the process, SABB's Risk Management Meeting (RMM) regularly monitors local key macroeconomic indicators, such as:

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

Strategic Risk

Strategic Risk is the risk that the business will fail to identify and react appropriately to opportunities and/or threats arising from changes in the market, some of which may emerge over a number of years such as changing economic and political circumstances, customer requirements, demographic trends, regulatory developments or competitor action. Risk may be mitigated by consideration of the potential opportunities and challenges through the strategic planning process.

Strategic and Operating Plans are established against clearly defined guidelines and via a rigorous process that considers the wider business, regulatory and economic environment when preparing the plans. Plans are monitored on an ongoing basis to ensure that targets are being achieved and to proactively consider risks, which might arise to non-achievement of goals.

The strategic risks are monitored by the strategic planning function on a regular basis and variations, if any are reported to the Risk Management Meeting. Where necessary the Board holds strategic review meetings to refine the bank's strategy in light of market developments.

Compliance Risk

Compliance Risk is the risk leading to statutory, legal sanctions, material financial loss, or damage to the reputation of SABB that may be suffered as a result of the failure to comply with all applicable laws, rules and regulations. The aim of compliance is to protect the reputation and credibility of SABB and protect the interest of shareholders and depositors, and safeguard the institution against legal consequences.

Compliance risk is managed by adhering to industry best practice and local regulator requirements for the management of Compliance in banks. A dedicated compliance manual, responsibilities assigned to business compliance officers, periodic risk based compliance risk assessments and quarterly meetings are methods used to manage compliance risk. Annual Compliance Risk Assessments (CRA) are required by every business and Business control heat maps monitor and report progress. In 2009 a Compliance Committee was formed based on the guidelines of the SAMA Compliance Manual issued during the year.

3. Capital Adequacy *(continued)*

Risk Exposure and Assessment *(continued)*

General Qualitative Disclosure Requirements *(continued)*

Wrong-Way Risk

Wrong-way risk occurs when there is an adverse correlation between the counterparty's probability of default and the mark-to-market value of the underlying transaction. Wrong way risks arising from customer activity is managed under defined guidelines and limits on a regular basis. The following control infrastructure is in place and reported to senior management on monthly basis.

- Business referral process where Wrong-Way Risk transactions are passed for separate approval prior to execution
- A wrong way risk exposure report is tabled in the senior Risk Management Meeting
- Total exposure at counterparty level is maintained under predefined credit approved limits

Other Risks

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

4. Credit Risk: General Disclosures for All Banks

Past due loans:

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

Impaired loan:

Individual Impairment Provisions

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

Collective Impairment Provisions

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

4. Credit Risk: General Disclosures for All Banks *(continued)*

Credit Risk:

Standardised Approach

Overall, SABB currently calculates its models and assessments based on the Basel II Standardised Approach, in line with the approval granted by SAMA. Specifically, SABB is segmenting its asset portfolio and generating associated RWAs and capital support data in accordance with SAMA guidelines and uses the Standardised approach to calculate the minimum capital requirements.

Advanced IRB Approach

SABB is developing its processes, in line with SAMA guidance notes, to enable it to move to the advanced approaches of Basel II for credit risk.

SABB has a set of independently validated corporate scorecards to calculate the PD for each exposure. Along with this, specific LGD & EAD engines are being developed to calculate the respective LGD & EAD for each client. The output from these engines, combined with additional appropriate data such as maturity, allow SABB to calculate RWA based on the IRB-A approach. It is important to note that each distinct portfolio has a dedicated PD scorecard to determine the appropriate credit risk rating. These scorecards are reviewed at least annually and approved by the RMM.

For retail portfolios SABB uses a wide range of application and behavioural models and has completed a risk segmentation process as well as having developed a full range of Basle II IRB-A compliant scorecards to calculate expected and unexpected losses for each retail portfolio. SABB is currently in the process of embedding these models into its capital generation system.

5. Standardized Approach and Supervisory Risk Weights in the IRB Approaches

For portfolios under the standardized approach, External Credit Assessment Institutions risk assessments are used by SABB as part of the determination of risk weightings:

- SABB has nominated three SAMA recognized External Credit Assessment Institutions for this purpose – Moody's Investors Service, Standard and Poor's Ratings Group and the Fitch Group
- Credit ratings of all exposures are individually determined from the above credit rating agencies and mapped to the exposures assigning a risk weight according to the supervisory tables

  The alignment of alphanumeric scales of each agency to risk buckets is as follows:

Moody's	*Standard and Poor's*	*Fitch*
Aaa	AAA	AAA
Aa1	AA+	AA+
Aa2	AA	AA
Aa3	AA-	AA-
A1	A+	A+
A2	A	A
A3	A-	A-
Baa1	BBB+	BBB+
Baa2	BBB	BBB
Baa3	BBB-	BBB-
Ba1	BB+	BB+
Ba2	BB	BB
Ba3	BB-	BB-
B1	B+	B+
B2	B	B
B3	B-	B-
Caa1	CCC+	CCC+
Caa2	CCC	CCC
Caa3	CCC-	CCC-
Ca	CC	CC
C	C	C
WR	D	D
	NR	NR

Claims on sovereigns and their central banks

Credit Assessment	*AAA to AA-*	*A+ to A-*	*BBB+ to BBB-*	*BB+ to B-*	*Below B-*	*Unrated*
Risk Weight	0%	20%	50%	100%	150%	100%

Claims on Banks and Securities Firms (Under Option 2 as required by SAMA)

Credit Assessment	*AAA to AA-*	*A+ to A-*	*BBB+ to BBB-*	*BB+ to B-*	*Below B-*	*Unrated*
Risk Weight under option 2	20%	50%	50%	100%	150%	50%
Risk Weight for short-term claims under option 2	20%	20%	20%	50%	150%	20%

Basel II – Pillar 3 Annual Disclosures (31 December 2011) (continued)

5. Standardized Approach and Supervisory Risk Weights in the IRB Approaches *(continued)*

Multilateral Development Banks

0% risk weight for qualifying MDB's as per SAMA and in general risk weights to be determined on the basis of individual MDB rating as for option# 2 for banks.

Claims on public sector entities (PSEs)

As per Option 2

Claims on corporates

Credit Assessment	*AAA to AA-*	*A+ to A-*	*BBB+ to BB-*	*Below BB-*	*Unrated*
Risk Weight	20%	50%	100%	150%	100%

Claims included in the regulatory non-mortgage retail portfolios

A 75% risk weight to be assigned to such exposures.

Claims secured by residential mortgages

A 100% retail risk weight to be applied to such claims.

Claims secured by commercial real estate

A 100% retail risk weight to be applied to such claims.

Past due loans

Risk Weight%	*Level of Provisioning*
150	Up to 20%
100	20% to 50%
100	50% to above

Other assets

The standard risk weight for all other assets will be 100% except gold to be treated equivalent to cash and risk weighted at 0%.

When calculating the risk weighted value of any exposure under the standardized approach, look up function is applied to the central data base maintained in Excel and assigns to each individual exposures.

6. Credit Risk: Disclosures for Portfolios Subject to IRB Approaches

Not Applicable.

7. Credit Risk Mitigation: Disclosures for Standardised and IRB Approaches

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

SABB grants facilities based on the borrower's ability to repay, rather than placing its reliance on credit risk mitigation. SABB nevertheless does hold a range of security to reduce the risk of loss and maximise the probability of facilities being repaid. A number of these risk mitigants have been applied under the Standardised approach in Pillar I and there are other securities that cannot be assigned a value such as shares, land and local property.

The main types of collateral taken by the bank are as follows:

- Savings and Time deposits
- Listed Shares
- Bank Guarantees
- Title deeds of property
- Government Bonds
- Mutual Funds Units
- Corporate/Individual Guarantees
- Assignment of salary or contract proceeds

International and Local Banks Guarantees are referred to Institutional Banking for counterparty and cross border country risk approval.

The granting of facilities and taking of collateral as risk mitigants is governed by defined policies and procedures, as well as the use of bank standard documentation that cater for the offset of credit balances against facilities granted, the control over the integrity and valuation of collateral and the rights required to enforce and realize security. SABB monitors the concentration of risk mitigants and does not have any material concentrations in the risk mitigants currently held.

8. General Disclosure for Exposure Related to Counterparty Credit Risk

Counterparty credit risk is the risk that a counterparty to a transaction may default before completing the satisfactory settlement of the transaction.

The Bank calculates its counterparty credit risk for both trading and banking book exposures by assigning risk weights to exposure types:

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

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

9. Securitisation

Currently there are no securitisation deals involving SABB. There is a prescribed process in SABB for managing securitisation transactions. This risk assessment and reporting process will be observed when the need to apply the same arises.

Basel II – Pillar 3 Annual Disclosures (31 December 2011) (continued)

10. Market Risk: Disclosure for Banks Using Standardised Approaches

Market risk is identified by businesses and transferred into SABB Treasury who has the necessary expertise to manage the positions using risk limits approved by the executive committee of the Board (EXCOM). Exposures are separated into trading (market-making, proprietary trading, and mark to market positions) and non-trading (interest rate management, and financial investments either held to maturity or available for sale) portfolios.

The monitoring and control of market risk is handled by an independent market risk team which is responsible for ensuring market risk exposures are measured in accordance with defined policies and reported daily against prescribed control limits.

SABB uses a range of control measures to manage market risk ranging from specific stop loss control limits, to sensitivity analysis limits including the present value of a basis point movement of interest rates, as well as VAR loss limits designed to estimate the potential loss from market movements across a specified time horizon and for a given level of confidence using a historical simulation approach. SABB recognizes the limitations of VAR and compliments its analysis with scenario stress testing to evaluate the impact of more extreme but plausible events or movements in market variables.

Stress testing is performed at a portfolio level covering the impacts of movements in any single risk factor, technical scenarios looking at the largest observed movements, hypothetical scenarios looking at potential macro-economic events and historical scenarios which incorporate observed market movements from periods not captured in the VAR. These scenarios are governed by an oversight committee and the results are reported to senior management together with an assessment of the impact such events would have on SABB together with proposals for mitigating actions.

The risk of credit spread movements or specific issuer risk which arises from the change in value of a bond due to perceived changes in the credit quality of an issuer is managed through credit VAR and stress testing limits and tolerance levels.

Whilst SABB uses both VAR and standard rules to manage market risk, capital requirements are assessed for all positions using the standard rules approaches prescribed by SAMA.

11. Market Risk: Disclosure for Banks Using Internal Models Approach (IMA) for Trading Portfolios

Not Applicable.

12. Operational Risk

SABB manages operational risk by tracking actual and near miss operational losses. Historical loss experiences have been seen in the areas of fraudulent activities, breakdown in processes due to misjudgment or human error and systems failures.

Whilst operational risk is the responsibility of individual employees and businesses it is organized as an independent risk discipline within SABB. The operational risk function seeks to manage and control risk in a cost efficient manner within agreed risk tolerance levels. A formal governance structure is in place to provide oversight over the management of risk within which designated business coordinators feed into a committee structure and ultimately to the Risk Management Meeting and Board.

Operational risk policies and procedures explain the requirements for identifying, assessing, monitoring reporting and controlling risk as well as providing guidance on the mitigation action to be taken when weaknesses are identified. Businesses are responsible for undertaking a self assessment, designing controls and reporting defined key risk indicators all of which are subject to an independent challenge and review process. Systems and centralised databases are in place to track and record actual as well as near miss loss events for collation, analysis and reporting to senior management.

Capital requirements are assessed using the standardised approach, which applies one of three fixed percentages to an average of the last three financial years gross revenues allocated across eight defined business lines.

13. Equities: Disclosures for Banking Book Positions

Equity Investments are either classified as “Available for sale” or as “Investments in Associate”.

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

Investments, which are classified as “available for sale”, are subsequently measured at fair value. For an available-for-sale investment where the fair value has not been hedged, any gain or loss arising from a change in its fair value is recognised directly in “Other reserves” under Shareholders’ equity. On derecognition, any cumulative gain or loss previously recognized in shareholders’ equity is included in the consolidated statement of income for the period.

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

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

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

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

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

14. Interest Rate Risk in the Banking Book (IRRBB)

The analysis of Interest Rate risk is complicated by having to make assumptions on embedded optionality in products such as loan prepayments, and from behavioural assumptions regarding the economic duration of liabilities, which are contractually repayable on demand. Product reviews are undertaken annually to review and validate any behavioural assumptions.

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

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

SABB Treasury seeks to manage the impact of interest rate risk on net interest income in so far as such hedging is possible and cost effective to undertake.

Basel II – Pillar 3 Annual Disclosures (31 December 2011) (continued)

1. Table – Scope of Application

Capital Deficiencies (Table 1, (e))

Particulars	*Amount* **SAR'000**
The aggregate amount of capital deficiencies in subsidiaries not included in the consolidation i.e that are deducted	
1. HSBC Saudi Arabia Limited	453,689
2. Saudi Travellers Cheque Company	5,676
3. SABB Takaful	111,502

2. Table – Capital Structure

Capital Structure (Table 2, (b to e))

Components of capital	*Amount* **SAR'000**
Core capital – Tier 1:	
Eligible paid-up share capital	7,500,000
Shares premium accounts	-
Eligible reserves	5,955,262
Minority interests in the equity of subsidiaries	-
Retained earnings	1,014,821
IAS type adjustments	-
Deductions from Tier 1:	
Interim losses during the year	-
Intangible assets (including goodwill)	-
Other country specific deductions from Tier 1 at 50%	-
Regulatory calculation differences deduction from Tier 1 at 50%	-
Reciprocal holding of bank capital at 50% deduction	-
Significant minority investments at 10% and above at 50% deduction:	-
Banking and securities entities not fully consolidated	226,845
Insurance organizations	55,751
Commercial organizations	2,838
Total Tier I	**14,184,649**
Supplementary capital – Tier 2:	
Revaluation gains/ reserves	-
Subordinated loan capital	-
Qualifying general provisions	852,139
Interim profits	2,888,435
Deductions from Tier 2:	
Reciprocal holding of bank capital at 50% deduction	-
Significant minority investments at 10% and above at 50% deduction	-
Banking and securities entities not fully consolidated	226,845
Insurance organizations	55,751
Commercial Organizations	2,838
Other country specific deductions from Tier2 at 50%	-
Regulatory calculation differences deduction from Tier 2 at 50%	-
Total Tier II	**3,455,140**
Capital to cover market risks – Tier III	
Short Term Subordinated Debt	-
Tier I and Tier II Capital Available for Market Risk	-
Total eligible capital	**17,639,789**

3. Table – Capital Adequacy

Amount of Exposures Subject To Standardised Approach of Credit Risk and related Capital Requirements (Table 3, (b))

Portfolios	*Amount of exposure* SAR'000	*Capital requirement* SAR'000
Sovereigns and central banks:		
SAMA and Saudi Government	33,334,130	-
Others	1,555,635	908
Multilateral Development Banks (MDBs)	-	-
Public Sector Entities (PSEs)	-	-
Banks and securities firms	4,362,029	69,792
Corporates	78,043,721	5,598,053
Retail non-mortgages	11,858,749	651,434
Small Business Facilities Enterprises (SBFE's)	-	-
Mortgages	-	-
Residential	4,925,075	394,006
Commercial	-	-
Securitized assets	-	-
Equity	1,034,116	82,729
Others	2,118,932	60,970
Total	**137,232,387**	**6,857,892**

Capital requirements for Market Risk* (822, Table 3, (d))

	Interest rate risk SAR'000	*Equity position risk* SAR'000	*Foreign exchange risk* SAR'000	*Commodity risk* SAR'000	*Total* SAR'000
Standardised approach	49,299	-	2,573	-	**51,872**

**Capital requirements are to be disclosed only for the approaches used.*

Capital Requirements for Operational Risk* (Table 3, (e))

Particulars	*Capital requirement* SAR'000
Standardised approach	789,191

**Capital requirements are to be disclosed only for the approaches used.*

Capital Adequacy Ratios (Table 3, (f))

Particulars	*Total capital ratio* %	*Tier I capital ratio* %
Top consolidated level	14.70	11.82

Basel II – Pillar 3 Annual Disclosures (31 December 2011) (continued)

4. Table (STA) – Credit Risk: General Disclosures

Credit Risk Exposure (Table 4, (b))

Portfolios	*Total gross credit risk exposure* SAR'000	*Average gross credit risk exposure over the period* SAR'000
Sovereigns and central banks:		
SAMA and Saudi Government	33,388,730	-
Others	1,555,635	-
Multilateral Development Banks (MDBs)	-	-
Public Sector Entities (PSEs)	-	-
Banks and securities firms	10,662,188	-
Corporates	101,222,426	-
Retail non-mortgages	10,844,062	-
Small Business Facilities Enterprises (SBFE's)	-	-
Mortgages	-	-
Residential	4,925,075	-
Commercial	-	-
Securitized assets	-	-
Equity	1,034,116	-
Others	2,118,932	-
Total	**165,751,164**	**-**

4. Table (STA) – Credit Risk: General Disclosures *(continued)*

Geographic Breakdown (Table 4, (c))

Portfolios	*Saudi Arabia* SAR'000	*Other GCC & Middle East* SAR'000	*Europe* SAR'000	*North America* SAR'000	*South East Asia* SAR'000	*Other countries* SAR'000	*Total* SAR'000
Sovereigns and central banks:							
SAMA and Saudi Government	33,388,730	-	-	-	-	-	**33,388,730**
Others	-	1,498,854	-	-	56,781	-	**1,555,635**
Multilateral Development Banks (MDBs)	-	-	-	-	-	-	**-**
Public Sector Entities (PSEs)	-	-	-	-	-	-	**-**
Banks and securities firms	340,400	513,106	4,052,997	2,274,014	721,589	2,760,082	**10,662,188**
Corporates	96,542,333	3,001,132	458,277	92,604	1,053,071	75,009	**101,222,426**
Retail non-mortgages	10,844,062	-	-	-	-	-	**10,844,062**
Small Business Facilities Enterprises (SBFE's)	-	-	-	-	-	-	**-**
Mortgages	-	-	-	-	-	-	**-**
Residential	4,925,075	-	-	-	-	-	**4,925,075**
Commercial	-	-	-	-	-	-	**-**
Securitized assets	-	-	-	-	-	-	**-**
Equity	978,495	-	55,621	-	-	-	**1,034,116**
Others	2,118,932	-	-	-	-	-	**2,118,932**
Total	**149,138,027**	**5,013,092**	**4,566,895**	**2,366,618**	**1,831,441**	**2,835,091**	**165,751,164**

Basel II – Pillar 3 Annual Disclosures (31 December 2011) (continued)

4. Table (STA) – Credit Risk: General Disclosures *(continued)*

Industry Sector Breakdown (Table 4, (d))

Portfolios	*Government and quasi-government* SAR'000	*Banks and other financial institutions* SAR'000	*Agriculture and fishing* SAR'000	*Manufacturing* SAR'000	*Mining and quarrying* SAR'000
Sovereigns and central banks:					
SAMA and Saudi Government	33,388,730	-	-	-	-
Others	1,555,635	-	-	-	-
Multilateral Development Banks (MDBs)	-	-	-	-	-
Public Sector Entities (PSEs)	-	-	-	-	-
Banks and securities firms	-	10,662,188	-	-	-
Corporates	-	9,113,512	562,915	22,029,804	602,745
Retail non-mortgages	-	-	-	-	-
Small Business Facilities Enterprises (SBFE's)	-	-	-	-	-
Mortgages	-	-	-	-	-
Residential	-	-	-	-	-
Commercial	-	-	-	-	-
Securitized assets	-	-	-	-	-
Equity	-	969,335	-	5,296	10
Others	-	-	-	-	-
Total	**34,944,365**	**20,745,035**	**562,915**	**22,035,100**	**602,755**

Residual Contractual Maturity Breakdown (Table 4, (e))

	Maturity Breakdown	
Portfolios	*Less then 8 days* **SAR'000**	*8 - 30 days* **SAR'000**
Sovereigns and central banks:		
SAMA and Saudi Government	17,163,181	2,957,859
Others	-	-
Multilateral Development Banks (MDBs)	-	-
Public Sector Entitties (PSEs)	-	-
Banks and Securities Firms	4,601,411	784,988
Corporates	11,876,464	18,167,341
Retail non-mortgages	1,556,647	67,176
Small Business Facilities Enterprises (SBFE's)	-	-
Mortgages	-	-
Residential	932	23
Commercial	-	-
Securitized assets	-	-
Equity	-	-
Others	-	-
Total	**35,198,635**	**21,977,387**

Electricity, water, gas and health services	*Building and construction*	*Commerce*	*Transportation and communication*	*Services*	*Consumer loans and credit cards*	*Others*	*Total*
SAR'000	**SAR'000**	**SAR'000**	**SAR'000**	**SAR'000**	**SAR'000**	**SAR'000**	**SAR'000**
-	-	-	-	-	-	-	**33,388,730**
-	-	-	-	-	-	-	**1,555,635**
-	-	-	-	-	-	-	**-**
-	-	-	-	-	-	-	**-**
-	-	-	-	-	-	-	**10,662,188**
2,775,797	19,661,445	30,251,829	7,168,664	1,562,156	-	7,493,559	**101,222,426**
-	-	-	-	-	10,844,062	-	**10,844,062**
-	-	-	-	-	-	-	**-**
-	-	-	-	-	-	-	**-**
-	-	-	-	-	4,925,075	-	**4,925,075**
-	-	-	-	-	-	-	**-**
-	-	-	-	-	-	-	**-**
-	-	-	666	3,705	-	55,104	**1,034,116**
-	-	-	-	-	-	2,118,932	**2,118,932**
2,775,797	**19,661,445**	**30,251,829**	**7,169,330**	**1,565,861**	**15,769,137**	**9,667,595**	**165,751,164**

Maturity Breakdown

30 - 90 days	*90 - 180 days*	*180 - 360 days*	*1 - 3 years*	*3 - 5 years*	*Over 5 years*	**No Maturity*	*Total*
SAR'000	**SAR'000**	**SAR'000**	**SAR'000**	**SAR'000**	**SAR'000**	**SAR'000**	**SAR'000**
138,477	1,625,109	4,579,849	981,702	127,874	5,814,679	-	**33,388,730**
-	-	-	907,683	234,529	413,423	-	**1,555,635**
-	-	-	-	-	-	-	**-**
-	-	-	-	-	-	-	**-**
2,302,901	633,101	823,274	814,117	388,888	313,508	-	**10,662,188**
20,437,534	11,267,119	10,966,867	13,667,907	8,628,962	6,210,232	-	**101,222,426**
63,546	146,906	183,019	2,762,792	5,966,041	97,935	-	**10,844,062**
-	-	-	-	-	-	-	**-**
-	-	-	-	-	-	-	**-**
374	352	3,356	61,957	145,837	4,712,244	-	**4,925,075**
-	-	-	-	-	-	-	**-**
-	-	-	-	-	-	-	**-**
-	-	-	-	-	-	1,034,116	**1,034,116**
-	-	-	-	-	-	2,118,932	**2,118,932**
22,942,832	**13,672,587**	**16,556,365**	**19,196,158**	**15,492,131**	**17,562,021**	**3,153,048**	**165,751,164**

Basel II – Pillar 3 Annual Disclosures (31 December 2011) (continued)

4. Table (STA) – Credit Risk: General Disclosures *(continued)*

Impaired Loans, Past Due Loans and Allowances (Table 4, (f))

			Ageing of past due loans
	Impaired loans	*Defaulted*	*Less than 90 days*
Industry sector	**SAR'000**	**SAR'000**	**SAR'000**
Government and quasi government	-	-	-
Banks and other financial institutions	-	-	-
Agriculture and fishing	495	495	2,531
Manufacturing	164,235	220,813	60,419
Mining and quarrying	-	-	-
Electricity, water. Gas and health services	-	-	3,327
Building and construction	436,546	436,546	742,715
Commerce	305,426	310,047	69,199
Transportation and communication	918	1,018	50,776
Services	26,045	26,045	1,350
Consumer loans and credit cards	42,126	173,873	780,379
Others	702,273	800,875	329,741
Total	**1,678,064**	**1,969,712**	**2,040,437**

Impaired loans, Past Due Loans and Allowances (Table 4, (g))

		Ageing of past due loans			
	Impaired loans	*Less than 90 days*	*90 - 180 days*	*180 - 360 days*	*Over 360 days*
Geographic area	**SAR'000**	**SAR'000**	**SAR'000**	**SAR'000**	**SAR'000**
Saudi Arabia	1,636,128	2,040,437	291,648	-	-
Other GCC and Middle East	41,936	-	-	-	-
Europe	-	-	-	-	-
North America	-	-	-	-	-
SouthEast Asia	-	-	-	-	-
Others countries	-	-	-	-	-
Total	**1,678,064**	**2,040,437**	**291,648**	**-**	**-**

Reconciliation of Changes in the Allowances for Loan Impairment (Table 4, (h))

	Specific allowances	*General allowances*
Particulars	**SAR'000**	**SAR'000**
Balance, beginning of the year	2,108,747	505,725
Charge-offs taken against the allowances during the period	(1,121,671)	-
Amounts set aside (or reversed) during the period	49,191	538,731
Other adjustments:	-	-
– exchange rate differences	-	-
– business combinations	-	-
– acquisitions and disposals of subsidiaries	-	-
– etc.	-	-
Transfers between allowances	-	-
Balance, end of the year	**1,036,267**	**1,044,456**

Ageing of past due loans			Specific allowances				
90 - 180 days	*180 - 360 days*	*Over 360 days*	*Balance at the beginning of the period*	*Charges during the period*	*Charge-offs during the period*	*Balance at the end of the period*	*General allowances*
SAR'000	**SAR'000**	**SAR'000**	**SAR'000**	**SAR'000**	**SAR'000**	**SAR'000**	**SAR'000**
-	-	-	-	-	-	-	-
-	-	-	-	-	-	-	-
-	-	-	-	-	-	-	1,854
56,578	-	-	89,920	54,845	(82,503)	62,262	237,433
-	-	-	-	-	-	-	2,351
-	-	-	7,128	(7,128)	-	-	6,988
-	-	-	42,828	115,833	(48,000)	110,661	163,740
4,621	-	-	824,835	63,219	(610,883)	277,171	344,762
100	-	-	1,083	-	(481)	602	10,789
-	-	-	10,630	13,872	-	24,502	2,123
131,747	-	-	383,187	142,873	(301,626)	224,434	-
98,602	-	-	749,136	(334,323)	(78,178)	336,635	274,416
291,648	**-**	**-**	**2,108,747**	**49,191**	**(1,121,671)**	**1,036,267**	**1,044,456**

Specific allowances	*General allowances*
SAR'000	**SAR'000**
993,297	1,044,456
42,970	-
-	-
-	-
-	-
-	-
1,036,267	**1,044,456**

Basel II – Pillar 3 Annual Disclosures (31 December 2011) (continued)

5. Table (STA) – Credit Risk: Disclosures for Portfolios Subject to the Standardised Approach

Allocation of Exposures to Risk Buckets (Table 5, (b))

	Risk buckets		
	0%	*20%*	*35%*
Particulars	**SAR'000**	**SAR'000**	**SAR'000**
Sovereigns and central banks:			
SAMA and Saudi Government	33,388,730	-	-
Others	1,498,854	56,781	-
Multilateral Development Banks (MDBs)	-	-	-
Public Sector Entities (PSEs)	-	-	-
Banks and securities firms	-	6,124,969	-
Corporates	168,098	3,358,122	-
Retail non-mortgages	-	-	-
Small Business Facilities Enterprises (SBFE's)	-	-	-
Mortgages	-	-	-
Residential	-	-	-
Commercial	-	-	-
Securitized assets	-	-	-
Equity	-	-	-
Others	1,356,805	-	-
Total	**36,412,487**	**9,539,872**	**-**

7. Table (STA) – Credit Risk Mitigation (CRM); Disclosures for Standardised Approach

Credit Risk Exposure covered by CRM (Table 7, (b) and (c))

	Covered by	
	*Eligible financial collateral**	*Guarantees/ credit derivatives*
Portfolios	**SAR'000**	**SAR'000**
Sovereigns and central banks:		
SAMA and Saudi Government	-	-
Others	-	-
Multilateral Development Banks (MDBs)	-	-
Public Sector Entities (PSEs)	-	-
Banks and securities firms	-	-
Corporates	3,750,426	453,304
Retail non-mortgages	-	-
Small Business Facilities Enterprises (SBFE's)	-	-
Mortgages	-	-
Residential	-	-
Commercial	-	-
Securitized assets	-	-
Equity	-	-
Others	-	-
Total	**3,750,426**	**453,304**

Risk buckets							
50%	*75%*	*100%*	*150%*	*Other risk weights*	*Unrated*	*Total*	*Deducted*
SAR'000	**SAR'000**	**SAR'000**	**SAR'000**	**SAR'000**	**SAR'000**	**SAR'000**	**SAR'000**
-	-	-	-	-	-	**33,388,730**	**-**
-	-	-	-	-	-	**1,555,635**	**-**
-	-	-	-	-	-	**-**	**-**
-	-	-	-	-	-	**-**	**-**
4,531,488	-	5,731	-	-	-	**10,662,188**	**-**
6,523,186	-	86,507,760	461,530	-	-	**97,018,696**	**-**
-	10,804,524	39,538	-	-	-	**10,844,062**	**-**
-	-	-	-	-	-	**-**	**-**
-	-	-	-	-	-	**-**	**-**
-	-	4,925,075	-	-	-	**4,925,075**	**-**
-	-	-	-	-	-	**-**	**-**
-	-	-	-	-	-	**-**	**-**
-	-	1,034,116	-	-	-	**1,034,116**	**570,867**
-	-	762,127	-	-	-	**2,118,932**	**-**
11,054,674	**10,804,524**	**93,274,347**	**461,530**	**-**	**-**	**161,547,434**	**570,867**

Basel II – Pillar 3 Annual Disclosures (31 December 2011) (continued)

8. Table (STA) – Credit Derivative Transactions (Table 8, (c))

	Proprietary activities		Intermediation activities	
	Protection bought	*Protection sold*	*Protection bought*	*Protection sold*
Credit derivative transactions	**SAR'000**	**SAR'000**	**SAR'000**	**SAR'000**
Total return swaps				
Credit default swaps				
Credit options				
Credit linked notes			**N I L**	
Collateralised debt obligations				
Collateralised bond obligations				
Collateralised loan obligations				
Others				
Total	**-**	**-**	**-**	**-**

9. Table (STA) – Securitisation: Disclosures for Standardised Approach

Outstanding Exposures Securitised by the Bank (Table 9,(d) to (f))

	Outstanding exposures				
	Traditional	*Synthetic*	*Impaired/ Past due assets securitised*	*Losses recognised by the Bank during the current period*	*Securitisation exposures retained or purchased*
Exposures Type	**SAR'000**	**SAR'000**	**SAR'000**	**SAR'000**	**SAR'000**
Credit cards					
Home equity loans					
Commercial loans					
Automobile loans			**N I L**		
Small business loans					
Equipment leases					
Others					

Exposures by Risk Weight Bands (Table 9, (g))

	Securitisation exposures retained or purchased	*Associated capital charges*
Risk Weight bands	**SAR'000**	**SAR'000**
0% to 20%		
Above 20% to 40%		
Above 40% to 60%		
Above 60% to 80%	**N I L**	
Above 80% to 100%		
Above 100%		

9. Table (STA) – Securitisation: Disclosures for Standardised Approach *(continued)*

Deductions from capital (Table 9, (g))

	Exposures deducted from Tier 1 capital	*Credit enhancing I/Os deducted from total capital*	*Other exposures deducted from total capital*
Type of underlying assets	**SAR'000**	**SAR'000**	**SAR'000**
Loans			
Commitments			
Asset-backed securities			
Mortgage-backed securities			
Corporate bonds		N I L	
Equity securities			
Private equity investments			
Others			

Securitisations Subject to Early Amortisation Treatment (Table 9, (h))

		Aggregate capital charges incurred by the Bank against	
	Aggregate draw exposures attributed to the seller's and investor's interest	*Its retained shares of the drawn balances and undrawn lines*	*The investor's shares of drawn balances and undrawn lines*
Type of underlying assets	**SAR'000**	**SAR'000**	**SAR'000**
Loans			
Commitments			
Asset-backed securities			
Mortgage-backed securities			
Corporate bonds		N I L	
Equity securities			
Private equity investments			
Others			

Summary of Current Year's Securitisation Activity (Table 9, (j))

	Amount of exposures securitised	*Recognised gain or loss on sale*
Exposure types	**SAR'000**	**SAR'000**
Credit cards		
Home equity loans		
Commercial loans		
Automobile loans	N I L	
Small business loans		
Equipment leases		
Others		

Basel II – Pillar 3 Annual Disclosures (31 December 2011) (continued)

10. Table – Market Risk: Disclosures for Banks Using the Standardised Approach

Level of Market Risks in Terms of Capital Requirements (Table 10, (b))

	Interest rate risk	*Equity position risk*	*Foreign exchange risk*	*Commodity risk*	*Total*
	SAR'000	**SAR'000**	**SAR'000**	**SAR'000**	**SAR'000**
Capital requirements	49,299	-	2,573	-	**51,872**

13. Table – Equities: Disclosures for Banking Book Positions

Value of Investments (Table 13, (b))

	Unquoted Investments		**Quoted Investments**		
	Value disclosed in financial statements	*Fair value*	*Value disclosed in financial statements*	*Fair value*	*Publicly quoted share values (if materially different from fair value)**
	SAR'000	**SAR'000**	**SAR'000**	**SAR'000**	**SAR'000**
Investments	520,205	520,205	1,084,779	1,312,512	-

Type and Nature of Investments (Table 13, (c))

	Publicly traded	*Privately held*
Investments	**SAR'000**	**SAR'000**
Government and Quasi-government	-	-
Banks and Other Financial Institutions	1,078,807	455,719
Agriculture and fishing	-	-
Manufacturing	5,296	-
Mining and quarrying	10	-
Electricity, water, gas and health services	-	-
Building and construction	-	-
Commerce	-	-
Transportation and communication	666	-
Services	-	9,382
Others	-	55,104
Total	**1,084,779**	**520,205**

Gains and Losses etc. (Table 13, (d) and (e))

Particulars	**SAR'000**
Cummulative realised gains/(losses) arising from sales and liquidations in the reporting period	-
Total unrealised gains (losses)	(263,921)
Total latent revaluation gains (losses)*	N/A
Unrealised gains (losses) included in capital	(263,921)
Latent revaluation gains (losses) included in capital*	N/A

**Not applicable to KSA to date.*

13. Table – Equities: Disclosures for Banking Book Positions *(continued)*

Capital Requirements (Table 13, (f))

Equity Grouping	*Capital requirements* **SAR’000**
Government and Quasi-government	-
Banks and Other Financial Institutions	77,547
Agriculture and fishing	-
Manufacturing	424
Mining and quarrying	1
Electricity, water, gas and health services	-
Building and construction	-
Commerce	-
Transportation and communication	53
Services	296
Others	4,408
Total	**82,729**

Equity Investments Subject to Supervisory Transition or Grandfathering Provisions (Table 13, (f))

Equity Grouping	**SAR’000**
Government and quasi-government	
Banks and other financial institutions	
Agriculture and fishing	
Manufacturing	
Mining and quarrying	
Electricity, water, gas and health services	
Building and construction	
Commerce	
Transportation and communication	
Services	
Others	
Total	**Nil**

14. Table – Interest Rate Risk in the Banking Book (IRRBB)

200bp Interest Rate Shocks for currencies with more than 5% of Assets or Liabilities (Table 14, (b))

Rate Shocks	*Change in earnings* **SAR’000**
Upward Rate Shocks:	
SAR	(502,587)
USD	(151,014)
Downward rate shocks:	
SAR	502,587
USD	151,014

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