



**FALCOM Financial Services**

**Pillar III Disclosures**  
**Year ended 31 December 2015**

March 2016

FALCOM Pillar III Disclosures 2015



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## **Glossary**

BIA	Basic Indicator Approach
CAR	Capital Adequacy Ratio
CEO	Chief Executive officer
CMA	Capital Market Authority
CR	Capital Requirement
CRM	Credit Risk Mitigation
FX	Foreign Exchange
ICAAP	Internal Capital Adequacy Assessment Process
IT	Information Technology
KSA	Kingdom of Saudi Arabia
LRM	Liquidity Risk Management
NOP	Net Open Position
OR	Operational Risk
OTC	Over The Counter
PR	Prudential Rules
ROG	Red Orange Green
RWA	Risk Weighted Assets
S&P	Standard & Poor's
SA	Standard Approach
SAR	Saudi Arabian Riyal
USD	US Dollar



## 1 Overview

- This disclosure requirement meets the minimum requirements for the annual market disclosure of information as referred to by the Article 68 of the Prudential Rules (PRS) (the market disclosure is hereinafter referred to as the “Pillar III Disclosure”) to be published by all the Authorized persons (APs) licensed for the Dealing, Managing and/or Custody activities.
- The purpose of Pillar III Disclosure is for the market participants to assess the key pieces of information on the scope of application, capital, risk exposures, risk assessment processes, and hence the capital adequacy of the APs.
- This document has been prepared in accordance with the guidelines issued by the Capital Market Authority (CMA) of Saudi Arabia which supplements the disclosure requirements for the Pillar III Disclosure in the PRs.
- This Pillar III Disclosure comprises both the qualitative and quantitative disclosures.
- This Pillar III Disclosure has been approved by the Board of Directors of FALCOM Financial Services before its publication. The information presented in this Pillar III Report is not required to be, and has not been, subject to external audit.
- Comparative information for the year ended 2014 have been obtained from Capital Adequacy Model (CAM) 2014 and Financial statements 2014 instead of ICAAP pillar III disclosure document 2014.



## **2 Scope of Application**

### **2.1 Scope**

FALCOM Financial Services (the Company) a closed joint stock company, incorporated in Kingdom of Saudi Arabia was formed pursuant to Ministry Decree No.2631 dated 10 Ramadan 1427H (corresponding to October 3, 2006) The company commenced business on February 25,2007 in Kingdom of Saudi Arabia. The company operates under Commercial Registration No. 1010226584 dated 4 Dhu Al Hijjah 1427H (corresponding to December 25, 2006) in Riyadh, through its 4 branches in the Kingdom of Saudi Arabia.

The Company obtained license number (37-06020) from the Capital Market Authority on May 27, 2006 to perform the following securities related activities:

1. Act as principal and agent and provide cover
2. Manage and establish mutual funds and portfolios
3. Provide arranging services
4. Provide advisory services
5. Provide custodial services for the purposes attributable to mutual funds and management of portfolios and brokerage for international equity.

The Pillar III Disclosure Report (hereinafter referred to as “Pillar III Disclosure”) is prepared and issued in accordance with the Article 68 of the Capital Market Authority (CMA) Prudential Rules (PRs). The Pillar III disclosures have been prepared to explain the basis on which the Company has prepared and disclosed capital requirements and information pertaining to the management of its risks and is in accordance with the “Suggested Format for Pillar III Disclosure” published on 15 December 2014, which sets the minimum requirements for the annual market disclosure of information as referred to by the Article 68 of the Prudential Rules (PRs).

### **2.2 Group Structure**

FALCOM Financial Services have following subsidiaries:

<b>Subsidiary name</b>	<b>Country</b>	<b>Ownership percentage Year 2015</b>
Nayifat Finance Company	Saudi Arabia	75.85%
FALCOM Financial Service and Partners SAOC	Oman	99.99%
Boursa Café	Saudi Arabia	90%



### **Nayifat Finance Company**

Effective January 1, 2014, the Company increased its shareholding in Nayifat Finance Company (NFC) from 37.93% to 75.85%. NFC (formerly known as Nayifat Instalment Company), was registered as a Closed Joint Stock Company under Commercial Registration (“CR”) Number 1010176451 issued in Riyadh on 9 JumadThani 1431H (corresponding to 23 May 2010). In accordance with the Finance Lease Law of Saudi Arabian Monetary Agency (SAMA), NFC was granted a leasing license by SAMA to operate under the new name of Nayifat Finance Company in the Kingdom of Saudi Arabia under license No. 5A/S/201312 dated 28 Safar 1435 (corresponding to 31 December 2013). As per SAMA license, NFC is involved in lease financing, financing consumers and small and medium enterprises in the Kingdom of Saudi Arabia.

### **FALCOM Financial Service and Partners SAOC**

During 2008, the Company established a subsidiary in the Sultanate of Oman under the name FALCOM Financial Service and Partners SAOC (Omani closed joint stock company), in which of the Company has an ownership interest of 99.99% and the remaining 0.01% held by Company’s two other shareholders resulting in an effective ownership interest of 100%. The subsidiary is registered under Commercial Registration number 1041405 dated 15 Muharram 1429H (corresponding to March 11, 2008).

### **Boursa Café**

The Company has an investment in a subsidiary under the name of Boursa Café which was established on 13 Safar 1430H (corresponding to February 9, 2009) with a share capital of SR 50,000. Boursa Café is a limited liability company which aims to start and operate cafes, restaurants and hotels and buying and acquiring real estates for the benefit of the Company, as well as, managing commercial agencies. The Company owns 90% share in Boursa Café and the remaining share is owned by a related party. Boursa Café accounts were not consolidated as they were insignificant to the consolidated accounts and due to the fact that Boursa Café did not commence its operations yet.

## **2.3 Capital Transferability**

There is no current or foreseen material or legal impediment to the prompt transfer of capital or repayment of liabilities between the Company and its subsidiaries.

### **Restrictions by Memorandum and Articles of Association**

The Board of Directors of the Company can recommend any sale or transfer of shares of the Company; however the ownership of the company shall not change prior to approval by the Capital Market Authority of Saudi Arabia. Apart from the above, no other restrictions have been imposed by the management on transfer of shares.



**Statutory Restriction**

As per Article 15-1 of the Articles of Association and Article 176 of the Saudi Companies Law, the Company is required to transfer 10% of its net profit to establish and fund the statutory reserves before declaration of dividend until the amount of statutory reserves is equal to the half of the paid up capital of the Company.

**Regulatory Restriction**

The CMA has imposed a restriction that the Company shall continuously possess a capital base which corresponds to not less than the total of the minimum capital requirements in accordance with Chapter 4 to Chapter 16 of Part 3 of the Prudential Rules at any point in time.

### 3 Capital Structure

It is the company's policy to maintain a strong capital base and to utilize it efficiently throughout its activities to optimize the return to shareholders, while maintaining a prudent relationship between the capital base and the underlying risks of the business. In carrying out this policy, the Company has taken into account the supervisory requirements of the Prudential Rules.

FALCOM has a basic capital structure consisting of:

Capital Items	Details
Share capital	The share capital of FALCOM, amounting to SAR 1,050 million is fully paid and is divided into 105 million shares at a nominal value of SAR 10 per share.
Retained Earnings	This represents the accumulated undistributed profits that are available for future dividend distributions as recommended by the Board and approved by the shareholders at the Annual General Meeting or to be eventually capitalized.
Statutory Reserves	In accordance with FALCOM's Article of Association and the Regulation for Companies in the Kingdom of Saudi Arabia, the Company has established a statutory reserve by appropriation of 10% of the net income until the reserve equals 50% of capital. The reserve is not available for dividend distribution.

The capital of FALCOM is composed of only Tier 1 Capital as mentioned in the below section.

#### 3.1 Tier 1 and Tier 2 Capital

The components of Tier1 and Tier 2 capital for FALCOM as of 31 December 2015 are as follows:

Capital Base	SAR '000	
	2015	2014
<b>Tier 1 Capital</b>		
Paid-up capital	1,050,000	1,050,000
Audited retained earnings	148,600	110,535
Share premium	-	-



Capital Base	SAR '000	
Reserves (other than revaluation reserves)	24,440	20,211
Tier 1 capital contribution	-	-
Deductions from Tier 1 capital	(163,357)	(188,703)
<b>Total Tier 1 Capital</b>	<b>1,059,683</b>	<b>992,043</b>
<b>Tier 2 Capital</b>		
Subordinated loans	-	-
Cumulative preference shares	-	-
Revaluation reserves	-	-
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>1,059,683</b>	<b>992,043</b>

The Company does not have Tier 2 capital as at 31 December 2015 in its capital structure.

### 3.2 Total Capital Base

The total capital base of the Company net of deductions as at 31 December 2015 is SAR 1,059,683,000 (rounded to nearest thousand).

## 4 Capital Adequacy

Capital Adequacy indicates the ability of a company to ensure efficient utilization of its capital in relation to its business requirements, growth, risk profile, shareholder returns and expansion. The first line of defense against future losses arising from business risks for a company is to recognize that earnings retention is the best option. Capital is vital to ensure maintaining a sufficient level of solvency that is achieved by having a buffer above regulatory capital adequacy requirements in order to meet risks arising from fluctuations in asset values, business cycles, expansions and future requirements. Since FALCOM's incorporation, the equity has increased over years by applying the earnings retention approach.

FALCOM calculate the Capital Adequacy Ratio (CAR) based on the Consolidated Financial Statements, with FALCOM Financial Service and Partners SAOC (OMAN) and Nayifat Financing Company (Saudi Arabia). Nayifat Finance Company, a Closed Joint Stock Company, leasing Company license by SAMA in the Kingdom of Saudi Arabia and have the following products; lease financing, financing consumers, small and medium enterprise.

From a Company Law Perspective, Article 48 of the current Companies Law, which was issued under the Royal Decree No. (M/6) Dated 22/3/1385H (corresponding to 22/7/1965AD) and will continue to be in force until 2 May 2016, states that: "The capital of a joint stock company shall be divided into negotiable shares of equal value. The shareholders thereof shall be responsible only to the extent of the value of their shares, and their number shall not be less than five." It follows from Article 48 above that the shareholders of a joint stock company ("JSC") are responsible for the debt of such company to the extent of their respective contributions in the share capital of such company. This effectively means that the shareholders of a JSC have no liability to any debt obligation or losses incurred by the JSC, beyond their respective capital contributions in the share capital of the JSC.

FALCOM Capital Adequacy Ratio (CAR) based on the Consolidated Financial Statements as per prudential guidelines issued by the Capital Markets Authority, with FALCOM Financial Service and Partners SAOC (OMAN) and Nayifat Financing Company (Saudi Arabia), is 0.98%. Which is considered shortfall by an amount of SAR 16.9 million (1.59 % of Capital base i.e. 1,059 million). FALCOM's management objective is to have a Capital Adequacy Ratio above the minimum requirements with a buffer to support the Company risks in the course of its business. Therefore, FALCOM is planning to divest its investment in Nayifat by listing during the year 2016 in order to improve the Capital Adequacy Ratio (CAR) of the company.

The Company seeks to achieve the following goals by implementing an effective capital management framework:

- ◆ Maintain sufficient capital to support overall business strategy;
- ◆ Integrate capital allocation decisions with the strategic and financial planning process;
- ◆ Enhance Board and senior management's ability to understand how much capital flexibility exists to support the overall business strategy;
- ◆ Enhance the Company's understanding on capital requirements under different economic and stress scenarios;
- ◆ Build and support linkage between risks and capital and tie performance to both of them; and
- ◆ Meet the regulatory capital adequacy ratios and have a prudent buffer

## **4.1 Strategy and Approach for ICAAP**

FALCOM has developed an ICAAP Policy to measure, monitor and report all material risks and adopt an efficient capital planning process to ensure sufficient capital is available to meet usual business activities as well as any unforeseen contingencies. The company will continue to hold capital to cover those risks specified by CMA (under Pillar I) and hold additional capital to cover other risks (Pillar II), supporting its business activities while ensuring a comfortable buffer is held for capital requirement.

FALCOM has established a monitoring and reporting system that allows the senior management and the Board to:

- evaluate the level and trend of material risks and their effect on capital levels;
- evaluate the sensitivity and reasonableness of key assumptions used in the Company's business projections;
- determine that the Company holds sufficient capital against the various risks and is in compliance with established capital adequacy goals; and
- assess its future capital requirements based on the Company reported risk profile and make necessary adjustments to the Company's strategic plan accordingly.

The Company's capital management is aimed at maintaining optimum level of capital, enabling it to pursue strategies that build long-term shareholder value, whilst always meeting minimum regulatory capital requirements as well as internal capital requirements calculated.

## 4.2 Capital Requirements and Capital Adequacy Ratio

The capital requirements for credit risk, market risks, operational risks, foreign exchange risks and commodity risk in accordance with the Prudential Rules is provided in the table below:

Exposure Class	Notes	Exposures before CRM	Net Exposures after CRM	Risk Weighted Assets	Capital Requirement	
					2015	2014
					<i>SAR '000</i>	
<b><u>Credit Risk</u></b>						
On-balance Sheet Exposures						
Governments and Central Banks		-	-	-	-	-
Administrative bodies and NPO		-	-	-	-	-
Authorized Persons and Banks		107,106	107,106	21,421	2,999	3,435
Corporates		19,154	19,154	136,761	19,147	57,839
Past due items	1	-	-	-	-	48,732
Securitization & re-securitization		-	-	-	-	-
Margin Financing		122,957	122,957	184,435	25,821	11,080
Other Assets	2	1,916,234	1,916,234	5,748,928	804,850	551,180
High risk investment	3	203,548	203,548	814,193	113,987	137,836
Investment funds (underlying)	4	82,529	82,529	123,793	17,331	-
Investment funds		85,629	85,629	128,443	17,982	11,631
Total On-Balance sheet Exposures		2,537,157	2,537,157	7,157,974	1,002,116	821,734
Off-balance Sheet Exposures		-	-	-	-	-

Exposure Class	Notes	Exposures before CRM		Net Exposures after CRM	Risk Weighted Assets	Capital Requirement	
						2015	2014
						SAR '000	
OTC/Credit Derivatives		-	-	-	-	-	-
Repurchase agreements		-	-	-	-	-	-
Securities borrowing/lending		-	-	-	-	-	-
Commitments		-	-	-	-	-	-
Other off-balance sheet exposures		-	-	-	-	-	-
Total Off-Balance sheet Exposures		-	-	-	-	-	-
Total On and Off-Balance sheet Exposures		2,537,157		2,537,157	7,157,974	1,002,116	821,734
Prohibited Exposure Risk Requirement		-		-	-	-	-
Total Credit Risk Exposures		2,537,157		2,537,157	7,157,974	1,002,116	821,734
<b>Market Risk</b>							
		<i>Long Position</i>	<i>Short Position</i>				
Interest rate risks		-				-	-
Equity price risks		3,393				543	658
Risks related to investment funds		-				-	-
Securitization/re - securitization positions		-				-	-
Excess exposure risks		-				-	-
Settlement risks and counterparty risks		-				-	-

Exposure Class	Notes	Exposures before CRM		Net Exposures after CRM	Risk Weighted Assets	Capital Requirement	
						2015	2014
						SAR '000	
Foreign exchange rate risks		17,328				354	456
Commodities risks		-				-	-
Total Market Risk Exposures		20,721				897	1,114
<b>Operational Risk</b>							
						73,610	47,450
Minimum Capital Requirements							
						1,076,623	870,298
Surplus/(Deficit) in capital							
						(16,940)	121,745
Total Capital ratio (time)							
						0.9842	1.14
<p><b>Notes:</b></p> <p>1 <b>Past due item</b> – This classification was part of last year CAM i.e. 2014, but does not appear in the same sheet under CAM 2015.</p> <p>2 <b>Other Assets</b> includes Retail exposure (i.e. 1,774,648) deferred exposure, accrued income (i.e. 22,619) tangible assets (i.e. 118,855), cash or gold (i.e. 33) and other assets (i.e. 79).</p> <ul style="list-style-type: none"> <li>• <b>Retail exposure</b> consist of mainly Nayifat investment.</li> </ul> <p>3 <b>High risk investment</b> consist of Investment in associates (i.e. 57,948) and real estate investment (i.e. 145,600)</p> <p>4 <b>Investment fund (underlying)</b> – As per CAM 2014 criteria, investment listed shares fell into other assets, however, as per CAM 2015 criteria investment in listed share fall into investment fund underlying category.</p>							

## **5 Risk Management**

### **5.1 Risk Management Objectives**

FALCOM assumes a variety of risks in undertaking its business activities. The risk management objective for each area of risk is to adopt the best practices available to adhere to Prudential Rules requirements i.e. to identify, capture, monitor and manage different dimensions of risk with the aim of protecting asset values and income streams. FALCOM is able to maximize returns intended to optimize the Company's shareholder return, while maintaining its risk exposure within defined parameters.

### **5.2 Risk Management Framework**

#### **5.2.1 Structure and Organization**

The Company's senior management is responsible for understanding the nature and level of risk being taken by the Company and how this risk relates to adequate capital levels. Senior management is responsible for formulating the Company's risk appetite, strategy and approves the limit structure for different types of risks faced by the Company. The Board of Directors of the Company has overall responsibility for establishing the risk culture and ensuring that an effective risk management framework is in place. Compliance & Risk management Committee – a management committee have been established to ensure effective implementation of risk management framework across the organization. The Internal Auditor provide independent assurance that all types of risk are being measured and managed in accordance with the regulations, policies and guidelines set by the Board of Directors.

#### **5.2.2 Risk Management Strategy**

The Company's risk strategy, backed by appropriate limit structures, is expressed through Risk Management policies. These policies provide an enterprise-wide integrated risk management framework in the Company. The risk policies identify risk objectives, policies, strategies and risk governance both at the Board and the management level.

Based on the risk appetite of the Company, the Company has put in place various risk limits. These limits have been approved by the Board of Directors. Limit breaches, if any, are reported by the Risk Management function to the CEO and Board. The limits are reviewed and revised, when required.

## **6 Credit Risk**

Credit risk is the risk that one party of a financial instrument will fail to discharge an obligation and cause the other party to incur a financial loss. The maximum exposure to credit risk is equal to the carrying amount of financial assets. The management analyses credit risk in the following categories:

1. Islamic financing receivables (IFR), Margin facilities to corporate clients and retail customers – both conventional and Islamic facilities
2. Proprietary Investments of the Company

With respect to the margin facilities provided by FALCOM, there is a detailed policy that covers the parameters that should be considered prior to the acceptance of a customer for the provision of margin facilities, rules of disbursement, different controls that need to be in place during the facility period, etc. There are stipulated minimum coverage ratios required for the disbursement of margin facilities depending on the market, regulations and client collators.

The Compliance and Risk Management Group is engaged in frequent monitoring of the different limits and controls that are in place for the provision of such facilities. In addition to the minimum coverage ratios, there are controls in terms of maximum limit per customer, tenor limits, margin calls, and various other risk controls in order to minimize the credit risk arising from margin facilities.

Margin lending decisions are based on credit scoring models and credit committee decision, developed using internal data with behavioral and historical data applied. The approval process is reviewed regularly by Credit Committee with limit delegations from the Board. Within the company, emphasis is placed on the responsibility for making credit decisions and as such there is a series of delegated approval limits agreed by Board or Executive Committee.

In terms of the proprietary investment portfolio, the Company invests only after performing enhanced due diligence on the investment and obtaining appropriate approvals from the Board of the Company through the Investment Committee recommendation. The approval process is very organized and sufficient care is taken while taking those investments in accordance with the Investment Policy Guidelines.

Cash and bank balances and other receivables are placed with banks having good credit ratings, and therefore are not subject to significant credit risk. Other receivables are not significant and also not exposed to significant credit risk

Credit risk consumes the largest proportion of the Company's minimum capital requirement. Within the established principles and parameters the company ensures that strict capital discipline is maintained in relation to the regulatory and economic capital requirements.



Currently, FALCOM uses the Standardized Approach prescribed under the Pillar I requirements of the CMA Prudential Rules to calculate regulatory capital for the credit risk faced by it.

## 6.1 Credit Risk Disclosures

### 6.1.1 Past Due Claims

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

### 6.1.2 Provision against Doubtful Receivables

Provisions are recognized when the company has a present legal or constructive obligation as a result of past events, it is probable that an outflow of resources embodying economic benefits will be required to settle the obligation and a reliable estimate of the amount of obligation can be made.

### 6.1.3 Impaired Assets

An assessment is made at each balance sheet date to determine whether there is objective evidence that a specific financial asset or a group of financial assets may be impaired. If such evidence exists, any impairment loss is recognized in the statement of income. For assets carried at cost, impairment is determined as difference between cost and the present value of future cash flows discounted at the current market rate of return for similar financial assets.

### 6.1.4 Total Gross Credit Risk Exposure

Total gross credit risk exposures broken down by major types of credit exposure is provided in table below:

Risk Weights	Exposures after Netting and Credit Risk Mitigation - 2015												
	Authorized persons and banks	Administrative bodies and NPO	Margin Financing	Corporates	High risk investment*	Investment fund	Investment fund (underlying)	Securitization	Real Estate	Other assets*	Off-balance sheet commitments	Total Exposure after netting and CRM	Total RWA
	SAR '000												
0%	-	-	-	-	-	-	-	-	-	33	-	-	-
20%	107,106	-	-	-	-	-	-	-	-	-	-	21,421	2,999



Risk Weights	Exposures after Netting and Credit Risk Mitigation - 2015												
	Authorized persons and banks	Administrative bodies and NPO	Margin Financing	Corporates	High risk investment*	Investment fund	Investment fund (underlying)	Securitization	Real Estate	Other assets*	Off-balance sheet commitments	Total Exposure after netting and CRM	Total RWA
50%	-	-	-	-	-	-	-	-	-	-	-	-	-
100%	-	-	-	-	-	-	-	-	-	-	-	-	-
150%	-	-	122,957	-	-	85,629	82,529	-	-	-	-	436,673	61,134
200%	-	-	-	-	-	-	-	-	-	-	-	-	-
300%	-	-	-	-	-	-	-	-	-	1,916,122	-	5,748,366	804,771
400%	-	-	-	-	203,548	-	-	-	146,500	-	-	814,192	113,987
500%	-	-	-	-	-	-	-	-	-	-	-	-	-
714%	-	-	-	19,154	-	-	-	-	-	79	-	137,324	19,225
Average Risk Weight	107,106	-	122,957	19,154	203,548	85,629	82,529	-	-	1,916,234	-	7,157,974	1,002,116
Deduction from Capital Base	-	-	-	-	-	-	(40,020)	-	-	(123,337)	-	(163,357)	-
	<ul style="list-style-type: none"> <li>• <b>High risk investment</b> consist of Investment in associates (i.e. 57,948) and real estate investment (i.e. 145,600)</li> <li>• <b>Other Assets</b> includes Retail exposure (i.e. 1,774,648) deferred exposure on accrued income (i.e. 22,619) tangible assets (i.e.118 855), cash or gold (i.e. 33) and other assets (i.e. 79).</li> <li>• <b>Retail exposure</b> consist of mainly Nayifat investment.</li> </ul>												



Risk Weights	Exposures after Netting and Credit Risk Mitigation - 2014												Total RWA
	Authorized persons and banks	Administrative bodies and NPO	Margin Financing	Corporates	Past due item	High risk investment*	Investment fund	Investment fund ( underlying)	Securitization	Other assets*	Off-balance sheet	Total Exposure after netting and CRM	
	SAR '000												
0%	-	-	-	-	-	-	-	-	-	43	-	-	-
20%	99,723	-	-	-	-	-	-	-	-	-	-	19,945	2,792
50%	-	-	-	-	-	-	-	-	-	-	-	-	-
100%	-	-	-	-	-	-	-	-	-	-	-	79,146	11,080
150%	3,061	-	-	-	-	-	55,387	83,449	-	-	-	-	-
200%	-	-	-	-	-	-	-	-	-	-	-	-	-
300%	-	-	-	-	-	-	-	-	-	1,200,171	-	3,600,513	504,072
400%	-	-	-	-	-	214,841	-	-	-	-	-	859,364	120,311
500%	-	-	-	-	-	-	-	-	-	-	-	-	-
714%	-	-	-	57,862	48,752	-	-	-	-	47,127	-	1,097,711	153,680
Average Risk Weight	102,784	-	79,146	57,862	48,752	214,841	55,387	83,449	-	1,247,341	-	5,869,524	821,733
Deduction from Capital Base	-	-	-	-	-	-	-	(63,317)	-	(125,386)	-	(188,703)	-
	<ul style="list-style-type: none"> <li>• <b>High risk investment</b> consist of Investment in associates (i.e. 57,948) and real estate investment (i.e. 174,099)</li> <li>• <b>Other Assets</b> includes Retail exposure (i.e. 1,122,448) deferred exposure on accrued income (i.e. 22,619) tangible assets (i.e.60, 583), cash or gold (i.e. 43) and other assets (i.e. 47,127). <ul style="list-style-type: none"> <li>○ <b>Retail exposure</b> consist of mainly Nayifat investment.</li> </ul> </li> </ul>												

### 6.1.5 Geographic Distribution of Credit Risk

The table below provides break-up of credit exposure in geographic areas:

		<u>Saudi Arabia</u>	<u>Oman</u>	<u>Total</u>
				<i>SAR '000</i>
<b>2015</b>				
Revenues		355,207	1,338	356,545
Other income		24,203	3,898	28,101
Expenses (Including zakat)		313,379	3,022	316,401
Net income (loss) before non-controlling interest		66,031	2,215	68,245
Total assets		2,645,016	18,733	2,663,749
Total Liabilities		1,334,391	2,010	1,336,401
<b>2014</b>				
Revenues		351,207	(610)	350,597
Other income		3,214	-	3,214
Expenses (Including zakat)		204,818	5,578	210,396
Net income (loss) before non-controlling interest		149,603	(6,188)	143,415
Total assets		1,997,628	17,961	2,015,589
Total Liabilities		776,296	3,487	779,783



6.1.6 Residual Contractual Maturity Breakdown

2015			
	Less than 12 months	More than 12 months	Total
	SAR'000		
Cash & Cash Equivalent	107,139	-	107,139
Other Receivable	82,389	-	82,389
Due from related party	7,431	-	7,431
Prepaid expenses and other assets	21,750	-	21,750
Investments	3,393	371,106	374,499
Islamic financing receivables	444,057	1,260,873	1,704,930
Margin lending and Murabaha financing	122,957	-	122,957
<b>Total Assets</b>	<b>789,116</b>	<b>1,631,979</b>	<b>2,421,095</b>
Accounts Payable	23,255	-	23,255
Islamic bank financing	584,935	639,923	1,224,858
Provision for Zakat	73,496	-	73,496
Employees' termination benefits	-	14,792	14,792
<b>Total Liabilities</b>	<b>681,686</b>	<b>654,715</b>	<b>1,336,401</b>
<b>Net</b>	<b>107,430</b>	<b>977,264</b>	<b>1,084,694</b>



2014			
	Less than 12 months	More than 12 months	Total
	SAR'000		
Cash & Cash Equivalent	102,827	-	102,827
Other Receivable	52,266	-	52,266
Due from related party	1,697	-	1,697
Prepaid expenses and other assets	14,810	-	14,810
Investments	3,655	325,178	328,833
Islamic financing receivables	368,330	758,330	1,126,660
Margin lending and Murabaha financing	164,354	-	164,354
<b>Total Assets</b>	<b>707,939</b>	<b>1,083,508</b>	<b>1,791,447</b>
Accounts Payable	33,245	-	33,245
Islamic bank financing	403,863	271,251	675,114
Provision for Zakat	59,732	-	59,732
Employees' termination benefits	-	11,692	11,692
<b>Total Liabilities</b>	<b>496,840</b>	<b>282,943</b>	<b>779,783</b>
<b>Net</b>	<b>211,099</b>	<b>800,565</b>	<b>1,011,664</b>

#### **6.1.7 Past Due and Impaired Exposures**

Islamic finance receivables which are neither past due nor impaired has a satisfactory history of repayments. Past due but not impaired balances are less than 90 days outstanding. Past due and impaired balances of SAR 55.4 million are outstanding for more than 360 days. Account receivables quality was assessed and allowance for doubtful receivables was made by FALCOM as of 31 December 2015. The specific and collective provision as at year end were SAR 28 million (on the portfolio of SAR 64.4 million) and SAR 25 million (on the portfolio of SAR 1.66 billion of which SAR 1.11 billion neither past due nor impaired) respectively.

An assessment was carried out at the balance sheet date to determine whether there is any objective evidence that a specific financial asset or a group of financial assets may be impaired. A provision for impairment against available for sales investment amounting to SAR 5.6 million was recognized by the Company as of 31 December 2015.

#### **6.1.8 Credit Risk Protection**

Exposure amounts before and after credit risk protection associated with each credit quality step in regards to non-trading activities, as well as the exposure amounts that are deducted from capital are detailed in tables 6.1.8.1, 6.1.8.2 and 6.1.8.3 below:



6.1.8.1 Long term Ratings of Counterparties

Exposure Class	Long term Ratings of counterparties - 2015							
	Credit quality step	1	2	3	4	5	6	Unrated
	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	-	-	-	-	-	-	-	
Authorized Persons and Banks	-	-	-	-	-	-	-	
Corporates	-	-	-	-	-	-	5,219	
Retail	-	-	-	-	-	-	1,255,654	
Investments	-	-	-	-	-	-	85,629	
Securitization	-	-	-	-	-	-	-	
Margin Financing	-	-	-	-	-	-	-	
Other Assets	-	-	-	-	-	-	-	
<b>Total</b>	-	-	-	-	-	-	<b>1,346,502</b>	





Exposure Class	Long term Ratings of counterparties - 2014							
	Credit quality step	1	2	3	4	5	6	Unrated
	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		-	-	-	-	-	-	-
Authorized Persons and Banks		-	-	-	-	-	-	-
Corporates		-	-	-	-	-	-	21,859
Retail		-	-	-	-	-	-	687,719
Investments		-	-	-	-	-	-	55,387
Securitization		-	-	-	-	-	-	-
Margin Financing		-	-	-	-	-	-	-
Other Assets		-	-	-	-	-	-	-
<b>Total</b>		-	-	-	-	-	-	<b>764,965</b>



6.1.8.2 Short term Ratings of Counterparties

Exposure Class	Short term Ratings of counterparties - 2015					
	Credit quality step	1	2	3	4	Unrated
	S & P	A-1+, A-1	A-2	A-3	Below A-3	Unrated
	Fitch	F1+, F1	F2	F3	Below F3	Unrated
	Moody's	P-1	P-2	P-3	Not Prime	Unrated
Capital Intelligence	A1	A2	A3	Below A3	Unrated	
<b>On and Off-balance-sheet Exposures</b>						
Governments and Central Banks		-	-	-	-	-
Authorised Persons and Banks		107,106 *	-	-	-	-
Corporates		-	-	-	-	13,935
Retail		-	-	-	-	518,995
Investments		-	-	-	-	-
Securitisation		-	-	-	-	-
Margin Financing		-	-	-	-	122,957
Other Assets						
<b>Total</b>		<b>107,106</b>	-	-	-	<b>655,887</b>
* Placed with banks having good credit ratings						



Exposure Class	Short term Ratings of counterparties - 2014					
	Credit quality step	1	2	3	4	Unrated
	S & P	A-1+, A-1	A-2	A-3	Below A-3	Unrated
	Fitch	F1+, F1	F2	F3	Below F3	Unrated
	Moody's	P-1	P-2	P-3	Not Prime	Unrated
Capital Intelligence	A1	A2	A3	Below A3	Unrated	
<b>On and Off-balance-sheet Exposures</b>						
Governments and Central Banks		-	-	-	-	-
Authorized Persons and Banks		99,723 *	-	-	-	3061
Corporates		-	-	-	-	36,003
Retail		-	-	-	-	434,729
Investments		-	-	-	-	-
Securitization		-	-	-	-	-
Margin Financing		-	-	-	-	78,976
Other Assets		-	-	-	-	-
<b>Total</b>		<b>99,723</b>	-	-	-	<b>552,769</b>
* Placed with banks having good credit ratings						



6.1.8.3 Credit Risk Mitigation Exposure

FALCOM credit risk exposure comprises mainly of Islamic financing receivables (IFR), placements with local banks and account receivables. Details of the exposure covered by collateral is provided in table below:

Exposure Class	Notes	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	
							2015	2014
							SAR '000	
On-balance Sheet Exposures								
Governments and Central Banks		-	-	-	-	-	-	-
Administrative bodies and NPO		-	-	-	-	-	-	-
Authorized Persons and Banks		107,106	-	-	-	-	107,106	102,784
Corporates		19,154	-	-	-	-	19,154	57,862
Past due items	1							48,752
Securitization		-	-	-	-	-	-	-
Margin Financing		122,957	-	-	-	-	122,957	79,146
Other Assets	2	1,916,234	-	-	-	-	1,916,234	1,247,341
High risk investment	3	203,548	-	-	-	-	203,548	214,841
Investment funds ( underlying)	4	82,529	-	-	-	-	82,529	83,449
Investment funds		85,629	-	-	-	-	85,629	55,387
<b>Total On-Balance sheet Exposures</b>		<b>2,537,157</b>	-	-	-	-	<b>2,537,157</b>	<b>1,889,562</b>
Off-balance Sheet Exposures		-	-	-	-	-	-	-



Exposure Class	Notes	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	
							2015	2014
OTC/Credit Derivatives		-	-	-	-	-	-	-
Repurchase agreements		-	-	-	-	-	-	-
Securities borrowing/lending		-	-	-	-	-	-	-
Commitments		-	-	-	-	-	-	-
Other off-balance sheet exposures		-	-	-	-	-	-	-
<b>Total Off-Balance sheet Exposures</b>		-	-	-	-	-	-	-
<b>Total On and Off-Balance sheet Exposures</b>		<b>2,537,157</b>	-	-	-	-	<b>2,537,157</b>	<b>1,889,562</b>

**Notes:**

- Past due item** – This classification was part of last year CAM i.e. 2014, but does not appear in the same sheet under CAM 2015.
- High risk investment** consist of Investment in associates (i.e. 57,948) and real estate investment (i.e. 174,099)
- Other Assets** includes Retail exposure (i.e. 1,122,448) deferred exposure on accrued income (i.e. 22,619) tangible assets (i.e.60,583), cash or gold (i.e. 43) and other assets (i.e. 47,127).
  - Retail exposure** consist of mainly Nayifat investment.
- Investment fund (underlying)** – As per CAM 2014 criteria, investment listed shares fell into other assets, however, as per CAM 2015 criteria investment in listed share fall into investment fund underlying category.



6.1.8.4 Off-Balance Sheet Disclosure

Credit Risk	Principal Amount	Credit Equivalent Amount	Risk Weighted Assets	
			2015	2014
				SAR '000
<i>Off-balance Sheet Exposures</i>				
Security Pledging	-	-	-	-
Exposure in the form of commitments – Letter of Guarantee	-	-	-	-
<b>Total Off-Balance sheet Exposures</b>	-	-	-	-

## 7 **Market Risk**

Market risk is the potential of losses in earnings or an adverse change in the value of FALCOM's assets and liabilities in response to changes in their respective market prices.

For the Company, market risk may arise from movements in equity price, interest rate risk, foreign exchange rates, credit spread risk, underwriting risk, commodity risk, settlement risk, commission rates and foreign exchange markets or equity markets. A single transaction or financial product may be subject to any number of these risks.

The Company has very little market risk given that it does not operate an active trading book. It invests its excess cash in carefully analyzed and selected investment after appropriate due diligence and investment committee recommendations.

**Interest Rate Risk** is the risk that a movement in interest rates will impact the profitability of the Company. Interest rate risk arises principally from mismatches between the future yield on assets such as margin loans and their respective funding costs, as a result of changes in interest rates.

In order to manage interest rate risk, the pricing of margin loans are carefully performed taking into account the funding costs in order to minimize the mismatch in interest rate spreads. Risk monitoring is done on a periodic basis to assess this risk and to manage it effectively.

The Company does not engage in any hedging techniques to minimize interest rate risk.

**Foreign Exchange Risk** is the risk that the value of a financial investment will fluctuate due to change in foreign exchange rates. Currency or foreign exchange risk arises from an open position, either long or short, in a foreign currency, creating exposure to a change in the relevant exchange rate. This may arise from holding of assets in one currency funded by liabilities in another currency, or from a spot or forward foreign exchange trade, currency swap, currency future or currency option which is not matched with an offsetting contract.

**Equity Risk** is the sensitivity of financial products to the changes in equity prices. Equity risk arises from holding open positions, either long or short, in equities or equity based instruments, thereby creating exposure to a change in the market price of the equity or equity instrument. This exposure may arise from holding actual equities, from an equity derivative, or from an index arbitrage. In addition to Company performance expectations, equity prices are also susceptible to general economic data and sector performance expectations.

The Group is exposed to market risk with respect to its investments. The Group limits market risks by diversification of its investments and monitoring continuously the developments in the stock and international funds markets. In addition, the key factors that affect the stock and bond market movements are monitored including analysis of the operational and financial performance of investees.

**Price Risk** is the risk that the value of a financial instrument will fluctuate because of changes in market prices, whether those changes are caused by factors specific to the individual instrument or its issuer or factors affecting all instruments traded in the market.

**Fair Value** is the amount for which an asset could be exchanged or a liability settled between knowledgeable willing parties in an arm's length transaction. As the Group's and subsidiary's financial instruments are compiled under the historical cost convention, except for investments at fair value, differences can arise between the book values and the fair value estimates. Management believes that the fair values of the financial assets and liabilities are not materially different from their carrying values.

The monitoring and control of market risk is handled by ensuring market risk exposures are measured in accordance with defined policies and reported against prescribed control limits. The Company will use a combination of limits to control its market risk exposures.

## 7.1 Capital Requirements

### 7.1.1 Trading Book activities

Risk	Exposure		Capital Requirement	
			2015	2014
				<i>SAR '000</i>
	Net long	Net Short		
Interest Rate Risk	-	-	-	-
Equity Price Risk	3,393	-	543	658
Investment Fund Risks				
Securitisation/Resecuritisation positions	-	-	-	-
Excess exposure risk; and	-	-	-	-
Settlement Risk	-	-	-	-
Counterparty risk	-	-	-	-
<b>Total Capital Requirement</b>			<b>543</b>	<b>658</b>



**Business Activities**

Risk	Position Subject to Capital Charge		Capital Requirements	
			2015	2014
				<i>SAR '000</i>
	Net long	Net Short		
Foreign Exchange Rate Risk	17,328	-	354	456
Commodity Risk	-	-	-	-
<b>Total Capital Requirement</b>			<b>354</b>	<b>456</b>

## **8 Operational Risk**

Operational risk is the risk of direct or indirect loss resulting from inadequate or failed internal processes, people and systems or from external events. This definition excludes reputational and strategic risk.

Currently, FALCOM uses the capital calculated under the Basic Indicator Approach (BIA) as well as expenditure based approach (whichever is higher) for calculating its internal capital requirement for operational risk. The Company has established guidelines which have been classified into major factors that give rise to the operational risk including people risk, process risk, system risk and external events and manage them accordingly.

In order to manage the operational risks within the Company, FALCOM operates a ‘three line of defense’ model as indicated below:

- ◆ The first line of defense is business line management. It has the primary responsibility for the identification, management and mitigation of the risks associated with the products and processes of its business. It engages in regular testing and certification of the adequacy and effectiveness of controls and compliance with the company’s policies and procedures.
- ◆ The second line of defense is the company’s Compliance & Risk Management Group. This group is responsible for identifying the potential sources of risks that can arise as a result of the differing business lines and support functions in the Company. It is also responsible for the preparation and maintenance of risk and control tests that have to be in place in order to mitigate the identified risks.
- ◆ The third line of defense is Audit. The Company’s internal audit is responsible for assessing compliance with the policies, regulations and for providing independent evaluation of the adequacy and effectiveness of the compliance and risk control framework. The Internal Auditor reports to the Board Audit Committee.

In addition, to the above framework, it has been the Company’s practice to document detailed policies and procedures, for all business lines and functions within the Company, which shall detail the ways in which things should be carried out to achieve the objectives of the function with minimal errors. The Company’s policies and procedures are regularly reviewed by the management and approved by the Board of Directors.

Formal reporting is done to keep the top management apprised of the state of risks within the Company.

## 8.1 Risk Mitigation and Control

The business units/support functions, in consultation with the Compliance & Risk Management Group, determine all material operational risks and decide whether to use appropriate procedures to control and/or mitigate the risks, or accept the risks. For those risks that cannot be controlled, the Company will decide whether to accept these risks, reduce the level of business activity involved, transfer the risk outside the Company or withdraw from the associated activity completely, after consulting the CEO.

The Company has developed Control Risk Self-Assessment framework and going forward, the Company will carry out a Control Risk and Self-Assessment (“CRSA”) exercise to identify its major operational risks and assess the likelihood of occurrence as well as severity of each risk.

## 8.2 Capital Requirements

The Company based its internal capital requirement for operational risk on the Basic Indicator Approach as it provides higher capital charge than capital charge under Expenditure based approach. The capital requirement was assessed at 73,610 SAR in thousands.

### 8.2.1 Basic Indicator Approach

Operational Risk	Gross Operating Income			Average Gross Operating Income	Risk Capital Charge	Capital Requirement	
	2013	2014	2015			2015	2014
	SAR'000				%	SAR'000	
Basic Indicator Approach	205,502	350,597	356,545	304,215	15	45,632	25,600

### 8.2.2 Expenditure Based Approach

Operational Risk	Overhead Expenses (Year-1)	Average Gross Operating Income	Risk Capital Charge	Capital Requirement	
				2015	2014
	SAR'000			%	SAR'000
Expenditure Based Approach	294,440	N/A	25	73,610	47,450

## 9 Liquidity Risk

Liquidity risk is the risk of not having available sufficient resources to enable it to meet its obligations as they fall due or can only secure such resources at excessive cost. The two aspects of liquidity are asset liquidity and funding liquidity.

- ◆ Funding liquidity risk arises when the necessary liquidity to fund obligations cannot be obtained at the expected terms and when required.
- ◆ Asset liquidity (or market liquidity) risk arises when the assets are not able to be disposed or transferred into cash without affecting the liquidity of the asset or incurring significant losses.

The company has a liquidity risk policy that aims to describe the policies and guidelines through which it manages its cash flow mismatches.

FALCOM pursues a policy of maintaining a high level of liquidity through active and prudent management of assets and liabilities. Since FALCOM has limited or insignificant liabilities and the majority of assets are placed with the Financial Institutions for short term. FALCOM does not have significant exposure to liquidity risk. FALCOM monitors its cash flow movements for day to day management.

When it comes to funding liquidity risk, the Company monitors the liquidity position of the company regularly to meet any commitments in a timely manner. The Company also carries out stress testing to assess the worst case scenario in terms of liquidity crisis with a view to assess the company's ability to maintain an adequate capital position in such a scenario.

### 9.1 Sources of Liquidity Risk

The sources of liquidity risk can broadly be categorized in the following:

- **Funding Risk** – Risk of inability to fund net outflows due to unanticipated withdrawal of capital or deposits;
- **Call Risk** – Risk of crystallization of a contingent liability; and
- **Event Risk** – Risk of rating downgrades or other negative public news leading to a loss of market confidence in the Company.

### 9.2 Funding and Liquidity Risk Strategy

The company monitors the following on a periodic basis as agreed by the management to assess the liquidity risk:

1. Surplus/deficit in availability of funding – in order to assess the ability to meet commitments.
2. Residual contractual mismatch –in order to assess the mismatch in maturity of assets and liabilities.

The Company collates the projected cash flow and liquidity profiles of its financial assets and liability. It maintains a portfolio of short term liquid assets to cover requirements, largely consisting of certain liquid placements with financial institutions. The Finance Department is responsible for the day-to-day liquidity management process of the Company. On the basis of the budgeted cash flows and investment commitments, the finance department tracks the immediate liquidity needs of the Company on a frequent basis.

The company will establish a contingency liquidity plan to meet urgent liquidity requirements in stressed conditions that will address how funding liquidity will be managed if either the specific financial conditions were to decline or broader conditions created a liquidity problem. The plan will be reviewed and updated regularly.

#### **9.2.1 Stress Testing**

FALCOM's ICAAP policy includes set of scenarios and assumptions that are used on an annual basis to measure liquidity risk over one year time horizon. Stress testing is an evolutionary process that is constantly reviewed and refined through time to capture the experiences of volatile markets.

The stress testing assumptions are updated on periodic basis. It is then be reviewed by Compliance and Risk management Group along with CFO and approved by CEO before being reported and approved by the Board.

### **9.3 Contingency Funding Plan**

The company plans to liquidate Murahaba funds in the event of a liquidity stress.

#### **9.3.1 Liquidity Ratio**

FALCOM has demonstrated strong liquidity position during 2015. As at 31 December 2015, the liquidity ratio (Current Assets/ Current Liabilities) was 1.15 times (**SAR 789,116,000/ SAR 681,686,000**), (2014: 1.42 times).

**End of Document**