

# **HSBC Saudi Arabia**

## **Pillar III Disclosures 2020**



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## 1. Introduction

HSBC Saudi Arabia (“HSBC SA”/“Company”) is a Closed Joint Stock Company registered in the Kingdom of Saudi Arabia under Commercial Registration No. 1010221555 dated 27/06/1427H (corresponding to 23/07/2006G), organized and existing under the laws of Saudi Arabia with its principal place of business address at HSBC Building 7267, Main Olaya Street (North), Al Morooj District, Riyadh 12283-2255, Kingdom of Saudi Arabia.

The main activities of the Company are to provide a full range of investment banking services including investment banking advisory, debt capital market and syndicated finance advisory and project and export finance advisory, agency and trustee services and custody and funds securities services. It also manages mutual funds and discretionary portfolios and provides brokerage services including margin lending conventional and Shariah compliant overdraft facility for customers to trade in the capital market. The Company serves a wide range of clients including but not limited to corporates, financial institutions, non-bank financial institutions and individuals.

The report has been prepared in accordance to meet the minimum disclosure requirement as set out in Article 68 (Annex 10) of the CMA Prudential Rules relating to Pillar III Disclosure and Reporting requirements. In accordance with the capital adequacy framework issued by CMA, the prudential rules comprise of three pillars as summarised below:

Pillar I includes the company’s minimum capital requirements as per risk based approach;

- Credit risk in the company mainly arises from margin lending, receivables related to Arranging & advisory services and securities services, cash balances held with banks, Investments and other assets.
- Market Risk in the company arises from Special commission/Interest rate risk, equity price risk and liquidity risk.
- Operational Risk, company has applied Expenditure based approach for 2020.

Pillar II includes the company’s Internal Capital Adequacy Assessment Process (ICAAP) pursuant to Annex. 9 of the CMA prudential rules and ensures that there is governing body oversight; sound capital assessment; comprehensive assessment of risks; monitoring and reporting; and internal control review.

Pillar III includes the company’s disclosure and reporting framework that enhances market discipline, transparency and enables comparability and includes information regarding the calculation of capital base, minimum capital requirements and large exposures in accordance with the capital adequacy model.

## 2. Capital Structure

Description	Number of Shares	% of contribution	As at 31 <sup>st</sup> December 2020 (SAR)
HSBC Asia Holding BV (HAHB)	25,500,000	51%	255,000,000
The Saudi British Bank (“SABB”)	24,500,000	49%	245,000,000
<b>Total</b>	<b>50, 000,000</b>	<b>100%</b>	<b>500,000,000</b>

**Tier 1 and 2 Tier Capital**

<b>Capital Base</b>	<b>SAR '000</b>	
	<b>2020</b>	<b>2019</b>
<b><u>Tier-1 capital</u></b>		
Paid-up capital	500,000	500,000
Audited retained earnings	206,407	261,071
Other reserves	(7,153)	(4,835)
Statutory Reserve	150,000	150,000
Deductions from Tier-1 capital	(13,796)	(8,633)
<b>Total Tier-1 capital</b>	<b>835,458</b>	<b>897,603</b>
<b><u>Tier-2 capital</u></b>		
<b>Total Tier-2 capital</b>	<b>-</b>	<b>-</b>
<b>TOTAL CAPITAL BASE</b>	<b>835,458</b>	<b>897,603</b>

**Paid-up capital:** The authorized, issued and fully paid share capital of the Company consists of 50 million shares of SAR 10 each.

**Statutory Reserve:** In accordance with Article 176 of the Saudi Arabian Regulations for Companies, the Company is required to transfer 10% of net income to a statutory reserve until such reserve equals 30% of the paid up capital as a minimum. This reserve is not available for distribution. As the company's cumulative transfers to statutory reserves had reached the 30% of the total paid up capital, the company was not required to make any transfers to the statutory reserve during this year.

**Retained Earnings:** This constitutes undistributed profits relating to prior years if any and profit for the current year 2020 net of any deductions relating to zakat, income tax and statutory reserves.

**Other Reserves:** The balances pertain to adjustments made for the recognition of deferred tax asset and re-measurement of the end of service benefits resulting from the Company's adoption of IFRS.

**3. Capital Adequacy**

HSBC SA as of 31 December 2020 is maintaining a strong capital adequacy ratio of 2.16 and is reasonably well capitalised in accordance with the capital adequacy guidelines defined under Pillar 1. As at 31 December 2020, total Pillar 1 minimum capital requirement was SAR 386.8 million, whilst total available capital was SAR 835.5 million resulting in a surplus capital of SR 448.7 million. HSBC SA is fully committed to maintain adequate levels of capital in line with the overall risks taken by the company. HSBC SA has ensured that capital levels are maintained above the levels required by CMA and is fully committed to meet the capital requirements as regulated by CMA going forward.

HSBC SA capital adequacy as of 31<sup>st</sup> December 2020 is as below

HSBC SA Capital Summary SAR 000	December 2020
<b>Total capital available HSBC SA</b>	<b>835,458</b>
Capital Required - Market Risk	15,578
Capital Required - Credit Risk	286,235
Capital Required - Operational Risks	84,972
<b>Total Minimum Capital Requirement</b>	<b>386,785</b>
<b>Surplus Capital</b>	<b>448,673</b>
<b>Capital Ratio (times)</b>	<b>2.16</b>

#### 4. Risk Management

HSBC SA through its risk management and governance framework seeks to maintain a conservative and consistent approach to risk, helping to ensure we protect customers' and support economies. By carefully aligning our risk appetite to our strategy, we aim to deliver sustainable long-term shareholder returns.

All employees are responsible for the management of risk, with the ultimate accountability residing with the Board. We have a strong risk culture, which is embedded through clear and consistent communication and appropriate training for all employees. A comprehensive risk management framework is applied throughout the company, with governance and corresponding risk management tools. This framework is underpinned by our risk culture and reinforced by the HSBC values and required conduct outcomes. The Risk function oversees the framework and is led by the Chief Risk Officer and it is independent from the businesses, including our sales and trading functions, to provide challenge, appropriate oversight and balance in risk/reward decisions. The Board of Directors are responsible for the overall risk management approach with HSBC SA and for reviewing its effectiveness.

**4.1 Risk Framework:** The key risk management and internal control include the following key elements:

- The company's risk appetite defines the desired forward-looking risk profile, and informs the strategic and financial planning process. It is articulated in our risk appetite statement, which is approved by the Board. Key elements include:
  - risks that we accept as part of doing business, such as credit risk and market risk;
  - risks that we incur as part of doing business, such as operational risk, which are actively managed to remain below an acceptable tolerance; and
  - risks for which we have zero tolerance, such as knowingly engaging in activities where foreseeable reputational risk and misconduct has not been considered

We operate stress testing programme and undertake both internal and regulatory stress tests. Internal stress tests are an important element in our risk management and capital management frameworks. They assess the impacts of potential adverse macroeconomic, geopolitical and other HSBC SA-specific events.

The selection of scenarios reflects our top and emerging risks identification process and our risk appetite. Stress testing analysis helps management understand the nature and extent of vulnerabilities to which the company is exposed.

The Board’s designated committee for risk matters is the Board Risk Committee which approves and provides oversight for the Company’s risk framework, plans and performance targets which include the establishment of risk appetite statements, risk management strategies, the appointment of senior officers, the delegation of authorities for credit and other risks and the establishment of effective control procedures.

Our Internal Capital Adequacy Assessment Process (ICAAP) is based on the following key elements:

- Framework to assess capital adequacy, process and governance and the risks included in the ICAAP assessment;
  - The company’s legal, operating and governance structures;
  - The company’s strategy and approach to risk and capital management;
  - Assessment of capital adequacy in light of the financial projections over a 3 year horizon;
  - Stress testing including reverse stress testing.
- Our top and emerging risks framework helps enable us to identify forward looking risks so that we may take action either to prevent them materialising or limit their effect. Top risks are those that may have a material impact on the financial results, reputation or business model of the company in the year ahead. Emerging risks are those that have large unknown components and may form beyond a one-year horizon. If any of these risks were to occur, they could have a material effect on the company. The identification of these risks is an annual exercise undertaken at entity level.
  - HSBC SA standards and policies outline the core principles within which the Company and its employees must operate in conducting its business.
  - Risk identification and monitoring. Systems and procedures are in place to identify, assess, control and monitor the material risk types facing HSBC SA. Our risk measurement and reporting systems are designed to help ensure that risks are captured with all the attributes necessary to support well-founded decisions.
  - HSBC SA has maintained a conservative risk profile. This is central to our business and strategy. The following principles guide the company’s overarching risk appetite and determine how its businesses and risks. Our risk appetite encapsulates consideration of financial and nonfinancial risks and is expressed in both quantitative and qualitative terms. It is applied at the enterprise wide level.

Financial Position	Operating Model	Business Practice
<ul style="list-style-type: none"> <li>▪ Strong capital position, defined by regulatory and internal capital ratios.</li> <li>▪ Strong Liquidity and funding management for the operating entity</li> </ul>	<ul style="list-style-type: none"> <li>▪ Ambition and capability to generate returns in line with a conservative risk appetite and strong risk management capability.</li> <li>▪ Ambition and capability to deliver sustainable earnings and consistent returns for shareholders</li> </ul>	<ul style="list-style-type: none"> <li>▪ Zero tolerance for knowingly engaging in any business, activity or association where foreseeable reputational risk or damage has not been considered and/or mitigated.</li> <li>▪ No appetite for deliberately or knowingly causing detriment to consumers, or incurring a breach of the letter or spirit of regulatory requirements.</li> <li>▪ No appetite for inappropriate market conduct by a member of staff or by any business.</li> </ul>

HSBC SA has implemented a ‘Three Lines of Defence’ model for managing its risks. This model delineates management accountabilities and responsibilities for risk management and the control environment. The model underpins our approach to risk management by clarifying responsibility, encouraging collaboration, and enabling efficient coordination of risk and control activities.

**First Line of Defence:** Business management is responsible for setting policies, procedures and standards across all areas under their responsibility. Functional management is also responsible for implementing effective monitoring mechanisms to detect and prevent deviations or breaches from established policies and regulatory requirements. The first line of defence owns the risks and is responsible for identifying, recording, reporting and managing them, and ensuring that the right controls and assessments are in place to mitigate them.

**Second Line of Defence:** It comprises various risk management and control functions which maintain oversight of credit, market, legal, compliance, information technology, financial control, reputational risks as well as other operational risks relating to business continuity, security and fraud. Risks are analysed qualitatively as well as by quantitative methods and reported to the Board and sub-committees through HSBC SA’s management committees.

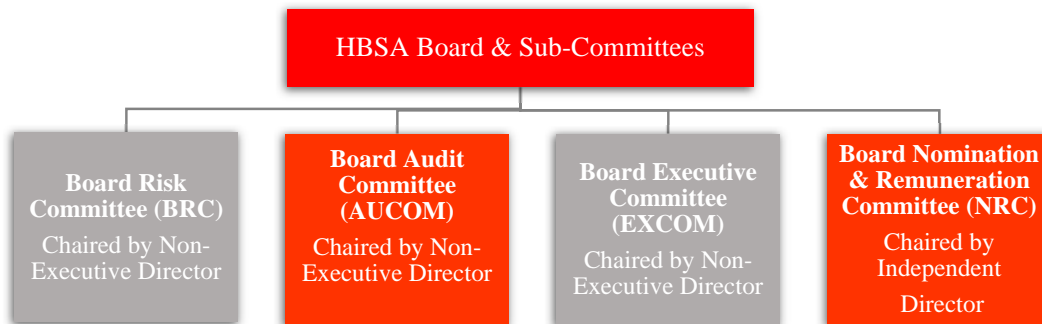
**Third Line of Defence:** Internal Audit (INA) represents the independent and reviews the design and operating effectiveness of the HSBC SA internal control framework and policies established by business and functional Risk Owners to provide independent and objective assurance that HSBC SA is operating within its stated risk appetite and in compliance with the regulatory framework.

**4.2 Corporate Governance:**

HSBC SA is committed to high standards of corporate governance. We have a comprehensive range of policies and systems in place to ensure that the company is well-managed, with effective oversight and control

HSBC SA is aware of the positive impact associated with the adoption of prudent Corporate Governance Principles and Standards and that such adoption will lead to observance of professional and ethical standards in the company’s dealings as well as transparency and disclosure which will contribute to the furthering and improvement of its efficiency and relations with all interested parties. It is also believed that the adoption of this approach will enhance investors’ confidence both in the HSBC SA and in the Saudi Securities Business in the Kingdom. HSBC SA’s Bylaws and the HSBC SA Governance Document, provide for disclosure policies and procedures, formation of the Board and Sub-committees, responsibilities of the Board of Directors, policy regulating relationships with stakeholders, shareholders’ rights and attendance of meetings.

The Board aims to promote the Company’s long-term success, deliver sustainable value to shareholders and promote a culture of openness and debate. Led by the Chairman, the Board sets the company’s strategy and risk appetite. It also approves capital and operating plans for achieving strategic objectives on the recommendation of management. The Board regularly reviews reports on performance against financial and other strategic objectives, key business challenges, risk, business developments and the company’s relationships with its key stakeholders. The Board routinely tracks progress with respect to each strategic priority, together with the CEO and members of his management team. The Board is committed to regular, independent evaluation of its own effectiveness and that of its committees.



HSBC’s Board and its committees are subject to regular, independent evaluation of their effectiveness. All Board members also undergo regular performance reviews. In the case of executive directors, this helps determine the level of variable pay they receive each year. In addition, the Board is directly accountable to our shareholders. Shareholders

vote at each Annual General Meeting on whether to re-elect individual directors. Committees are smaller groups delegated by the full Board to provide advice on and oversight of the Company's different activities. Each standing committee is chaired by a non-executive Board member and has a remit to cover specific topics.

**Board Risk Committee (BRC):** This committee was formed by the Board to handle risk management affairs. The committee has non-executive responsibility for the oversight of enterprise risk management, risk governance and internal control systems (other than internal financial controls overseen by the audit committee). The committee gives advice to the Board on all matters relating to high level risks pertinent to the Company's business in addition to strategic direction of risks across the Company and overseeing the execution of major transformational risk initiatives.

**Board Audit Committee (AUCOM):** The Audit Committee reporting directly to the Board of Directors, and meets minimum four times during the year.

In discharging their responsibility, the Audit committee oversees:

- preparation of financial statements, compliance with accounting standards and accounting judgements;
- the effectiveness of internal financial control functions;
- the independence and performance of Internal Audit;
- the relationships with external auditors, including their independence, performance and approval of any special services.

**Board Nomination and Remuneration Committee (NRC):** The Committee leads the Board appointment process, agrees the criteria for any appointments and engages as required. In discharging its responsibilities, the Committee regularly reviews the Board's structure, size and composition, including skills, knowledge, independence represented on the Board so as to ensure it is aligned with the company's strategic priorities. The Committee determines the membership of Board committees and reviews appointments to the boards sub committees. The Committee is also responsible for overseeing succession planning for the top management roles across the company. The Committee sets the overarching principles, parameters and governance framework of the company's remuneration policy and the remuneration of executive directors and other senior company employees. The Committee also oversees the company's corporate governance framework, providing recommendations to the Board to ensure the framework remains robust and reflects best practice.

**Board Executive Committee (EXCOM):** The main task of this committee is to assist the Company's CEO, within the authorities entrusted to CEO by the Board, and in handling the matters referred to CEO by the Board. In addition, EXCOM reviews, inter alia, Business Performance Reports, Financial Markets Reports, business performance reports and analysis, progress against financial and strategic objectives, reviews business challenges and other key operational matters of the company.

HSBC SA's management is responsible for establishing and maintaining an adequate and effective framework of internal control which encompasses the policies as approved by the Board. As part of the risk governance and internal control framework, the management has established various committees such as Risk Management Committee. HSBC Compliance Committee, Management Committee, Asset Liability Committee, Shariah Committee and Operations Risk Working Group to ensure compliance with applicable laws and regulations, internal policies and procedures, and quality of external and internal reporting.



**4.3 Risk Appetite Statement:** HSBC SA Risk Appetite framework includes the following;

Risk Matric Category	Risk Components Monitored
Earnings	Not achieving Return on Equity, cost efficiency and Jaws targets
Capital and Liquidity	Breach in capital and Liquidity ratios, Lending coverage ratios
Risk Categories & Diversification	Breaches to Limits/controls established for Operations risk, Credit risk, , Reputational, Fiduciary, People and Resilience Risk
Financial Crime Compliance	AML Transaction Monitoring Alert Management and Suspicious Activity, AML risk profile, Sanctions Breaches and High Risk Customer Reviews.
Regulatory Compliance	Failure to meet Sales quality standards, inappropriate product due diligence, customer conduct and complaints, Inappropriate market conduct, PAD breaches, and regulatory fines
FCC and RC Audit Issues	Past due Regulatory and Audit Points
Trainings	Overdue FCC and RC trainings and other mandatory training

## 5. Credit Risk

Credit risk 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 risk exposure within the company principally is receivables from advisory services rendered, margin lending, cash with Banks, and Investments in HSBC Funds.

The Company manages its credit risk by measuring and monitoring credit exposures, establishing limits for transactions with specific counterparties and continually assessing the creditworthiness of counterparties. The Company's risk management policies are designed to identify and set appropriate risk limits and monitor on a continuous basis.

Concentrations of credit risk arises when a number of counterparties are engaged in similar business activities, related group of counterparties, 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 company's performance to developments affecting these counterparties.

The Company seeks to mitigate its overall credit risk exposure through sound risk strategies, establish credit limits, segment diversification and ensures there are sound internal control. Procedures for identifying and recording and monitoring all large exposures are managed as per thresholds defined by the regulator. The company has defined large exposures as an exposure to a counterparty or group of connected counterparties that exceeds 10% of the capital base.

The company had invested part of its surplus capital into HSBC Funds after performing adequate due diligence and approvals of the Board.

The table below shows the capital requirement related to the credit risk of the company;

<b>Credit Risks (Capital Requirement)</b>	<b>286,234</b>
<i>Exposures to government, central banks</i>	194
<i>Exposures to corporates, admin bodies, NPO</i>	48,324
<i>Exposures to APs, banks</i>	5,480
<i>Investment funds</i>	766
<i>Margin financing</i>	153,458
<i>Other on-balance sheet exposures</i>	78,012
<i>Off-balance sheet commitments</i>	-

#### **Impairment of financial assets (Expected credit losses):**

The Company assesses on a forward looking basis the expected credit losses associated with its financial assets carried at amortised cost using 'expected credit loss' model ("ECL") in accordance with IFRS 9.

The ECL methodology applied depends on whether there has been a significant increase in credit risk. The allowance is based on the ECL associated with the probability of default in the next twelve months unless there has been a significant increase in credit risk since origination.

For fee receivables, the Company applies the simplified approach permitted in IFRS 9 to estimate the ECL, which requires expected lifetime losses to be recognized from initial recognition of the receivables. The methodology applied in estimating the provisions is detailed in note 26.

For margin lending receivables, the ECL methodology applied uses a general approach, based on judgments and assumptions, staging criteria, as detailed in note 26 and consideration of collateral in case of liquidation. Furthermore, existing market conditions as well as forward looking estimates are considered in the methodology.

The key inputs into the measurement of ECL are the following risk estimates:

- Probability of default (PD);
- Loss given default (LGD); and
- Exposure at default (EAD). The Company considers a financial asset to be in default when:

In assessing whether a borrower is in default the Company considers indicators that are:

- Qualitative - e.g. breaches of covenant;
- Quantitative - e.g. overdue status and non-payment on another obligation of the same issuer to Company;

#### **ADVISORY INCOME RECEIVABLE**

	<b>As at 31 December 2020</b>	As at 31 December 2019
Gross advisory income receivable	47,250,579	16,824,137
Less: Provision for expected credit losses	<u>(16,797,307)</u>	<u>(7,261,815)</u>
	<b><u>30,453,272</u></b>	<b><u>9,562,322</u></b>

These advisory income receivables are expected to be settled in short term, thus do not contain any financing component.

**RECEIVABLE AGAINST MARGIN LENDING**

	<b>As at 31 December 2020</b>	As at 31 December <u>2019</u>
Gross receivable against margin lending	<b>731,509,212</b>	742,408,348
Less: provision for expected credit losses	<b>(758,433)</b>	(769,733)
	<b><u>730,750,779</u></b>	<u>741,638,615</u>

The Company extends margin financing facilities to its customers to invest in the Saudi stock exchange (Tadawul) who wish to actively trade on a leveraged basis, secured by the tradable securities. The facilities are reviewed at least on an annual basis.

**6. Market Risk**

Market risk is the risk that movements in market factors, such as foreign exchange rates, interest rates, credit spreads, equity prices will reduce our income or the value of our portfolios. Exposure to market risk is separated into two portfolios: trading and non-trading Investments of its surplus capital in the Company's managed mutual funds, margin lending and borrowing from banks, Equity Underwriting limits to cover IPO's and Rights issues with nominal limits. Measured using sensitivities and stress testing, giving a detailed picture of potential gains and losses for a range of market movements and scenarios, monitored using measures, including daily limits, sensitivity of net interest income and the sensitivity of foreign exchange; managed using risk limits approved by the Board and reviewed by the risk management committee.

The market risk taken by HSBC SA is limited and is operating under approved market risk limits

**Market Risk Trading Book**

The board has set limits for the acceptable level of risks in managing the trading book. Nominal limits have been established covering the product and the daily and monthly Mark to Market Loss referral limits.

Within trading limits the Board has authorized Equity Underwriting limits to cover IPO's and rights issues with nominal limits. The nature of the Saudi Market currently is focused on soft underwriting where the Company is not exposed to Equity Price risk, although certain transactions can have hard underwriting limits where the Company would be exposed.

**Market Risk Non Trading Book**

The Company has deployed its surplus capital in the Company's Asset Management Funds which provide exposure to Saudi and International Money Market and Fixed Income investments. The company non trading book is operated within the nominal limits approved by the Board including MTM Referral Limits.

Equity price risk refers to the risk of decrease in fair values of equity securities held by the Company. Currently the Company does not have any investments in equity securities, however, there are investments in mutual funds where underlying assets are equity securities. The net asset value of these mutual funds are subject to equity price risk. Since these mutual funds' investments are highly liquid due to its open ended nature, management is able to minimize the risk while monitoring the net asset value changes due to fluctuations in equity price indices.

**Foreign exchange rate risk**

Foreign exchange rate risk arises when the actual or forecasted assets in a foreign currency are either greater or less than the liability in that currency. The Company's foreign currency transactions are primarily denominated in USD. The rate

of exchange for conversion of the Saudi Riyal to the US Dollar is pegged, on the basis of which the management believes that the Company is not significantly exposed to risk of fluctuation in foreign exchange rates.

### Special commission/Interest rate risk

Special commission/Interest rate risk is the uncertainty of future earnings resulting from fluctuations in special commission or Interest rates. The risk arises when there is a mismatch in assets and liabilities, which are subject to rate movements within a specified period. The most important source of such risk is the Company's difference in company's borrowing rates and the lending rates offered on margin lending facilities, where fluctuations in the rates, if any, are reflected in the results of its operations. Management monitors the change in the special commission rate and believes that the net special commission rate risk to the Company is not significant.

Capital requirements for market risk of the company as of 31<sup>st</sup> December 2020 are indicated below;

<b>Market Risks</b>	<b>15,578</b>
<i>Fund Risk</i>	<i>12,534</i>
<i>FX Risk</i>	<i>3,044</i>

## 7. Operational and Resilience Risk

Operational risk is the risk to achieving our strategy or objectives as a result of inadequate or failed internal processes, people and systems or from external events. Operational risk is relevant to every aspect of the Company's business and covers a wide spectrum of risks.

It is HSBC SA's strategy to manage operational risks in a cost effective manner, within targeted levels consistent with the company's risk appetite. The company's Operational Risk Management Framework ensures minimum standards of governance and organization over operational risk and internal control and covers all its businesses and operations.

Strong risk management and internal control are core elements of HSBC SA's strategy and all staff are responsible for managing and mitigating operational risks in their core operations.

Operational Risk 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. Operational Risk also reviews and reports on the adequacy and effectiveness of oversight maintained by support functions such as compliance and risk management departments, to ensure that the Company is operating within its stated risk appetite and in compliance with the regulatory framework.

Operational Risk has specific responsibilities in relation to the operational risk framework. These are:

- Set the Operational Risk framework and policy and oversee their implementation across HSBC SA.
- Provide quality assurance and challenge of risk and control assessments, internal control monitoring plans, the results of control monitoring activity conducted by the First Line and of the completeness of second line oversight of the business and functions.
- Provide independent oversight of HSBC SA's operational risk profile, identify emerging risks and gaps and carry out specific reviews of key risk issues.
- Flag breaches of risk appetite and unacceptable delays in resolving control issues to the appropriate governance committees.

**Operations Risk capital requirements of the company as of 31st December 2020 are indicated below;**

The company applied the Expenditure-Based Approach as per which all overhead expenses except extraordinary expenses for the most recent audited annual financial statement.

Operational Risks	Year -3	Year -2	Year -1			
Basic Indicator Approach	2018	2019	2020	Average	Risk charge (%)	Capital requirements (SAR '000)
Operating income (SAR '000)	409,223	625,868	561,576	532,222	15	79,833
<b>Expenditure-based approach</b>						
Overhead expenses (SAR '000)	339,889				25	84,972
<b>Total Operational Risks</b>						<b>84,972</b>

## 8. Liquidity and Funding Risk

This risk is managed by cash flow matching and maintaining sufficient cash resources, investing in high credit-quality liquid investments, monitoring investments and cash concentrations and restricting them where appropriate, and establishing committed borrowing facilities. The liquidity risk related to these cash flows is managed by matching external debt obligations, internal margin lending growth and internal cash flows and by maintaining an appropriate liquidity buffer that is monitored by the company's ALCO.

Our primary sources of funding are internal cash flows generated from its business operations, cash from excess capital and finally borrowings from banks in form of committed facilities. We use a combination of these funding sources and meet the company's minimum requirement thresholds established for own funds and eligible liabilities. The positive funding gap is deployed in liquid assets (investments in HSBC managed local funds) within the liquidity framework.

Management monitors the maturity profile of the Company's assets and liabilities based on the remaining year at the balance sheet date to the contractual maturity date to ensure that adequate liquidity is maintained. All liabilities other than end of service benefits and long-term loans are contractually payable on a current basis.

In addition to the operational profits, the main source of funds for HSBC SA is its capital and undistributed profits. The Company has established a short term revolving loan facility from and other local commercial bank carrying commission rate at agreed commercial rate. In the case of HSBC SA liquidity risk may arise by an inability to sell a financial instrument in the market on a timely basis. Within HSBC SA one of the main liquidity risk is of a fiduciary basis within Asset Management.

With the advent of the market change to a two-days settlement cycle, the company has set settlement limits for both its Custody and Brokerage activities on a per counterparty basis, these limits generate liquidity risk in the advent of client defaults or delayed trades. Such instances historically are very limited. HSBC SA has sufficient committed credit lines in place to match liquidity settlement risk on these lines. These are further ring fenced by our Settlement agent who guarantees to Tadawul all HSBC SA market trade settlements.

The company has established a liquidity management process for Margin lending product is to ensure that the company has access to adequate level of funding at all times to meet the cash flow requirements driven by changes in utilization levels and to fully mitigate any liquidity and reputation risks for the company.

The liquidity ratio of HSBC SA as at 31 Dec 2020 is 3.86. The ratio has been computed as current asset divided by current liabilities.

## 9. Fiduciary Risk

Assets held in trust or in a fiduciary capacity by the Company are not treated as assets of the Company and accordingly are treated as off-balance sheet items in these financial statements.

The risk to HSBC SA of breaching its fiduciary duties where it acts in a fiduciary capacity as Trustee, Investment Manager, Broker (for cash balances maintained at SABB) as mandated by law or regulation. Within HSBC SA this risk is mainly within the Asset Management business where we are investing in funds on behalf of clients. The risk within Asset Management is primarily managed by the business, with additional limits and controls established with the individual fund prospectus or client mandate – these limits are independently monitored by Risk

The fiduciary risk in asset management can arise from market risk, liquidity risk, credit risk, and product design and product suitability amongst others. The risk is managed through internal controls exercised primarily through the following committees:

Committee	Objective
Investment Committee	The primary objective of the Investment Committee is to govern and manage the investment strategies to ensure all strategies are aligned to the investment objective of the product/service. Additionally the committee ensures that investment process followed by HSBC SA complies with the standards required by both CMA regulations and HSBC best practices
Performance Review Committee	To review performance of Funds and Discretionary Portfolios and ensure consistency of performance across portfolios following similar strategies.
Product Approval Committee	Oversee initiatives to develop or distribute new products.
Fund Board	The fund board oversees the management and operations of the fund on behalf of the funds' unit holders. Among other things, the fund board oversees the performance of the fund, approve the fees paid to the service providers, and oversee the fund's compliance to the regulations.
Retail Banking Oversight Committee	The committee oversee the wealth activities related to retail clients with the prime objective of ensuring the sales monitoring, sales quality control and Client servicing

In addition, a business risk control team is part of the first line of defense integrated within the asset management business and it keeps the business head apprised of any emerging risk and / or any issues that need to be addressed.

Control departments including compliance and risk management also oversee the operations of the business with the risk management committee. The risk department in particular monitors the management of all investment funds and portfolios with daily reports generated to identify any breaches against regulatory requirements, client imposed restrictions or Management Action Triggers (MAT) that generally specify the maximum deviation of a portfolio's performance compared to its benchmark.

## **10. Compliance Risk**

It is the risk to HSBC SA in breaching Local Regulatory and International Best Standards in regard to Financial Crime Compliance and Regulatory Compliance. As any business operating in such regulated environment, this risk exists throughout all areas of the Company.

HSBC SA applied “Three Line of Defence” approach to manage risks. Therefore, compliance risk among other risks is owned by business as first line of defence and is being monitored through an independent compliance function which is responsible for providing guidance and independent control and review of the compliance risks within the company as a second line of defence while Audit function which conducts regular reviews acts as the third line of defence.

HSBC SA has implemented a strong internal control structure to ensure full compliance with all directives issued by CMA. Frequent reviews are conducted and business owners certify on an annual basis their compliance with existing regulatory requirements.

## **11. Other Risks**

HSBC SA continues identifying risks that will adversely impact on present and future operations of the Company. Issues are addressed in a proactive manner with respect to risk assessment and management to ensure compliance with local regulatory requirements.

## 12. Appendixes

### 12.1 Disclosure of Capital Base

App 1: Disclosure on Capital Base		
	2020	2019
Capital Base	SAR '000	SAR '000
<b><u>Tier-1 capital</u></b>		
Paid-up capital	500,000	500,000
Audited retained earnings	206,407	261,071
Share premium		
Other reserves	(7,153)	(4,835)
Statutory Reserve	150,000	150,000
Tier-1 capital contribution		
Deductions from Tier-1 capital	(13,796)	(8,633)
<b>Total Tier-1 capital</b>	<b>835,458</b>	<b>897,603</b>
<b><u>Tier-2 capital</u></b>		
Subordinated loans		
Cumulative preference shares		
Unrealised gain on investments - available for sale	-	-
Other deductions from Tier-2 (-)		
Deduction to meet Tier-2 capital limit (-)		
<b>Total Tier-2 capital</b>	<b>-</b>	<b>-</b>
<b>TOTAL CAPITAL BASE</b>	<b>835,458</b>	<b>897,603</b>



## 12.2 Disclosure of Capital Adequacy

## App II: Disclosure on Capital Adequacy - 2020

Exposure Class	Exposures before CRM SAR '000	Net Exposures after CRM SAR '000	Risk Weighted Assets SR '000	Capital Requirement SAR '000
<b><u>Credit Risk</u></b>				
<i>On-balance Sheet Exposures</i>				
Governments and Central Banks	6,924		1,385	194
CMI and banks	195,721		39,144	5,480
Corporates	54,478		345,174	48,324
Retail				
Investments	88,128		5,474	766
Securitisation				
Margin Financing	730,751		1,096,127	153,458
Other Assets	123,286		557,230	78,012
<b>Total On-Balance sheet Exposures</b>	<b>1,199,288</b>		<b>2,044,534</b>	<b>286,234</b>
<i>Off-balance Sheet Exposures</i>				
OTC/Credit Derivatives				
Repurchase agreements				
Securities borrowing/lending				
Commitments				
Other off-balance sheet exposures				
<b>Total Off-Balance sheet Exposures</b>	<b>-</b>		<b>-</b>	<b>-</b>
<b>Total On and Off-Balance sheet Exposures</b>	<b>1,199,288</b>		<b>2,044,534</b>	<b>286,234</b>
<b>Prohibited Exposure Risk Requirement</b>				
<b>Total Credit Risk Exposures</b>	<b>1,199,288</b>		<b>2,044,534</b>	<b>286,234</b>
<b><u>Market Risk</u></b>				
	Long Position	Short Position		
Interest rate risks				
Equity price risks				
Risks related to investment funds	78,340			12,534
Securitisation/resecuritisation positions				
Excess exposure risks				
Settlement risks and counterparty risks				
Foreign exchange rate risks	295,833	(165,048)		3,043
Commodities risks.				
<b>Total Market Risk Exposures</b>	<b>374,173</b>	<b>(165,048)</b>		<b>15,578</b>
<b><u>Operational Risk</u></b>				
				84,972
<b>Minimum Capital Requirements</b>				<b>386,784</b>
<b>Surplus/(Deficit) in capital</b>				<b>448,673</b>
<b>Total Capital ratio (time)</b>				<b>2.16</b>

## App II: Disclosure on Capital Adequacy - 2019

Exposure Class	Exposures before CRM SAR '000	Net Exposures after CRM SAR '000	Risk Weighted Assets SR '000	Capital Requirement SAR '000
<b><u>Credit Risk</u></b>				
<i>On-balance Sheet Exposures</i>				
Governments and Central Banks	3,988		798	112
Authorised Persons and Banks	531,320		106,264	14,877
Corporates	58,273		388,185	54,346
Retail				
Investments	231,741		93,585	13,102
Securitisation				
Margin Financing	741,639		1,112,459	155,744
Other Assets	39,430		165,361	23,150
<b>Total On-Balance sheet Exposures</b>	<b>1,606,391</b>		<b>1,866,651</b>	<b>261,331</b>
<i>Off-balance Sheet Exposures</i>				
OTC/Credit Derivatives				
Repurchase agreements				
Securities borrowing/lending				
Commitments	6,000		42,840	5,998
Other off-balance sheet exposures				
<b>Total Off-Balance sheet Exposures</b>	<b>6,000</b>		<b>42,840</b>	<b>5,998</b>
<b>Total On and Off-Balance sheet Exposures</b>	<b>1,612,391</b>		<b>1,909,491</b>	<b>267,329</b>
<b>Prohibited Exposure Risk Requirement</b>				
<b>Total Credit Risk Exposures</b>	<b>1,612,391</b>		<b>1,909,491</b>	<b>267,329</b>
<b><u>Market Risk</u></b>				
	Long Position	Short Position		
Interest rate risks				
Equity price risks				
Risks related to investment funds	78,793			12,607
Securitisation/resecuritisation positions				
Excess exposure risks				
Settlement risks and counterparty risks				
Foreign exchange rate risks	187,440	(112,682)		1,845
Commodities risks.				
<b>Total Market Risk Exposures</b>	<b>266,233</b>	<b>(112,682)</b>		<b>14,452</b>
<b><u>Operational Risk</u></b>				
				82,278
<b>Minimum Capital Requirements</b>				<b>364,059</b>
<b>Surplus/(Deficit) in capital</b>				<b>533,544</b>
<b>Total Capital ratio (time)</b>				<b>2.47</b>

12.3 Disclosure on Credit Risk's Risk Weight

App III: Disclosure on Credit Risk's Risk Weight - 2020														
Risk Weights	Exposures after netting and credit risk mitigation												Total Exposure after netting and Credit Risk Mitigation	Total Risk Weighted Assets
	Governments and central banks	Administrative bodies and NPO	CMI and banks	Margin Financing	Corporates	Retail	Past due items	Investments	Securitisation	Other assets	Off-balance sheet commitments			
-												73	73	-
0	6,924		195,721					2,033					204,678	40,936
1					6,596			5,375					11,971	5,986
1								2,379					2,379	2,379
2				730,751									730,751	1,096,127
2														
3										77,902			77,902	233,706
4														
5														
714% (include prohibited exposure)					47,882					45,311			93,193	665,400
Average Risk Weight														2
Deduction from Capital Base														286,235

App III: Disclosure on Credit Risk's Risk Weight - 2019														
Risk Weights	Exposures after netting and credit risk mitigation												Total Exposure after netting and Credit Risk Mitigation	Total Risk Weighted Assets
	Governments and central banks	Administrative bodies and NPO	Authorised persons and banks	Margin Financing	Corporates	Retail	Past due items	Investments	Securitisation	Other assets	Off-balance sheet commitments			
0%										28			28	-
20%	3,988		531,320					16,329					551,637	110,327
50%					4,199			92,549					96,748	48,374
100%								44,069					44,069	44,069
150%				741,639									741,639	1,112,459
200%														
300%										28,012			28,012	84,036
400%														
500%														
714% (include prohibited exposure)					54,074					11,390	6,000		71,464	510,250
Average Risk Weight														1
Deduction from Capital Base														267,332

12.4 Disclosure of Credit Risk's Rated Exposure

**App IV: Disclosure on Credit Risk's Rated Exposure - 2020**

Exposure Class	Long term Ratings of counterparties							Unrated	
	Credit quality step	1	2	3	4	5	6		
	S&P	AAA TO AA-	A+ TO A-	BBB+ TO BBB-	BB+ TO BB-	B+ TO B-	CCC+ and below		Unrated
	Fitch	AAA TO AA-	A+ TO A-	BBB+ TO BBB-	BB+ TO BB-	B+ TO B-	CCC+ and below		Unrated
	Moody's	Aaa TO Aa3	A1 TO A3	Baa1 TO Baa3	Ba1 TO Ba3	B1 TO B3	Caa1 and below		Unrated
Capital Intelligence	AAA	AA TO A	BBB	BB	B	C and below	Unrated		
<b>On and Off-balance-sheet Exposures</b>									
Governments and Central Banks			6,924						
Authorised Persons and Banks	175,006		20,965						
Corporates			6,596					47,882	
Retail									
Investments									
Securitisation									
Margin Financing								730,751	
Other Assets									
<b>Total</b>		175,006	34,485	-				778,633	

**App IV: Disclosure on Credit Risk's Rated Exposure - 2019**

Exposure Class	Long term Ratings of counterparties							Unrated	
	Credit quality step	1	2	3	4	5	6		
	S&P	AAA TO AA-	A+ TO A-	BBB+ TO BBB-	BB+ TO BB-	B+ TO B-	CCC+ and below		Unrated
	Fitch	AAA TO AA-	A+ TO A-	BBB+ TO BBB-	BB+ TO BB-	B+ TO B-	CCC+ and below		Unrated
	Moody's	Aaa TO Aa3	A1 TO A3	Baa1 TO Baa3	Ba1 TO Ba3	B1 TO B3	Caa1 and below		Unrated
Capital Intelligence	AAA	AA TO A	BBB	BB	B	C and below	Unrated		
<b>On and Off-balance-sheet Exposures</b>									
Governments and Central Banks			3,988						
Authorised Persons and Banks	440,299		91,021						
Corporates			4,199					54,074	
Retail									
Investments									
Securitisation									
Margin Financing								741,639	
Other Assets									
<b>Total</b>		440,299	99,208	-				795,713	

\*Short term rating of counterparties is not applicable

## 12.5 Disclosure of Credit Risk Mitigation

## App V: Disclosure on Credit Risk Mitigation (CRM) - 2020

Exposure Class	Exposures before CRM	Exposures covered by Guarantees/ Credit derivatives	Exposures covered by Financial Collateral	Exposures covered by Netting Agreement	Exposures covered by other eligible collaterals	Exposures after CRM
<b>Credit Risk</b>						
<i>On-balance Sheet Exposures</i>						
Governments and Central Banks	6,924					6,924
Authorised Persons and Banks	195,721					195,721
Corporates	54,478					54,478
Retail	-					-
Investments	88,128					88,128
Securitisation	-					-
Margin Financing	730,751		(730,751)			-
Other Assets	123,286					123,286
<b>Total On-Balance sheet Exposures</b>	<b>1,199,288</b>		<b>(730,751)</b>			<b>468,537</b>
<i>Off-balance Sheet Exposures</i>						
OTC/Credit Derivatives						-
Exposure in the form of repurchase agreements						-
Exposure in the form of securities lending						-
Exposure in the form of commitments						-
*Other Off-Balance sheet Exposures						-
<b>Total Off-Balance sheet Exposures</b>	<b>-</b>	<b>-</b>	<b>-</b>	<b>-</b>	<b>-</b>	<b>-</b>
<b>Total On and Off-Balance sheet Exposures</b>	<b>1,199,288</b>	<b>-</b>	<b>(730,751)</b>	<b>-</b>	<b>-</b>	<b>468,537</b>

## App V: Disclosure on Credit Risk Mitigation (CRM) - 2019

Exposure Class	Exposures before CRM	Exposures covered by Guarantees/ Credit derivatives	Exposures covered by Financial Collateral	Exposures covered by Netting Agreement	Exposures covered by other eligible collaterals	Exposures after CRM
<b>Credit Risk</b>						
<i>On-balance Sheet Exposures</i>						
Governments and Central Banks	3,988					3,988
Authorised Persons and Banks	531,320					531,320
Corporates	58,273					58,273
Retail	-					-
Investments	231,741					231,741
Securitisation	-					-
Margin Financing	741,639		(741,639)			-
Other Assets	39,430					39,430
<b>Total On-Balance sheet Exposures</b>	<b>1,606,391</b>		<b>(741,639)</b>			<b>864,752</b>
<i>Off-balance Sheet Exposures</i>						
OTC/Credit Derivatives						-
Exposure in the form of repurchase agreements						-
Exposure in the form of securities lending						-
Exposure in the form of commitments	6,000					6,000
*Other Off-Balance sheet Exposures						-
<b>Total Off-Balance sheet Exposures</b>	<b>6,000</b>	<b>-</b>	<b>-</b>	<b>-</b>	<b>-</b>	<b>6,000</b>
<b>Total On and Off-Balance sheet Exposures</b>	<b>1,612,391</b>	<b>-</b>	<b>(741,639)</b>	<b>-</b>	<b>-</b>	<b>870,752</b>

## 12.6 Contractual Maturity Breakdown

<b>Appendix VI - Contractual Maturity Break down as at 31 Dec. 2020</b>				
	<b>Within 3 months</b>	<b>3 to 12 months</b>	<b>No fixed maturity</b>	<b>Total</b>
<b>Assets</b>				
Cash and cash equivalents	195,374,415	-	-	195,374,415
Investments - fair value through profit or loss	-	-	88,127,562	88,127,562
Advisory income receivable	30,453,272	-	-	30,453,272
Receivable against portfolio management	3,464,328	-	-	3,464,328
Receivable against margin lending	-	730,750,779	-	730,750,779
Due from related parties	16,241,824	-	-	16,241,824
<b>Total</b>	<b>245,533,839</b>	<b>730,750,779</b>	<b>88,127,562</b>	<b>1,064,412,180</b>
<b>Financial liabilities</b>				
Due to related parties	28,221,905	-	-	28,221,905
Short term loans	50,111,823	-	-	50,111,823
Accrued expenses and other liabilities	116,664,442	57,711,986	-	174,376,428
End of service benefits	-	-	56,877,853	56,877,853
<b>Total</b>	<b>194,998,170</b>	<b>57,711,986</b>	<b>56,877,853</b>	<b>309,588,009</b>
<b>Maturity gap</b>	<b>50,535,669</b>	<b>673,038,793</b>	<b>31,249,709</b>	<b>754,824,171</b>
<b>Cumulative maturity gap</b>	<b>50,535,669</b>	<b>723,574,462</b>	<b>754,824,171</b>	<b>-</b>

<b>Appendix VI - Contractual Maturity Break down as at 31 Dec. 2019</b>				
	<b>Within 3 months</b>	<b>3 to 12 months</b>	<b>No fixed maturity</b>	<b>Total</b>
<b>Assets</b>				
Cash and cash equivalents	347,318,521	-	-	347,318,521
Investments - fair value through profit or loss	-	-	231,739,849	231,739,849
Advisory income receivable	9,562,322	-	-	9,562,322
Receivable against portfolio management	3,122,021	-	-	3,122,021
Receivable against margin lending	-	741,638,615	-	741,638,615
Due from related parties	86,006,675	-	-	86,006,675
<b>Total</b>	<b>446,009,539</b>	<b>741,638,615</b>	<b>231,739,849</b>	<b>1,419,388,003</b>
<b>Liabilities and Shareholders' equity</b>				
Due to related parties	22,689,391	-	-	22,689,391
Short term loans	225,720,047	-	-	225,720,047
Accrued expenses and other liabilities	168,006,729	67,463,137	-	235,469,866
End of service benefits	-	-	49,186,585	49,186,585
<b>Total</b>	<b>416,416,167</b>	<b>67,463,137</b>	<b>49,186,585</b>	<b>533,065,889</b>
<b>Maturity gap</b>	<b>29,593,372</b>	<b>674,175,478</b>	<b>182,553,264</b>	<b>886,322,114</b>
<b>Cumulative maturity gap</b>	<b>29,593,372</b>	<b>703,768,850</b>	<b>886,322,114</b>	<b>-</b>

## Glossary of Terms

<b>Acronym</b>	<b>Definition</b>	<b>Acronym</b>	<b>Definition</b>
<b>AML</b>	Anti –Money Laundering	<b>HSBC</b>	HSBC Group Plc
<b>APR</b>	Authorised Persons Regulation	<b>HSBC SA</b>	HSBC Saudi Arabia
<b>AUCOM</b>	Board Audit Committee	<b>HCC</b>	HSBC Compliance Committee
<b>BOARD</b>	HSBC SA Board of Directors	<b>HSS</b>	HSBC Securities services
<b>BRC</b>	Board Risk Committee	<b>ICAAP</b>	Internal Capital Adequacy Assessment Process
<b>BRCM</b>	Business Risk Control Manager	<b>KRIs</b>	Key Risk Indicators
<b>CMA</b>	Capital Markets Authority	<b>MAT</b>	Management Attention Limits
<b>CEO</b>	Chief Executive Officer	<b>MTM</b>	Market to Market – Market Risk
<b>CRO</b>	Chief Risk Officer	<b>NRC</b>	Board Nomination and Remuneration Committee
<b>DPM</b>	Discretionary Portfolio Management	<b>AOP</b>	Annual operation plan
<b>EXCOM</b>	Board Executive Committee	<b>RAS</b>	Risk Appetite Statement
<b>FCC</b>	Financial Crime Compliance	<b>RC</b>	Regulatory Compliance
<b>RWAs</b>	Risk Weighted Assets	<b>RMM</b>	Risk Management Meeting
<b>SABB</b>	The Saudi British Bank		