

FALCOM Financial Services

Pillar III Disclosures
Year ended 31 December 2019

March 2020

FALCOM Pillar III Disclosures 2019

Contents

1	Overview	2	8.2	Capital Requirements	28
2	Scope of Application	3	9	Liquidity Risk	29
2.1	Scope	3	9.1	Sources of Liquidity Risk	29
2.2	Capital Transferability	4	9.2	Funding sources and Liquidity Risk Management	29
3	Capital Structure	5	9.3	Contingency Funding Plan	30
3.1	Tier 1 and Tier 2 Capital	6			
3.2	Total Capital Base	7			
4	Capital Adequacy	8			
4.1	Strategy and Approach for ICAAP	8			
4.2	Capital Requirements and Capital Adequacy Ratio	9			
5	Risk Management	13			
5.1	Risk Management Objectives	13			
5.2	Risk Management Framework	13			
6	Credit Risk	14			
6.1	Credit Risk Disclosures	15			
7	Market Risk	24			
7.1	Capital Requirements	25			
8	Operational Risk	27			
8.1	Risk Mitigation and Control	27			

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 that supplements the disclosure requirements for the Pillar III Disclosure in the PRs.
- This Pillar III Disclosure comprises both the qualitative and quantitative disclosures.
- The Board of Directors of Falcom Financial Services (FALCOM) has approved this Pillar III Disclosure 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 2018 have been obtained from Pillar III disclosure document 2018.

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 the Ministerial Resolution No. 2631 dated 10 Ramadan 1427H (corresponding to October 3, 2006). The Company operates under Commercial Registration No. 1010226584, dated 4 Dhu Al Hijjah 1427H (corresponding to December 25, 2006) in Riyadh, through its three 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:

- Act as principal and agent and provide cover.
- Manage and establish mutual funds and portfolios.
- Provide arranging services.
- Provide advisory services.
- 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 December 15, 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 Capital Transferability

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, the management on transfer of shares has imposed no other restrictions.

Statutory Restriction

As per Article 15-1 of the Articles of Association, the Company is required to transfer 10% of its net profit to establish and fund the statutory reserve before declaration of dividend until the amount of statutory reserve is equal to the half of the paid up capital of the Company, which the Company will continue to do so. While as per the Article 176 of the Saudi Companies Law, the Company is required to transfer 10% of its net profit to establish and fund the statutory reserve before declaration of dividend until the amount of statutory reserve is equal to the 30% 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 that 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 authorized and paid-in capital of the Company as of December 31, 2019 is SR 150 million (December 31, 2018: SR 150 million) divided into 15 million shares (2018: 15 million shares) of SR 10 each.
Retained Earnings	<p>This generally 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.</p> <p>During the year ended December 31, 2019, FALCOM does not have accumulated undistributed profits but have accumulated losses amounted to SAR 19.62 million.</p>
Statutory Reserve	In accordance with the Regulations for Companies in Saudi Arabia, the Company is required to set aside a statutory reserve, after absorption of accumulated losses, by the appropriation of 10% of net income until the reserve equals 30% of the share capital. This reserve is not available for distribution. Accordingly, the Company has made no transfer for the years 2019 and 2018 to the statutory reserve account as the Company incurred loss.

3.1 Tier 1 and Tier 2 Capital

The components of Tier1 and Tier 2 capital for FALCOM as of December 31, 2019 are as follows:

Capital Base	SAR '000	
	2019	2018
Tier 1 Capital		
Paid-up capital	150,000	150,000
Audited (accumulated losses) / retained earnings	(19,624)*	(5,057)
Share premium	-	-
Reserves (other than revaluation reserves)	25,118	25,119
Tier 1 capital contribution	-	-
Deductions from Tier 1 capital	-	(12,589)
Total Tier 1 Capital	155,494	157,473
Tier 2 Capital		
Subordinated loans	-	-
Cumulative preference shares	-	-
Revaluation reserves	35	-
Other deductions from Tier 2 (-)	-	-
Deduction to meet Tier 2 capital limit (-)	-	-
Total Tier 2 Capital	35	-
Total Capital Base	155,529	157,473

Capital Base	SAR '000	
	2019	2018
*Includes verified interim profit of SAR 9,197,511 as per year end audited FS.		

3.2 Total Capital Base

The total capital base of the Company net of deductions as at December 31, 2019 is SAR 155,529 (rounded to nearest thousand).

4 Capital Adequacy

FALCOM is adequately capitalized with respect to the minimum capital requirement of the Prudential Rules of the CMA i.e. the requirements for the minimum level of capital are fulfilled and FALCOM management ensures that adequate capital is retained at all times to support the risks the Company undertakes in the course of its business and its expansion plans. Capital Adequacy indicates the ability of FALCOM to ensure efficient utilization of capital in relation to its business requirements and growth, risk profile and shareholder returns and expectations.

Capital Adequacy indicates the ability of FALCOM to ensure efficient utilization of capital in relation to its business requirements and growth, risk profile and shareholder returns and expectations. The Company recognizes that earnings are the first line of defense against losses arising from business risks. However, since capital is vital to ensure continued solvency, the Company's objective is to maintain sufficient capital to ensure there is a buffer above regulatory capital adequacy requirement, in order to meet risks arising from fluctuations in asset values, business cycles, expansion and future requirements. The Company's Internal Capital Adequacy Assessment Process ("ICAAP") identifies risks that are material to its business and the capital that is required to be set aside for such risks. Since its incorporation, FALCOM's capital has increased over years by the retention of its dividends.

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; 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 whether 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 the calculation of the internal capital requirements.

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	
					2019	2018
SAR '000						
Credit Risk						
On-balance Sheet Exposures						
Governments and Central Banks		-	-	-	-	-
Administrative bodies and NPO		-	-	-	-	-
Authorized Persons and Banks		80,179	80,179	45,503	6,370	2,275
Corporates		9,425	9,425	67,293	9,421	3,897
Securitization & re-securitization		-	-	-	-	-
Margin Financing		83,896	83,896	125,844	17,618	30,274
Other Assets	1	74,559	74,559	223,694	31,317	31,068
High risk investment		-	-	-	-	-
Investment funds (underlying)		-	-	-	-	7,114
Investment funds		2,035	2,035	4,533	635	2,469

Exposure Class	Notes	Exposures before CRM	Net Exposures after CRM	Risk Weighted Assets	Capital Requirement	
					2019	2018
SAR '000						
Total On-Balance sheet Exposures		250,094	250,094	466,867	65,361	77,099
Off-balance Sheet Exposures						
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		-	-	-	-	-
Prohibited Exposure Risk Requirement		-	-	-	-	-
Total Credit Risk Exposures		250,094	250,094	466,867	65,361	77,099

Market Risk				
Risk Description	Long Position	Short Position	Capital Requirements	
			2019	2018
Interest rate risks	-	-	-	-
Equity price risks	-	-	-	759
Risks related to investment funds	13,572	-	2,171	-
Securitization/re - securitization positions	-	-	-	-
Excess exposure risks	-	-	-	-
Settlement risks and counterparty risks	-	-	-	-
Foreign exchange rate risks	93	-	2	9
Commodities risks	-	-	-	-
Total Market Risk Exposures	13,665	-	2,173	768

Operational Risk		
Risk Description	Capital Requirements	
	2019	2018
Expenditure-based approach	10,026	14,925

Summary			
	Notes	2019	2018
Minimum Capital Requirements		77,560	92,792
Surplus/(Deficit) in capital	2	77,969	64,681
Total Capital ratio (time)		2.01	1.70

Notes

- 1 Other assets include retail exposure (SAR 1,688), deferred exposure / accrued income (SAR 5,986), tangible assets (SAR 66,806), cash or gold (SAR 43) and other assets (SAR 36) [all amounts are in thousands].
- 2 This information has been extracted from the annual audited financial statements of the Company for the years ended December 31, 2019 and 2018.

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. Furthermore, the Company established a new Board of Directors committee (Risk Committee) in 2018. The Risk Committee ensures effective implementation of risk management framework across the organization. The Internal Auditor provides independent assurance that most of the risks are being measured and managed in accordance with the current 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. The Board of Directors has approved these limits. 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:

- Margin facilities to corporate clients and retail customers – both conventional and Islamic facilities
- Proprietary Investments of the Company

With respect to the margin facilities provided by the Company, a detailed policy 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.

The Compliance and Risk Management Department 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. Credit Committee reviews the approval process regularly 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 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 Impairment of financial assets

FALCOM adopted IFRS 9 – Financial Instruments from January 1, 2018. IFRS 9 replaces the ‘incurred loss’ model in IAS 39 with an ‘expected credit loss’ model (ECL). IFRS 9 requires the Company to record an allowance for ECLs for all loans and other debt financial assets not held at FVTPL, together with loan commitments and financial guarantee contracts. The allowance is based on the ECLs associated with the probability of default in the next twelve months unless there has been a significant increase in credit risk since origination, in which case, the allowance is based on the probability of default over the life of the asset. If the financial asset meets the definition of purchased or originated credit impaired (POCI), the allowance is based on the change in the ECLs over the life of the asset.

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 – 2019													2018
	Authorized persons and banks	Administrative bodies and	Margin Financing	Corporates	High risk investment	Investment fund	Listed Shares	Securitization	Real Estate	Other assets*	Off-balance sheet commitments	Total Exposure after netting and CRM	Total RWA	Total RWA
	<i>SAR '000</i>													
0%	-	-	-	-	-	-	-	-	-	43	-	43	-	-
20%	57,512	-	-	-	-	-	-	-	-	-	-	57,512	11,502	16,252
50%	-	-	-	-	-	-	-	-	-	-	-	-	-	-
100%	-	-	-	-	-	-	-	-	-	-	-	-	-	-
150%	22,667	-	83,896	-	-	1,047	-	-	-	-	-	107,610	161,415	284,697
200%	-	-	-	-	-	-	-	-	-	-	-	-	-	-
300%	-	-	-	-	-	988	-	-	-	74,480	-	75,468	226,403	221,646
400%	-	-	-	-	-	-	-	-	-	-	-	-	-	-
500%	-	-	-	-	-	-	-	-	-	-	-	-	-	-
714%	-	-	-	9,425	-	-	-	-	-	36	-	9,461	67,547	28,109
<i>Average Risk Weight</i>	45,503	-	125,844	67,293	-	4,533	-	-	-	223,694	-	466,867	466,867	550,704
<i>Deduction from Capital Base</i>	-	-	-	-	-	-	-	-	-	-	-	-	-	-

* Other assets include retail exposure (SAR 1,688), deferred exposure / accrued income (SAR 5,986), tangible assets (SAR 66,806), cash or gold (SAR 43) and other assets (SAR 36) [all amounts are in thousands]

6.1.5 Breakdown of Credit Risk

The table below provides break-up of credit exposure as follows:

	Total
2019	
Cash and cash equivalents	80,222
Investment at fair value through other comprehensive income	2,035
Islamic financing receivables	-
Margin lending and murabaha financing	83,896
Due from related parties	5,627
Prepaid expenses and accrued income	5,986
Other receivables	5,522
Property and equipment	66,806
Total	250,094
2018	
Cash and cash equivalents	81,305
Investment at fair value through other comprehensive income	34,879
Islamic financing receivables	-
Margin lending and murabaha financing	144,161
Due from related parties	3,484
Prepaid expenses and accrued income	6,378
Other receivables	3,051
Property and equipment	64,906
Total	338,164

6.1.6 Residual Contractual Maturity Breakdown

2019			
	Less than 12 months	More than 12 months	Total
	<i>SAR'000</i>		
Cash & Cash Equivalent	80,222	-	80,222
Other Receivable	5,522	-	5,522
Due from related party	5,627	-	5,627
Prepaid expenses and other assets	5,986	-	5,986
Investments at fair value	13,572	2,035	15,607
Islamic financing receivables	-	-	-
Margin lending and Murabaha financing	83,896	-	83,896
Total Assets	194,825	2,035	196,860
Accounts Payable	8,906	-	8,906
Islamic bank financing	86,784	-	86,784
Provision for Zakat	3,105	-	3,105
Employees' termination benefits	-	9,342	9,342
Total Liabilities	98,795	9,342	108,137
Net	96,030	(7,307)	88,723
2018			
	Less than 12 months	More than 12 months	Total
	<i>SAR'000</i>		
Cash & Cash Equivalent	81,305	-	81,305
Other Receivable	3,051	-	3,051
Due from related party	3,484	-	3,484
Prepaid expenses and other assets	6,378	-	6,378
Investments at fair value	14,972	34,879	49,851
Islamic financing receivables	-	-	-
Margin lending and Murabaha financing	144,161	-	144,161

Total Assets	253,351	34,879	288,230
Accounts Payable	5,453	-	5,453
Islamic bank financing	181,193	-	181,193
Provision for Zakat	1,369	-	1,369
Employees' termination benefits	-	7,648	7,648
Total Liabilities	188,015	7,648	195,663
Net	65,336	27,231	92,567

6.1.7 Past Due and Impaired Exposures

Past due but not impaired balances are less than 90 days outstanding. No Non-performing balances (2018: SR Nil) were outstanding for more than 360 days and hence no allowance for doubtful receivables was made by FALCOM as of December 31, 2019.

An assessment was carried out at the balance sheet date to determine whether there is any objective and subjective evidence that a specific financial asset or a group of financial assets may be impaired. No provision for impairment against investment at fair value through other comprehensive income (FVOCI) was recognized by the Company as of December 31, 2019 (2018: SR Nil).

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 and 6.1.8.2 below:

6.1.8.1 Short term Ratings of Counterparties

Exposure Class	Short term Ratings of counterparties							
	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	
2019								
On and Off-balance-sheet Exposures		-	-	-	-	-	-	-
Governments and Central Banks		-	-	-	-	-	-	-
Authorized Persons and Banks		57,512*	-	-	-	-	-	22,667
Corporates		-	-	-	-	-	-	9,425
Retail		-	-	-	-	-	-	1,688
Investments		-	-	-	-	-	-	-
Securitization		-	-	-	-	-	-	-
Margin Financing		-	-	-	-	-	-	83,896
Other Assets		-	-	-	-	-	-	-
Total		57,512	-	-	-	-	-	117,676

Exposure Class	Short term Ratings of counterparties							
	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	
Exposure Class	Short term Ratings of counterparties							
2018								
On and Off-balance-sheet Exposures								
Governments and Central Banks		-	-	-	-	-	-	-
Authorized Persons and Banks		81,262*	-	-	-	-	-	-
Corporates		-	-	-	-	-	-	3,899
Retail		-	-	-	-	-	-	2,598
Investments		-	-	-	-	-	-	-
Securitization		-	-	-	-	-	-	-
Margin Financing		-	-	-	-	-	-	144,161
Other Assets		-	-	-	-	-	-	-
Total		81,262	-	-	-	-	-	150,658
*Placed with banks having good credit ratings as given by the top credit rating agencies (S&P, Fitch, Moody's and Capital intelligence).								

6.1.8.2 Credit Risk Mitigation Exposure

FALCOM credit risk exposure comprises mainly of margin financing, 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		
							2019	2018	
								<i>SAR '000</i>	
On-balance Sheet Exposures									
Governments and Central Banks		-	-	-	-	-	-	-	
Administrative bodies and NPO		-	-	-	-	-	-	-	
Authorized Persons and Banks		80,179	-	-	-	-	80,179	81,262	
Corporates		9,425	-	-	-	-	9,425	3,899	
Securitization		-	-	-	-	-	-	-	
Margin Financing		83,896	-	-	-	-	83,896	144,161	
Other Assets	1	74,559	-	-	-	-	74,559	73,963	
High risk investment		-	-	-	-	-	-	-	
Listed Shares		-	-	-	-	-	-	33,878	
Investment funds		2,035	-	-	-	-	2,035	11,759	
Total On-Balance sheet Exposures		250,094	-	-	-	-	250,094	348,922	
Off-balance Sheet Exposures		-	-	-	-	-	-	-	
OTC/Credit Derivatives		-	-	-	-	-	-	-	
Repurchase agreements		-	-	-	-	-	-	-	

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		
							2019	2018	
								<i>SAR '000</i>	
Securities borrowing/lending		-	-	-	-	-	-	-	
Commitments		-	-	-	-	-	-	-	
Other off-balance sheet exposures		-	-	-	-	-	-	-	
Total Off-Balance sheet Exposures		-	-	-	-	-	-	-	
Total On and Off-Balance sheet Exposures		250,094	-	-	-	-	250,094	348,922	
Notes									
1 Other assets include retail exposure (SAR 1,688), deferred exposure / accrued income (SAR 5,986), tangible assets (SAR 66,806), cash or gold (SAR 43) and other assets (SAR 36) [all amounts are in thousands]									

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 a 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. Falcom 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

The risk that a movement in interest rates will affect 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, because 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

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

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 Company is exposed to market risk with respect to its investments and 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

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

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 Company'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	
			2019	2018
SAR '000				
	Net long	Net Short		
Interest Rate Risk	-	-	-	-
Equity Price Risk	-	-	-	759
Investment Fund Risks	13,572		2,171	
Securitisation/Re-securitisation positions	-	-	-	-
Excess exposure risk; and	-	-	-	-
Settlement Risk	-	-	-	-
Counterparty risk	-	-	-	-
Total Capital Requirement			2,171	759

7.1.2 Business Activities

Risk	Position Subject to Capital Charge		Capital Requirements	
			2019	2018
SAR '000				
	Net long	Net Short		
Foreign Exchange Rate Risk	93	-	2	9
Commodity Risk	-	-	-	-
Total Capital Requirement			2	9

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 Department. This department is responsible for identifying the potential sources of risks that can arise because 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 Department, 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.

8.2 Capital Requirements

The Company based its internal capital requirement for operational risk on the Expenditure based approach as it provides higher capital charge than capital charge under Basic Indicator Approach. The capital requirement was assessed at SAR 12,694 (amount in thousands).

8.2.1 Basic Indicator Approach

Operational Risk	Gross Operating Income			Average Gross Operating Income	Risk Capital Charge	Capital Requirement	
	2017	2018	2019			2019	2018
	SAR'000			%	SAR'000		
Basic Indicator Approach	38,666	34,282	49,364	40,771	15	6,116	11,946

8.2.2 Expenditure Based Approach

Operational Risk	Overhead Expenses (Year-1)	Average Gross Operating Income	Risk Capital Charge	Capital Requirement	
	2019			2019	2018
	SAR'000		%	SAR'000	
Expenditure Based Approach	40,103	N/A	25	10,026	14,925

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 cannot 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 sources and Liquidity Risk Management

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

- Surplus/deficit in availability of funding – in order to assess the ability to meet commitments.
- 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 liabilities. 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. Based on the budgeted cash flows and investment commitments, the finance department tracks the immediate liquidity needs of the Company on a frequent basis.

9.2.1 Liquidity Reserves

Significant portion of the assets (defined as cash in hand and banks, due from financial institutions and quoted investments) to total assets at December 31, 2019 are highly liquid in nature with a maturity period between 1 day to one month. In an adverse financial situation, the maturity period can be reduced to 1 to 5 days. FALCOM invests funds in money market instruments, which can be accessed instantly according to its needs to support the liquidity requirements of the Company.

9.2.2 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 reviewed by Compliance and Risk management Department along with CFO and approved by CEO before being reported and approved by the Board.

9.3 Contingency Funding Plan

In case of liquidity stress, management has liquidity plan to control margin lending financing and in case of severe condition, management may opt to use the Murabaha fund to place it in FALCOM.

9.3.1 Liquidity Risk – Ratio Analysis

FALCOM has demonstrated comparatively strong liquidity position during 2019. As at December 31, 2019, the liquidity ratio (Current Assets/ Current Liabilities) was 1.97 times (SAR 194,824,949 / SAR 98,795,312), (2018: 1.35 times).

End of Document