samba financial group مجموعة سامبا المالية

Capital Adequacy and Risk Management Report

(Basel II Pillar 3 Disclosure)

as at

31st December 2008

March 2009

samba سامبا

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1. Executive Summary

The Capital Adequacy and Risk Management Report for Samba Financial Group ("Samba" or "the bank") has been prepared in accordance with the public / market disclosure requirements and guidelines in respect of Pillar 3 of the Basel II Accord, as published by the Saudi Arabian Monetary Agency (SAMA) in May 2007[1].

The purpose of this disclosure is to inform market participants of the key components of the scope and effectiveness of Samba's risk measurement processes, risk management systems, risk profile and capital adequacy. This is accomplished by providing consistent and understandable disclosure of Samba's risk profile in a way that enhances comparability with other institutions.

Samba Financial Group (Samba) has complied with the aforementioned requirements with effect from 1st January 2008 and had published its first semi-annual Capital Adequacy and Risk Management Report as at 30th June 2008. This is the first Annual Report prepared by Samba under these guidelines.

Samba has adopted the Standardized Approach for Credit Risk, the Standardized Approach for Market Risk and the Standardized Approach for determining the capital requirements for Operational Risk. These are more fully discussed in the following pages of this report.

The Capital Adequacy and Risk Management Report provides details on Samba Financial Group consolidated risk profile with business volumes by customer categories and risk assets' classes, which form the basis for the calculation of the capital requirement.

The summary of Samba Financial Group's capital adequacy as at 31st December 2008 is as under:

Total Capital Adequacy Ratio	14.1%
Tier 1 Capital Adequacy Ratio	13.1%

in accordance with the minimum capital requirement calculation methodology as prescribed under Pillar 1 of Basel II.

Total Risk Weighted Assets (RWA) amounted to SAR 153,058,900,000 comprised of 86.5% Credit Risk; 5.8% Market Risk and 7.7% Operational Risk.

[1] Per SAMA circular 19402/BCS 378 entitled Basel II- Consultative Draft: Pillar 3 Requirements and Guidance Notes dated 24th May 2007

2. Background

Samba Financial Group is a Saudi Joint Stock company which has been in business in the Kingdom of Saudi Arabia since 1980 (more fully detailed information available in the published Annual Report) and is listed on the Saudi Stock Exchange (Tadawul) under symbol 1090. As a bank registered in the Kingdom of Saudi Arabia, Samba falls under the regulatory supervision of the Saudi Arabian Monetary Agency (SAMA).

Samba provides commercial banking services such as loans, trade finance, consumer financing, credit cards, and treasury products to all customer segments including retail (individuals), corporates, government and semi-government institutions. Samba also provides a broad range of Shariah compliant banking products approved by Samba's Shariah Board, an independent body of Shariah Scholars.

Samba operates in overseas markets through branches in London and Dubai, and has been recently granted a licence by the Qatar Financial Centre to commence operations in Qatar (business not yet commenced during the period covered by this report).

On 30th March 2007 Samba also acquired a 68.4% share in Samba Bank Limited (formerly Crescent Commercial Bank Limited) incorporated in Pakistan. Samba Bank Limited is a banking company engaged in commercial banking and related services and is listed on all the stock exchanges in Pakistan.

In addition, Samba has recently obtained a license from the Securities Exchange Board of India to undertake investment activities as a Foreign Institutional Investor (FII) in the securities market in India.

Information disclosed in this report is at the highest consolidated level i.e. Samba Financial Group including all branches and subsidiaries as at 31st December 2008.

The information provided in this document is not required to be subjected to external audit; reconciliation with audited financial accounts has been ensured for this disclosure.

3. Basel II Components

In March 2008, SAMA issued a circular[2] requiring banks operating in the Kingdom of Saudi Arabia to report their capital adequacy requirements according to the new Basel II guidelines. Basel II is an international initiative (adopted by SAMA) with a view to ensure adequate capitalization of banks on a more robust risk-sensitive framework for the assessment of risk and the calculation of a regulatory capital requirement i.e. the minimum capital that an institution must hold, given its risk profile. The Basel II framework is intended to strengthen risk management practices and processes within financial institutions.

SAMA's Basel II framework[3] describes the following three pillars which are designed to be mutually re-enforcing and are meant to ensure an adequate capital base which corresponds to the overall risk profile of the bank:

- Pillar 1: calculation of the capital adequacy ratio based on the charge for credit, market and operational risk stemming from its business operations.
- Pillar 2: The supervisory review process which includes:
    - the Internal Capital Adequacy Assessment Process (ICAAP) to assess incremental risk types not covered under Pillar 1
    - the quantification of capital required for these identified risks
    - the assurance that the bank has sufficient capital cushion (generated from internal/external sources) to cover these risks over and above the regulatory requirement under Pillar 1
- Pillar 3: Market discipline through public disclosures that are designed to provide transparent information on capital structure, risk exposures, risk mitigation and the risk assessment process.

These are more fully described in the following pages.

This report represents Samba's market disclosure under the Pillar 3 requirements of its risk profile and capital adequacy as at the end of 31st December 2008.

[2] Circular 10243/ B.C.S. 124 dated 5 March 2008, titled 'Transition from Basel I to Basel II'
[3] SAMA Guidance Document issued on 31st May 2005, entitled 'New Basel II Framework Initial Implementation Document for Banks Operating in Saudi Arabia' and related guidelines issued during the course of implementation.

3.1. Pillar 1 – Minimum Capital Requirements

Pillar 1 of the Basel II Accord, as adopted and implemented by SAMA, covers the minimum regulatory capital requirement that a bank is expected to maintain to cover credit, market and operational risk stemming from its business operations. It also sets out the basis for the consolidation of entities for capital adequacy reporting requirements, the definition and calculations of Risk Weighted Assets (RWA) and the various options given to banks to calculate these Risk Weighted Assets.

The regulatory capital requirements are calculated according to the following formula (expressed as a percentage):

$$\text{Minimum Capital Requirements} = \frac{\text{Capital Base}}{\text{RWA}}$$

where, the Minimum Capital Requirements are to be ≥ 8%

The RWA is calculated using more sophisticated and risk sensitive methods than the ones previously used under Basel I. In addition, Operational Risk is now included as a risk under the new accord, supplementing the credit and market risk components previously used.

The table below describes the approaches available for calculating the RWA for each of the aforementioned risk types:

Credit Risk	Market Risk	Operational Risk
Standardized Approach	Standardized Approach	Basic Indicator Approach
Foundation - Internal Ratings Based Approach (F-IRB)	Internal Models Approach	Standardized Approach
Advanced - Internal Ratings Based Approach (A-IRB)		Advanced Measurement Approach (AMA)

Samba Financial Group has elected the following approach for each of the risk types:

a) Credit Risk

Standardized Approach is currently being used by Samba for regulatory reporting purposes. This approach differs from the Basel I regulations in that it allows the use of external ratings, where available from accredited ratings agencies for the determination of appropriate risk weights, and also includes a wider range of eligible financial collaterals. The RWA is then calculated according to the following formula:

RWA = ∑ Credit Equivalent Amount[4] for all asset classes x Regulatory Defined Risk Weight[5]

[4] Credit equivalent amount is determined as gross exposure less specific provisions less eligible credit mitigants. A credit conversion factor (CCF) or add-on percentage is then applied to off-balance sheet and derivative exposures respectively.

b) Market Risk

Samba is currently adopting the Standardized Approach for the measurement of Market Risk capital requirement. Under this approach, the capital charge for Market Risk is determined by converting positions in the trading book into risk weighted assets, as per the respective SAMA guidelines[6].

c) Operational Risk

Samba is currently adopting the Standardized Approach for the measurement of Operational risk capital charge. This approach applies a range of beta coefficients (12%-18%) to the average gross income for the preceding three financial years for each of eight predetermined business lines.

3.2. Pillar 2 – Supervisory Review Process

The Supervisory Review Process (SRP) under Pillar 2 requires banks to have an Internal Capital Adequacy Assessment Process (ICAAP) that is aimed at capturing an additional capital charge for risks not specifically covered under Pillar 1 (examples of some risks identified in this respect are interest rate risk in the banking book, strategic risk, legal risk, concentration risk, etc.). This is designed to ensure that banks have a sufficient capital cushion to meet regulatory and internal capital requirements during periods of systemic/cyclical economic downturns or during times of financial distress.

Samba has submitted its detailed ICAAP Plan for 2009 to SAMA.

3.3. Pillar 3 – Market Discipline

Under Pillar 3 the accord prescribes the qualitative and quantitative disclosures which are required to be made to external stakeholders of the bank[7]. The disclosures are designed to enable stakeholders and market participants to assess an institution's risk appetite, risk exposures and risk profile. It encourages the move towards more advanced forms of risk management.

A reporting calendar has also been provided by SAMA to indicate which disclosures are required at the defined intervals. Quarterly requirements are disclosed in the quarterly financial statements and semi-annual/annual disclosures are contained in this report, which is complimentary to the disclosures made in the annual financial statements of the bank.

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[5] The regulatory defined risk weight is determined by the counterparty asset class and the external rating of the counterparty, where applicable.
[6] As defined in SAMA's circular No. BCS 355 of Dec. 29,2004
[7] SAMA circular 19402/B.C.S 378 dated 24 May 2007, entitled ' Basel II-Consultative Draft : Pillar 3 Disclosure Requirements and Guidance Notes'

4. Risk and Capital Management

In this chapter, the consolidation principles for the capital base within Samba are described, as well as the principles adopted for the management and control of risk and capital.

4.1. Group Structure

Samba Financial Group follows the Accounting Standards for Financial Institutions promulgated by the Saudi Arabian Monetary Agency (SAMA) and International Financial Reporting Standards (IFRS). Samba also prepares its consolidated financial statements to comply with the Banking Control Law and the Regulations for Companies in the Kingdom of Saudi Arabia.

The consolidated financial statements as at 31st December 2008 include financial statements of the Bank and its following subsidiaries:

Samba Fund Management (Guernsey) Limited: A wholly owned subsidiary incorporated in Guernsey and specializing in the management of mutual funds.

Samba Bank Ltd: A 68.4% owned subsidiary incorporated as a banking company in Pakistan and engaged in commercial banking and related services. This entity is listed on all stock exchanges in Pakistan.

Samba Real Estate Company: A wholly owned subsidiary incorporated in Saudi Arabia under commercial registration no. 1010234757 issued in Riyadh dated 9 Jumada II, 1428H (June 24, 2007). The company has been formed as limited liability company with the approval of SAMA and is engaged in managing real estate projects on behalf of Samba Real Estate Fund.

Samba Capital and Investment Management Company: A wholly owned subsidiary incorporated in Saudi Arabia under commercial registration number 1010237159. It was formed in accordance with the Securities Business regulations issued by the Capital Market Authority (CMA), requiring banks in Saudi Arabia to transfer their dealing, arranging, managing, advising and custody businesses into a separate legal entity licensed with CMA. This is referred to as Samba Capital.

Co-Invest Offshore Capital Limited: A wholly owned company incorporated under the laws of Cayman Island for the purpose of managing certain overseas investments.

The aggregation consolidation method is applied to subsidiaries reporting in other regulatory jurisdictions. To this end Samba Bank Limited calculates it's Risk Weighted Assets according to the regulations defined by the State Bank of Pakistan

4.2. Risk and Capital Management Process

Samba is exposed to a broad range of risks in the normal course of its business. The policies are designed to identify and quantify these risks, set appropriate limits in line with defined risk appetite, ensuring control and monitoring adherence to the limits. The principal risks associated with Samba's business are credit risk, including cross-border risk, market risk, liquidity risk, operational risk and reputation/franchise risk.

The Executive Committee of the Samba Board formulates high level strategies and policies, determines institutional risk appetite and approves specific transactions or programs that may pose material risks to the institution. This Committee, which has been appointed and empowered by the Samba Board of Directors, comprises three Board Members in addition to the Managing Director and Chief Executive Officer.

The process of risk management is supported by a set of independent control functions reporting to the Chief Risk Officer. Individual credit transactions are approved jointly by selected Credit Officers including both Business and Independent Risk Management representatives. The Credit Risk Control department reviews approval levels and documentation prior to allowing the availment of facilities. Market Risk reviews limits and provide independent reports about the bank's market risk exposures and liquidity positions, including measurement against stressed events. The Risk Strategy and Portfolio department manages the process of risk appetite definition, portfolio targets and overall limit settings.

The risk governance structure includes the following committees:

- Asset Liabilities Committee (ALCO), chaired by the Managing Director is responsible for monitoring and managing of the liquidity, balance sheet and the market risk resulting from the accrual portfolio.
- Market Risk Policy Committee (MRPC) is the management body within Samba for market and liquidity risk issues, including establishing and updating policies and guidelines, reviewing and approving market risk limits and exceptions.
- The Credit Risk Policy Committee (CRPC) has Samba-wide responsibility for maintaining sound, effective credit risk management architecture and process.
- The Capital Management Committee (CMC) examines components of the capital plan and proposes the internal capital adequacy targets for approval by the Executive Committee.

Samba Audit Risk Review (ARR) reports functionally to the Audit Committee of the Samba Board and has responsibility for:

- Providing independent evaluation of Samba's risk portfolio and processes.
- Assessing the adequacy of the Bank's policies, practices, and procedures for risk management.
- Documenting its findings in action-oriented reports to the relevant Board / Management Committees and Senior Management.

5. Regulatory Capital Requirements

This chapter describes the capital requirements in Samba, calculated based on the regulatory provided formulae. The risk types under Pillar 1 are in accordance with Basel II guidelines issued by SAMA[8] and contain credit, market and operational risk.

Samba's overall capital requirement can be broken down as follows:

SAR 000's

Risk type	Capital Requirement	% of Total Requirement
Credit Risk	10,598,422	86.5 %
Market Risk	705,216	5.8 %
Operational Risk	941,074	7.7 %
Total	**12,244,712**	**100.00%**

5.1. Capital requirements for Credit Risk

Samba calculates the capital requirements for credit risk according to the Standardized Approach. Under this approach, exposures are assigned to portfolio segments based on the type of counterparty and/or the nature of the underlying exposure.

The major portfolio segments as defined by the Basel guidelines adopted by SAMA are sovereigns, banks, corporates, retail, securitized assets and VIP/HNI (high net worth individuals). Each segment has a defined risk weight ranging from 0% to 150%, depending tenor, type of exposure, the asset class it belongs, whether the counterparty has an external rating, and whether the exposure is past due.

[8] Refer footnote on page 5

The following table describes the amount of exposures subject to credit risk and the related capital requirements, by portfolio:

SAR 000's

Portfolio	Amount of exposures	RWA	Capital requirements
Sovereigns and central banks:	45,033,659	125,445	10,036
Public Sector Entities (PSEs)	0	0	0
Banks and securities firms	9,666,376	3,029,978	242,398
Corporates	78,573,468	70,930,860	5,674,469
Retail non-mortgages	13,516,979	10,186,566	814,925
Mortgages - Residential and Commercial	11,592	8,694	695
Past Due Loans	1,307,383	733,338	58,667
Securitized assets	297,163	297,163	23,773
Equities	265,064	265,064	21,205
VIP/HNI	20,234,832	15,467,721	1,237,418
Others	13,057,455	2,257,834	180,627
Total - (On Balance Sheet)	***181,963,971**	**103,302,662**	**8,264,213**
Off Balance Sheet	43,357,347	21,706,924	1,736,554
Derivatives	12,437,918	7,470,689	597,655
Total	**237,759,236**	**132,480,275**	**10,598,422**

Exposures are stated at gross values without the reflecting the effect of aggregate credit risk mitigants (collaterals). Such collaterals amount to SAR 5,796,878,000. Credit risk mitigation is described in detail in chapter 6.3 of this report.

A definition of each portfolio is described in detail in chapter 6 of the report.

*The exposures are reflected at gross values, before provisions; while exposures in the financial statements are disclosed on a net basis.

5.2. Capital requirements for Market Risk

Samba uses the Standardized Approach to calculate the regulatory capital requirements relating to general market and specific market risk. The resultant measure of market risk is multiplied by 12.5, the reciprocal of the theoretical 8% minimum capital ratio, to give market risk-weighted exposure on a basis consistent with credit risk-weighted exposure. The principal market risks to which Samba is exposed are foreign exchange risk, interest rate risk and equity price risk associated with its trading, investment and asset and liability management activities. This figure does not include Interest Rate Risk in the Banking Book, as this is considered as part of the Pillar 2 risks (refer paragraph 9 of this document).

Brief descriptions of the risk items covered by market risk are given below:

a. Interest rate risk is the impact on banks earnings and market value of equity due to changes in interest rates; the risk is two-fold:

   - Specific Risk: risk of loss caused by an adverse price movement of a debt instrument or security due principally to factors related to the issuer.

   - General Market Risk: risk of loss arising from adverse changes in market conditions.

b. Equity position risk is the risk that the bank's investments will depreciate due to the dynamics of the equity markets.

c. Foreign exchange risk is the risk arising from a change in exchange-rates on the bank's net asset / liability positions.

d. Commodity risk refers to the uncertainties of future market values and of the size of the future income, caused by the fluctuation in the prices of commodities.

The capital requirements for Market Risk, calculated on assets and positions held in the trading book, are presented in the table below:

SAR 000's

Market Risk Type	RWA	Capital requirements
Interest rate - general risk	2,668,325	213,466
Interest rate - specific risk	145,638	11,651
Equity position risk	3,950,975	316,078
Foreign exchange risk	2,045,963	163,677
Commodity risk	4,297	344
Total	**8,815,198**	**705,216**

5.3. Capital requirements for Operational Risk

Samba uses the Standardized Approach for the calculation of the regulatory capital requirements with respect to Operational Risk. This approach applies a range of beta coefficients (12%-18%) to the average gross income for the preceding three financial years for each of eight predetermined business lines.

The capital requirements are detailed in the table below:

SAR 000's

Business line	Beta Coefficient	Total Capital requirement
Agency Services	15%	
Asset Management	12%	
Commercial Banking	15%	
Corporate Finance	18%	941,074
Payment and Settlement	18%	
Retail Banking	12%	
Retail Brokerage	12%	
Trading and Sales	18%	

5.4. Capital Structure

Samba maintains an adequate capital base to cover risks inherent in its business operations. The adequacy of capital is actively managed and monitored using, among other measures, the rules and ratios established under the Basel II Accord, as adopted by SAMA[9].

The primary objective of Samba's capital management is to ensure that the bank maintains a sufficient level of capital to meet/exceed all regulatory requirements and achieve a strong credit rating, while optimizing shareholder's value.

The total eligible capital (Tier 1 and 2) calculated in accordance with SAMA guidelines is a follows:

SAR 000's

Components of capital	Amount
Eligible paid-up share capital	9,000,000
Eligible reserves and Retained Earnings	10,845,785
Minority interests in the equity of subsidiaries	216,078
Deductions from Tier I:	
Intangible assets (including goodwill)	(29,940)
Total Tier I	20,031,923
Qualifying general provisions	1,516,176
Total Tier II	1,516,176
	-
Total eligible capital	**21,548,099**

[9] Refer footnote 2 page 5.

5.5. Capital Adequacy Ratio (Pillar 1)

Entity	Total capital ratio %	Tier 1 capital ratio %
Samba Financial Group (consolidated)	14.1%	13.1%
Samba Bank Limited, Pakistan	55.7%	54.5%

Samba has consistently maintained its capital adequacy ratio above the regulatory minimum of 8%. As at the end of December 2007, the capital ratio under Basel I regulations was 15.2%. The capital adequacy ratio as at the end of December 2008 is not comparable to 2007 owing to a change in the methodology from Basel I to the adoption of Basel II.

6. Credit Risk

In this section, Credit Risk components are disclosed according to the following dimensions:

a. Basel II exposure classes used in the calculations of RWA
b. Geography, industry, maturity and risk weight buckets as defined by Basel II
c. The effects of credit risk mitigation
d. Status of the loan book (performing/impaired) and corresponding loan loss reserves

6.1. Asset Classes

Samba has a diversified credit portfolio, which can be divided into the following exposure classes as defined by SAMA[10]:

Sovereigns and Central banks
Exposures to sovereigns and central banks carry a risk weight ranging between zero and 100 percent, depending on the external rating provided by the relevant ECAI's.
Average risk weight for this portfolio is 0.3%.

Banks and securities firms
SAMA has prescribed that exposures falling into this portfolio are to be treated according to Option 2 of the Basel Accord i.e. the risk weight is determined on the external rating of the bank or securities firm by a recognized ECAI. A preferential risk weight is assigned to short term exposures, defined as those exposures with a tenor of less than three months.
Average risk weight for this portfolio is 32.2%.

Corporates
This portfolio is assigned a risk weight based on the external rating wherever available of the counterparty with whom the exposure is held. Due to the fact that the majority of the corporates in Saudi Arabia are not rated by ECAIs, a regulatory risk weight of 100% is applied to a large portion of this portfolio.
Average risk weight for this portfolio is 93.8 %.

Retail non-mortgages
This portfolio consists of granular loans to individuals, leases, small business facilities, or car loans and other consumer loans. SAMA requires that exposures not meeting certain granularity criteria be assigned a 100% risk weight, whereas the balance of the exposure under this asset class is assigned a flat 75% risk weight.

[10] Per paragraph 4.1 of "Basel II- SAMA's Detailed Guidance Document Consultative Draft no 2.", issued 6 June 2006

Securitized & other assets

Samba's exposures which fall into this category primarily include CDOs and CLOs. In accordance with SAMA guidelines issued in this regard, this portfolio is assigned a 100% risk weight. In all such exposures Samba is an investor only, not an originator.

VIP/HNI

This portfolio has been defined to include exposures to high net worth individuals that fall outside the scope of Retail exposures. These would therefore include exposures to individuals in excess of SAR 5 million and they are not managed on a pooled basis. For regulatory purposes these exposures are assigned a 100% risk weight.

Others

The standard risk weight for all other assets is prescribed at 100%. These typically include fixed assets, prepayments and sundry debtors. Cash and cash equivalents are assigned a risk weight of 0%.

Average risk weight for this portfolio is 22.2%.

6.2. Credit Exposure

6.2.1 Gross Credit Exposure

The gross credit exposure as presented in the table below is reflected before applying any credit risk mitigation, such as financial collaterals and guarantees.

SAR 000's

Portfolio	Credit Risk Exposure			
	On-balance sheet	Off-balance sheet	Derivatives	Gross Credit Risk Exposure
Sovereigns and central banks:	45,033,659	3,658,303		48,691,962
Public Sector Entities (PSEs)	0			0
Banks and securities firms	9,666,376	3,000,064	*7,161,832	12,666,440
Corporates	78,573,468	33,827,413	5,047,200	117,448,081
Retail non-mortgages	13,516,979	12,740	992	13,530,711
Mortgages - Residential and Commercial	11,592			11,592
Past Due Loans	1,307,383			1,307,383
Securitized assets	297,163			297,163
Equities	265,064			265,064
VIP/HNI	20,234,832	921,563	227,894	21,384,289
Others	13,057,455	1,937,263		14,994,718
Total	**181,963,971**	**43,357,347**	**12,437,918**	**237,759,236**

The gross credit exposure for derivative and foreign exchange instruments is the replacement cost (current exposure) representing the cost of replacing the contracts at current market rates should the counterparty default prior to settlement date. It includes the add-on for potential future exposure which is used to determine the RWA amount for these exposures.

*Samba holds SAR 3,225,037,500 as collaterals in its favor against these positions from counterparties under margining agreements.

6.2.2 Geographic breakdown of on-balance sheet credit risk exposures

SAR 000's

Portfolios	Geographic area						
	Saudi Arabia	Other GCC & Middle East	Europe	North America	South East Asia	Others countries	Total
Sovereigns and central banks:	34,238,716	25,458	3,699,765	6,298,395	146,130	625,196	45,033,659
Public Sector Entities (PSEs)	-	-	-	-	-	-	-
Banks and securities firms	5,454,109	350,263	1,106,318	2,249,180	153,673	352,833	9,666,376
Corporates	67,733,710	5,756,926	3,722,879	792,424	294,307	273,222	78,573,468
Retail non-mortgages	13,398,545	-	-	-	104,130	14,304	13,516,979
Mortgages - Retail and Commercial	-	-	-	-	11,592	-	11,592
Past Due Loans	1,170,035	-	-	-	118,283	19,064	1,307,383
Securitized assets	36,750	-	-	260,413	-	-	297,163
Equities	219,894	-	24,403	-	20,767	-	265,064
VIP/HNI	20,167,083	1,472	4,385	61,892	-	-	20,234,832
Others	12,706,923	75,816	-	-	274,716	-	13,057,455
Total	**155,125,765**	**6,209,935**	**8,557,750**	**9,662,304**	**1,123,598**	**1,284,619**	**181,963,971**

Nearly 85.6% of Samba's portfolio is originated in Saudi Arabia, the host jurisdiction, thereby shielding it largely from the global financial markets. Through its recent expansion via acquisitions in Pakistan, coupled with the opening of branches in Dubai and Qatar, Samba is seeking to geographically diversify its credit risk exposure.

6.2.3 Industry sector breakdown of on-balance sheet credit risk exposures

SAR 000's

Portfolios	Industry sector												
	Govt. and quasi govt.	Banks and other financial institutions	Agriculture and fishing	Manufac-turing	Mining and quarrying	Electricity, water, gas and health services	Building and constru-ction	Commerce	Transportation and communication	Services	Consumer loans and credit cards	Others	Total
Sovereigns and central banks:	45,033,659	-	-	-	-	-	-	-	-	-	-	-	45,033,659
Public Sector Entities (PSEs)	-	-	-	-	-	-	-	-	-	-	-	-	-
Banks and securities firms	-	9,666,376	-	-	-	-	-	-	-	-	-	-	9,666,376
Corporates	-	-	3,167,575	10,174,658	658,728	1,411,194	10,128,232	14,887,426	4,931,465	5,008,078	-	28,206,112	78,573,468
Retail non-mortgages	-	-	-	-	-	-	-	-	-	-	13,516,979	-	13,516,979
Mortgages - Retail and Commercial	-	-	-	-	-	-	-	-	-	-	11,592	-	11,592
Past Due Loans	-	-	37,641	44,345	46,561	63,671	304,200	230,426	102,049	87,515	371,489	19,486	1,307,383
Securitized assets	-	297,163	-	-	-	-	-	-	-	-	-	-	297,163
Equities	-	-	-	-	-	-	-	-	-	-	-	265,064	265,064
VIP/HNI	-	0	815,738	2,620,255	169,640	363,421	2,608,299	3,833,922	1,269,988	1,289,718	-	7,263,851	20,234,832
Others	-	-	-	-	-	-	-	-	-	-	-	13,057,455	13,057,455
Total	**45,033,659**	**9,963,539**	**4,020,954**	**12,839,258**	**874,929**	**1,838,286**	**13,040,731**	**18,951,774**	**6,303,502**	**6,385,311**	**13,900,060**	**48,811,968**	**181,963,971**

6.2.4 Maturity breakdown of on-balance sheet credit risk exposures

The maturity profile of the credit exposures based on contractual maturity dates was as follows:

SAR 000's

Portfolios	Maturity breakdown									
	Less than 8 days	8-30 days	30-90 days	90-180 days	180-360 days	1-3 years	3-5 years	Over 5 years	No Fixed Maturity	Total
Sovereigns and central banks:	158,754	4,085	2,902,170	1,935,969	8,361,609	6,941,089	4,152,212	14,547,040	*6,030,730	45,033,659
Public Sector Entities (PSEs)	-	-	-	-	-	-	-	-	-	-
Banks and securities firms	3,194	92,446	7,201,797	92,260	182,881	194,365	1,544,181	-	355,252	9,666,376
Corporates	1,710,767	5,695,898	18,148,872	14,374,836	14,593,566	9,544,302	8,045,183	5,684,429	775,615	78,573,468
Retail non-mortgages	-	1,151,982	9,734	34,862	118,760	2,677,963	5,796,189	3,727,489	-	13,516,979
Mortgages - Retail and Commercial	-	-	-	-	-	-	-	11,592	-	11,592
Past Due Loans	-	123,239	301,979	239,183	242,822	158,807	133,864	94,583	12,905	1,307,383
Securitized assets	-	-	-	56,249	66,824	111,749	-	62,340	-	297,163
Equities	-	-	-	-	265,064	-	-	-	-	265,064
VIP/HNI	679,074	6,198,024	6,156,879	1,953,872	4,170,424	1,004,453	72,107	-	-	20,234,832
Others	-	-	2,413,000	-	2,315,255	-	3,099,128	1,535,656	**3,694,417	13,057,455
Total	**2,551,789**	**13,265,675**	**37,134,430**	**18,687,231**	**30,317,204**	**20,632,728**	**22,842,864**	**25,663,130**	**10,868,919**	**181,963,971**

* Cash and balances with Central Bank

**Primarily includes Fixed Assets

6.2.5. Allocation of on-balance sheet exposures to risk weight buckets

An analysis of the portfolio by the regulatory risk weight buckets is presented in the table below:

SAR 000s

Portfolio	Risk buckets						
	0%	20%	50%	75%	100%	150%	Total
Sovereigns and central banks:	44,875,100	-	-	-	158,560	-	45,033,659
Public Sector Entities (PSEs)	-	-	-	-	-	-	-
Banks and securities firms	-	6,419,404	3,124,261	-	122,711	-	9,666,376
Corporates	-	103,036	8,101,093	-	70,228,743	140,596	78,573,468
Retail non-mortgages	-	-	-	13,442,674	4,166	70,139	13,516,979
Mortgages - Retail and Commercial	-	-	-	11,592	-	-	11,592
Past Due Loans	-	-	-	-	1,029,928	277,455	1,307,383
Securitized assets	-	-	-	-	297,163	-	297,163
Equities	-	-	-	-	265,064	-	265,064
VIP/HNI	-	-	-	-	20,223,154	11,679	20,234,832
Others	10,877,937	-	-	-	2,179,518	-	13,057,455
Total	**55,753,036**	**6,522,440**	**11,225,353**	**13,454,265**	**94,509,008**	**499,868**	**181,963,971**

Exposures attracting a 0% risk weight are primarily to Sovereigns and Central banks which historically demonstrate an extremely low risk. In addition cash and the positive fair value of derivatives' contracts (as they are treated separately according to the current exposure method under Basel II regulations – refer paragraph 6.2.6) also fall in the 0% risk weight.

The 20% risk weight is applied to highly rated banks and corporates, whereas 50% is applied to lesser rated entities in the aforementioned asset classes. Retail exposures attract a 75% risk weight, while the remainder of the asset classes attracts a 100% risk weight. Past due exposures whose level of loan loss provisioning is only up to 20% of the outstanding exposure are assigned a 150% risk weight.

6.2.6. Exposures related to Counterparty Credit Risk (CCR)

Counterparty risk is the likelihood that bank's counterparty in a FX, interest, commodity, equity or credit derivative contract will defaults prior to maturity of the contract and the bank at that time has a claim on the counterparty. Counterparty risk is subject to credit limits like other credit exposures and is treated accordingly. Counterparty risk mainly arises in trading book.

General disclosures for exposures related to Counterparty Credit Risk are presented in the table below.

SAR 000's

Particulars	Amount
Gross positive fair value of contracts	9,363,038
Collateral held:	
-Cash	3,225,038
-Government securities	
-Others	
Exposure amount (under the applicable method)	
-Internal Models Method (IMM)	
-Current Exposure Method (CEM)	**12,437,918**
Notional value of credit derivative hedges	220,358,686
Current credit exposure (by type of credit exposure):	
-Interest rate contracts	7,779,850
-FX contracts	3,587,090
-Equity contracts	1,043,681
-Credit derivatives	
-Commodity/other contracts	27,297

Samba uses the current exposure method to assess the counterparty risk in accordance with the credit risk framework and it is measured as the positive mark-to-market value plus the notional principal amount multiplied by the regulatory defined add-on factor. The size of the add-on depends on the contracts remaining lifetime and the underlying asset.

To reduce the exposure towards single counterparties, risk mitigation techniques are widely used. In addition Samba also mitigates the exposures towards large banks and financial institutional counterparties by an increasing use of financial collateral agreements called margining agreements, whereby collateral is topped-up on a regular basis - collateral is placed or received to cover the current exposure beyond certain agreed threshold on either side.

6.3. Credit Risk Mitigation

The gross credit exposures disclosed in the prior sections have been stated prior to taking credit mitigation effects into account. In terms of the regulatory guidelines, not all forms of collateral currently used by Samba are recognized for the purposes of the calculation of the credit risk capital requirement. These include, interalia, corporate and personal guarantees, equity shares.

The bank uses the comprehensive method for the treatment of financial collaterals which requires a standard supervisory haircut to be applied to the acceptable collateral to account for currency and maturity mismatches between the underlying exposure and the collateral applied. The exposures with their corresponding credit risk mitigant are disclosed by portfolio in the table below:

SAR 000's

Portfolio	Gross Exposure	Covered by eligible financial collateral
Corporates	78,573,468	596,586
Retail non-mortgages	13,516,979	2,334
VIP/HNI	20,234,832	5,197,958
Total		5,796,878

Eligible financial collaterals under the Standardized Approach include[11]:

a. Cash (as well as certificates of deposit or comparable instruments issued by the lending bank);
b. Bank Guarantees;
c. Gold; and
d. Debt securities

[11] Per paragraph 15.4 of Additional Guidance Notes GN-2 contained in the "Basel II Package of Bank Returns and guidance Notes Regarding the Standardized Approach", issued on 29 March 2007 by SAMA.

6.4. Impaired credit facilities and provisions for impairment

A specific provision (for accounting treatment of impairment in assets) is made for past due facilities in respect of individually assessed loans or claims. Samba calculates the specific provision according to the guidelines contained in IAS 39[12]. These are calculated at counterparty level and the bank considers all the facilities for a counterparty to be defaulted if any one of the facilities of the counterparty is past due. The specific provisions are based on an assessment of the impairment in realizable value of the asset first at the facility level and then aggregated at the counterparty level.

6.4.1 Impaired Loans, past due loans and Allowances (by industry sector)

SAR 000's

Industry sector	Impaired loans	Defaulted	Specific allowances	Portfolio Allowances[13]
Finance	1,105	-	1,105	
Agriculture and fishing	79,125	-	79,125	
Manufacturing	54,269	-	54,269	
Mining and quarrying	46,561	-	46,561	
Electricity, water, gas and health services	63,671	-	63,671	
Building and construction	304,200	-	304,200	
Commerce	231,425	-	231,425	
Transportation and communication	86,529	-	86,529	
Services	87,134	-	87,134	
Consumer loans and credit cards	12,399	-	12,399	
Others	873,468	-	590,187	
Total	1,839,886	-	1,556,605	1,516,176

[12] "IAS 39: Financial Instruments: Recognition and Measurement" as issued by the International Accounting Standards Board
[13] Portfolio allowances, by their underlying nature, are not allocated to individual exposures and therefore cannot be distributed across industries

6.4.2 Impaired Loans, past due loans and Allowances (by geographic area):

SAR 000's

Geographic area	Impaired loans	Specific allowances	Portfolio allowances
Saudi Arabia	1,720,500	1,445,514	1,510,317
Other GCC & Middle East	1,102	1,102	-
South East Asia	118,284	109,989	5,859
Total	1,839,886	1,556,605	1,516,176

6.4.3 Reconciliation of changes in the allowances for Loan Impairment

SAR 000's

Particulars	Specific allowances	Portfolio allowances
Balance, beginning of the year	1,545,690	1,453,736
Charge-offs/Recoveries taken against the allowances during the period	(50,298)	
Amounts set aside (or reversed) during the period	18,982	136,544
FX Translation difference (overseas Subsidiary)	(30,634)	(1,239)
Transfers between allowances	72,865	(72,865)
Balance, end of the period	1,556,605	1,516,176

7. Market Risk

Market Risk is the risk that Samba's earnings or capital, or its ability to support its business strategy, will be impacted by changes in market rates or prices related to interest rates, equity prices, credit spreads, foreign exchange rates and commodity prices.

Samba has established risk management policies and limits within which exposure to market risk is monitored, measured and controlled by the Market Risk Management (MRM) division with strategic oversight exercised by ALCO. MRM is responsible for developing and implementing market risk policy and risk measuring/monitoring methodologies and for reviewing all new trading and investment products and product limits prior to ALCO approval. MRM has the primary responsibility to measure, report, monitor and control Market Risk in Samba. MRM is independent of Treasury business and reports into Risk Management.

Samba classifies market risk into the following categories:

Risk Item	Description
FX Risk	Foreign Exchange Risk is the risk arising from a change in exchange rates on bank's net asset / liability / off balance-sheet positions.
Interest Rate Risk (Trading Book)	Interest Rate Risk is the risk of holding or taking positions in debt securities and other interest rate related / fixed income instruments in the trading book and is two-fold: Specific Risk: Risk of loss caused by an adverse price movement of a debt instrument or security principally due to factors related to the issuer. General Market Risk: Risk of loss arising from adverse changes in market conditions.
Equity Risk	Equity Risk is the risk that the equity investments held in the trading book will depreciate due to equity market dynamics.
Options Risk	Is the implicit risk from an open option position arising from the option's sensitivity to a number of factors (Delta, Gamma and Vega risks).
Commodity Risk	Is the uncertainty of future market values and of the size of the future income arising from commodity trading positions due to price fluctuation.

Risk Item	Description
Interest Rate Risk (Banking Book)	Interest Rate Risk (in the Banking Book) is the current or prospective risk to both the earnings and capital arising from the impact of adverse movements in interest rates on mismatches in asset-liability structure.

7.1. Sensitivity Analysis of Interest Rate Risk in the Banking Book

The sensitivity analysis of the Interest Rate Risk in the Banking Book (IRRBB) is presented in the table below:

SAR 000's

200bp Interest Rate Shocks for currencies with more than 5% of Assets or Liabilities	
Rate Shocks	**Change in earnings**
Upward rate shocks:	
SAR	743,209
USD	(1,020,823)
EUR	(543.948)
Downward rate shocks:	
SAR	(759,426)
USD	1,040,550
EUR	554,837

8. Operational Risk

Operational Risk is defined as the risk of loss resulting from inadequate or failed internal processes, people, systems and/or external events. It is evident that operational risk is inherent in all activities within the organisation, in outsourced activities and in all interactions with external parties. Management of Operational Risk requires robust internal controls coupled with quality supervision and management.

In Samba, Operational Risk Management (ORM) is an integrated umbrella with all the underlying Operational Risk elements like Anti-Fraud, Quality Assurance, Business Continuity, and Policy & Procedure forming a part of the operational risk management chain. Operational Risk is embedded in each Business area and the Risk Mitigation technique applied to each activity. All Products / Services are covered in the Self-Assessment Grids which are independently tested periodically and monitored on a global basis. The exceptions and quality deficiencies are documented and monitored for its resolution on a Samba-wide basis. These are complemented by comprehensive reviews by Internal Audit / Quality Assurance unit. The analysis of operational risk-related events, potential risk indicators and other early-warning signals are in focus when developing the processes. The exceptions / issues are highlighted and resolved at the senior levels in Country Business Risk & Compliance Committee (CBRCC). The global Key Risk Indicators (KRIs) for the top ten components of Operational Risk are monitored and the exceptions along with the heat map are escalated to the Senior Management for its resolution.

The mitigating techniques include robust Information Security framework, strong Anti-Fraud / Compliance regime, comprehensive Physical / Access security and Certified Business Continuity plans together with crisis management preparedness and a broad insurance coverage for handling major incidents.

Each business area in Samba is primarily responsible for managing its own operational risk. Operational Risk Division develops and maintains a framework for identifying, assessing, monitoring and controlling operational risk and supports the line organisation in implementing the framework. Automation for Operational Risk includes Loss Data Base, Risk & Control Self-Assessment process, KRIs and Corrective Action tracking. The techniques and processes for managing operational risk are structured around the risk sources as described in the definition of operational risk. This approach improves the comparability of risk profiles throughout the organisation including Samba's branches and subsidiaries. It also supports the concentration on limiting and mitigating measures in relation to the sources, rather than the symptoms.

As described in chapter 5.3 the capital requirement for operational risk is calculated according to the Standardised approach, in which all of the institution's activities are divided into eight standardised business lines and the total capital requirement for operational risk is calculated as the sum of the capital requirements for each of the business lines for each entity. The risk for each business line is the beta coefficient multiplied by the average of the gross income from the preceding three financial years, where the beta coefficients differ between business lines and are in the range of 12% to 18%. Consequently, the operational risk is updated on an annual basis.

9. Other Risks (Pillar 2)

In line with industry best practices, working papers issued by Basel Committee on Banking Supervision and SAMA directives[14], Samba is integrating its capital planning and risk appetite definitions into its regular business budgeting and planning process.

The current ICAAP process encompasses the calculation of expected risk impact resulting from business strategies for the ensuing three year period and helps to evaluate whether Samba's capital funds are sufficient to support the level of risk. It also considers the impact on capital as a result of stress conditions and addresses means to raise capital should it fall below the stipulated levels.

For this purpose, two levels of risk are used as per regulatory guidelines:

- So called "Pillar 1" risks, which include Credit Risk, Market Risk and Operational Risk. For such risks the minimum regulatory ratio is 8%.

- So called "Pillar 2" risks which follow a wider definition and include additional risks such as Interest Rate Risk in the Banking Book, Strategic Risks, and Legal Risk, etc. Banks are required to declare potential other risks to which they might be exposed to SAMA at the beginning of every year and are expected to maintain at all times sufficient capital cushion to cover these risks.

Samba Management has defined such Pillar 2 risks and submitted its ICAAP Plan to SAMA outlining its minimum target levels of capital after setting aside additional capital cushion for such risks and is monitored through Supervisory Review Process.

The three year plan / strategy have been tested against these targets. Samba's plan demonstrates adequate cushion over and above the minimum regulatory capital requirement and should remain within the set targets, barring any large inorganic growth or deterioration in the economic environment which will be addressed at appropriate times. These projections have also been stress-tested to possible and hypothetical recessionary scenarios. Under these scenarios Samba would remain at all times within the regulatory minimum.

As part of this process a Capital Management Committee has been instituted comprising of senior executive management who will review actual quarterly capital ratios against the above targets and initiate corrective actions if certain internal trigger levels are breached. The committee also has the mandate to evaluate the capital impact of major strategic decisions like acquisitions or major expansion, etc

Samba Financial Group's Integrated Capital Plan for 2009 with high-level forecasts for subsequent years - 2010 and 2011 have already been submitted to Saudi Arabian Monetary Agency (SAMA), which has authority to assess the adequacy of the planning process.

[14] Per "SAMA's Draft Guidelines on the Internal Capital Assessment Plan (ICAAP)" issued by SAMA in December 2007.

The plan shows that Samba’s current and foreseen capital endowment is suitable to support its business strategy in the forecasted years. A set of adequate tools is in place to monitor this process going forward and the exercise has strengthened the awareness of risk appetite and capital needs within all business units in Samba.

10. Glossary

Some important phrases that have been referenced in this report carry respective meaning or definition as detailed below:

Add-On

Basel-II defined factor to reflect the potential future increase in exposure stemming from derivative transactions.

ALCO (Asset and Liability Management Committee)

Committee in the governance process responsible for the development (and follow-up of implementation) of the ALM framework. The activities of the ALCO entail asset allocation, setting internal limits, decision-making on investments for the ALM positions, the use of ALM opportunities to stimulate specific commercial initiatives, the monitoring of the impact on and of the policies of the business units, and reporting on the ALM profile.

ALM (Asset and Liability Management)

The ongoing process of formulating, implementing, monitoring and revising strategies for on-balance-sheet as well as the off-balance-sheet liquidity items, in order to achieve an organisation's financial objectives, given the organisation's risk tolerance and other constraints.

Asset Class

A classification of credit exposures according to the SAMA Basel II regulatory guidelines. The main classes are Sovereigns, Bank and Financial Institutions, Corporates, Retail and VIP/HNI. Classification depends on the type of obligor, the total annual sales of the obligor, the type of product and/or the exposure value.

Banking Book

Banking book is defined as all positions in the group that are not in the trading book. A trading book consists of positions in financial instruments and commodities held either with trading intent or in order to hedge other elements of the trading book. To be eligible for trading book capital treatment, financial instruments must either be free of any covenants restricting their tradability or be able to be hedged completely. In addition, positions should be frequently and accurately valued, and the portfolio actively managed.

Beta-factor

The capital charge for a business line in the context of operational risk is approximated by multiplying the gross income of that business line with the beta (ß) factor. The ß factor serves as a proxy for the industry-wide relationship between the operational risk loss experience for a given business line and the aggregate level of gross income of that business line. Under standardized approach of operational risk the ß factors are regulatory given.

Business Risk

The potential negative deviation from the expected economic value of the organisation due to changes in the volumes and operational margins resulting from changes in the business environment coupled with inappropriate or inadequately implemented strategies.

CAR (Capital Adequacy Ratio)

Total eligible Capital as proportion of Risk-weighted Assets (the result must be at least 8% according to the Basel regulations).

CDO (Collateralised Debt Obligation)

A type of asset-backed security and/or a structured credit product. CDOs are constructed from a portfolio of fixed-income assets.

CDS (Credit Default Swap)

A privately negotiated bilateral agreement where one party (the protection-buyer or risk-shedder) pays a premium to another party (the protection-seller or risk-taker) in order to secure protection against any potential losses that may be incurred through exposure to a reference entity or investment as a result of an unforeseen development (or 'credit event').

CLO (Collateralised Loan Obligation)

CDOs holding only loans as underlying assets.

Credit Risk

Credit Risk is the potential shortfall relative to the value expected consequent on non-payment or non-performance by an obligor (a borrower, guarantor, counterparty to an inter-professional transaction or issuer of a debt instrument), due to that party's insolvency or lack of willingness to pay. Credit Risk can also arise due to events or measures taken by the political or monetary authorities of a particular country. The latter risk is also referred to as 'country risk'.

EAD (Exposure at Default)

The amount expected to be outstanding if and when an obligor defaults. At the time of default, it is equal to the actual amount outstanding, and therefore is no longer an expectation.

ECAI (External Credit Assessment Institution)

Institutions providing independent credit ratings which have been determined by SAMA to meet the eligibility criteria defined in the Basel II regulations.

Haircuts

The difference between the market value of a security and its collateral value. Haircuts are taken in order to account for a possible decline in the market value of a collateralising security upon liquidation.

ICAAP (Internal Capital Adequacy Assessment Process)

The internal process a bank should have in place for assessing its overall capital adequacy in relation to its risk profile, as well as its strategy for maintaining adequate capital levels in the planning period.

Interest Rate Risk

The potential negative deviation from the expected net asset value of the trading book or the financial investment book due to changes in the level of or in the volatility of interest rates.

IRB (Internal Ratings-Based)

An approach defined in the Basel regulations to calculate the credit-risk-related capital requirements, where a financial institution uses its own models based on its own historical experience. There are two possibilities: the IRB Foundation or the IRB Advanced approach. When applying the IRB Foundation approach, internal estimates of the Probability of Default (PD) are used to calculate minimum capital requirements. The IRB Advanced approach also assesses internal estimates of Loss Given Default (LGD) and Exposure At Default (EAD). Under IRB Foundation Approach LGD is provided by the supervisory authority.

Liquidity Risk

The potential that an organisation will be unable to meet its obligations as they fall due because of the inability to liquidate assets or obtain adequate funding (liability liquidity risk) or the risk that it cannot easily unwind or offset specific exposures without significantly lowering market prices because of inadequate market depth or market disruptions (asset liquidity risk).

Market Risk

Market Risk is the potential negative deviation from the expected economic value of a financial instrument caused by fluctuations in market prices i.e. interest rates, exchange rates and equity or commodity prices.

Market Value

The cost that would be incurred or the gain that would be realised if an outstanding contract was replaced at current market prices (also called replacement value).

MTM (Mark-to-Market)

The act of assigning a fair market value to an asset.

Operational Risk

The potential negative deviation from the expected economic value of the organisation resulting from inadequate or failed internal processes, people and systems or from external events. This definition includes legal, IT and tax risk.

OTC (Over-the-Counter)

An over-the-counter contract is a bilateral contract where two parties agree on how a particular trade or agreement is to be settled in the future. It is usually a direct contract between a financial institution and its client. It contrasts with exchange trading, which occurs via corporate-owned facilities constructed for the purpose of trading (i.e. exchanges).

RBA (Ratings-Based Approach)

Basel II approach for calculating the risk-weighted assets applied to securitisation exposures that are externally rated, or where a rating can be inferred.

RWA (Risk-Weighted Asset)

An exposure weighted according to the 'riskiness' of the asset concerned. 'Riskiness' depends on factors such as the probability of default of the obligor, the amount of collateral or guarantees and the maturity of the exposure.

SAMA (Saudi Arabian Monetary Agency)

The regulatory authority responsible for the supervision of banks and financial institutions operating in the Kingdom of Saudi Arabia.

Samba (Samba Financial Group)

Samba or Samba Financial Group is interchangeably used in this report and connotes reference to the consolidated legal entity – the Samba Financial Group.

Trading Book

The trading book consists of positions in financial instruments and commodities held either with trading intent or in order to hedge other elements of the trading book. Positions held for trading intent are those held intentionally for resale in the short term and/or with the intent of benefiting from actual or expected price movements in the short term or to lock in an arbitrage profit.

END