

# FALCOM Financial Services

## Pillar III Disclosures December 31, 2020

March 2021

FALCOM Pillar III Disclosures December 31, 2020

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## Glossary

BIA	Basic Indicator Approach
SA	Standardized 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
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 Capital Markets institutions (CMIs) 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 a pplication, capital, risk exposures, risk assessment processes, and hence the capital adequacy of the CMIs.
- 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 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 2019 has been obtained from Pillar III disclosure document 2019.

## **2 Scope of Application**

### **2.1 Scope**

Falcom Financial Services (the "Company"), a closed joint stock company, incorporated in the 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 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 are 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 the 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 the declaration of the dividend until the amount of statutory reserve is equal to half of the paid up capital of the Company, which the Company will continue to do so. While as per 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 the declaration of the dividend until the amount of statutory reserve is equal to 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 considered the supervisory requirements of the Prudential Rules.

FALCOM has a basic capital structure consisting of:

Capital Items	Details
Share capital	<p>The authorized and paid-in capital of the Company as of December 31, 2020 is SR 150 million (December 31, 2019: SR 150 million) divided into 15 million shares (2019: 15 million shares) of SR 10 each.</p> <p>In October 2020, a shareholder of the Company transferred his shares to Falcom Holding Company. CMA was notified about the change in shareholding of the Company which is 100% owned by Falcom Holding Company. The Company received an approval letter from CMA on November 2, 2020. The legal formalities related to updating the commercial registration and Company's by-laws are under process.</p>
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, 2020, FALCOM's verified interim profit amounted to SAR 36.9 million. And the Company's accumulated undistributed profits amounted to SAR 10.8. However, the BOD has decided to distribute cash dividends of SAR 22.5 million. Additionally, based on the board of directors' recommendation on September 29, 2020 and shareholder's approval during the annual general assembly meeting on December 15, 2020 the accumulated losses as of December 31, 2019 amounting to SAR 19.62 million have been absorbed against the statutory reserves during 2020.</p>
Statutory Reserve	<p>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. Based on the board of directors' recommendation on September 29, 2020 and shareholder's approval during the annual general assembly meeting on December 15, 2020 the accumulated losses as of December 31, 2019 amounting to SAR 19.62 million have been absorbed against the statutory reserves during 2020.</p>

### 3.1 Tier 1 and Tier 2 Capital

The components of Tier1 and Tier 2 capital for FALCOM as of December 31, 2020 are as follows:

<b>Capital Base</b>	<b>SAR '000</b>	
	<b>2020</b>	<b>2019</b>
Tier 1 Capital		
Paid-up capital	150,000	150,000
Audited retained earnings / (accumulated losses) *	10,781	(19,624)
Share premium	-	-
Reserves (other than revaluation reserves)	9,192	25,118
Tier 1 capital contribution	-	-
Deductions from Tier 1 capital	-	-
<b>Total Tier 1 Capital</b>	<b>169,973</b>	<b>155,494</b>
Tier 2 Capital		
Subordinated loans	-	-
Cumulative preference shares	-	-
Revaluation reserves	80	35
Other deductions from Tier 2 (-)	-	-
Deduction to meet Tier 2 capital limit (-)	-	-
<b>Total Tier 2 Capital</b>	<b>80</b>	<b>35</b>
<b>Total Capital Base</b>	<b>170,053</b>	<b>155,529</b>
*Includes verified interim profit of SAR 36,978 thousand as per year end audited FS, after the BOD has decided to distribute cash dividends of SAR 22,5 million.		



## 3.2 Total Capital Base

The total capital base of the Company net of deductions as of December 31, 2020 is SAR 170,053 (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's 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.

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 of the 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 the 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's reported risk profile and make necessary adjustments to the Company's strategic plan accordingly.

The Company's Capital Management is aimed at maintaining an 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	
					2020	2019
SAR '000						
<b>Credit Risk</b>						
<b>On-balance Sheet Exposures</b>						
Governments and Central Banks		-	-	-	-	-
Administrative bodies and NPO		-	-	-	-	-
CMLs and Banks		39,669	39,669	7,934	1,111	6,370
Corporates		10,279	10,279	73,393	10,275	9,421
Securitization & re-securitization		-	-	-		-
Margin Financing		274,859	274,859	412,288	57,720	17,618
Other Exposures	1	80,581	80,581	241,767	33,847	31,317
High risk investment		-	-	-		-
Investment funds (underlying)		-	-	-		-
Investment funds		5,913	5,913	10,352	1,449	635
Total On-Balance Sheet Exposures		411,301	411,301	745,734	104,402	65,361
<b>Off-balance Sheet Exposures</b>						
OTC/Credit Derivatives		-	-	-	-	-
Repurchase agreements		-	-	-	-	-
Securities borrowing/lending		-	-	-	-	-

Exposure Class	Notes	Exposures before CRM	Net Exposures after CRM	Risk Weighted Assets	Capital Requirement	
					2020	2019
<b>SAR '000</b>						
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		411,301	411,301	745,734	104,402	65,361

<b>Market Risk</b>					
Risk Description	Long Position	Short Position	Capital Requirements		
			2020	2019	
Interest rate risks	-	-	-	-	
Equity price risks	-	-	-	-	
Risks related to investment funds	5,591	-	895	2,171	
Securitization/re - securitization positions	-	-	-	-	
Excess exposure risks	-	-	-	-	
Settlement risks and counterparty risks	-	-	-	-	
Foreign exchange rate risks	122	-	2	2	
Commodities risks	-	-	-	-	
Total Market Risk Exposures	5,713	-	897	2,173	

<b>Operational Risk</b>		
<b>Risk Description</b>	<b>Capital Requirements</b>	
	<b>2020</b>	<b>2019</b>
Expenditure Based Approach	14,111	10,026

<b>Summary</b>			
	<b>Notes</b>	<b>2020</b>	<b>2019</b>
Minimum Capital Requirements		119,410	77,560
Surplus/(Deficit) in capital	2	50,643	77,969
Total Capital ratio (time)		1.42	2.01

Notes

- 1 Other Exposures include retail exposure (SAR 3,209), deferred expenditure / accrued income (SAR 11,371), tangible assets (SAR 65,921), cash or gold (SAR 43) and other assets (SAR 37) [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, 2020 and 2019.

## **5 Risk Management**

### **5.1 Risk Management Objectives**

FALCOM assumes a variety of risks in undertaking its business activities. The objective of the Risk Management 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 to protect asset values and income streams. FALCOM can 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. 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 levels.

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

Concerning the margin facilities provided by the Company, a detailed policy covers the parameters that should be considered before 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 & 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.

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

In terms of the proprietary investment portfolio, the Company invests after obtaining appropriate approvals from the Board of the Company, based on the recommendations from the Investment Committee. The approval process is well-organized, and proper due diligence is performed while executing the 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 material 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 standard approach prescribed under the Pillar I requirements of the CMA Prudential Rules to calculate regulatory capital for the credit risk exposure.

### **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 calculate the ECLs for all loans and other debt financial assets not held at FVTPL, together with loan commitments and financial guarantee contracts, and adjust the ECL provision at the reporting date. The provision 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 provision 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 provision 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, an impairment loss is recognized in the statement of income. For assets carried at cost, impairment is determined as the 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 the table below:

Risk Weights	Exposures after Netting and Credit Risk Mitigation – 2020														2019
	Government and Central	CMI and banks	Administrative bodies and	Margin Financing	Corporates	High risk investment	Investment fund	Listed Shares	Securitization	Real Estate	Other Exposures *	Off-balance sheet commitments	Total Exposure after netting and CRM	Total RWA	Total RWA
	SAR '000														
0%	-	-	-	-	-	-	-	-	-	-	43	-	43	-	-
20%	-	39,669	-	-	-	-	-	-	-	-	-	-	39,669	7,934	11,502
50%	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-
100%	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-
150%	-	-	-	274,859	-	-	4,925	-	-	-	-	-	279,785	419,672	161,415
200%	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-
300%	-	-	-	-	-	-	988	-	-	-	80,501	-	81,492	244,473	226,403
400%	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-
500%	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-
714%	-	-	-	-	10,279	-	-	-	-	-	37	-	10,316	73,655	67,547
Average Risk Weight	-	7,934	-	412,288	73,393	-	10,352	-	-	-	241,767	-	411,305	745,734	466,867
Deduction from Capital Base	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-

\* Other Exposures include retail exposure (SAR 3,209), deferred expenditure / accrued income (SAR 11,371), tangible assets (SAR 65,921), cash or gold (SAR 43) and other assets (SAR 37) [all amounts are in thousands].

6.1.5 Breakdown of Credit Risk

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

	<b>Total</b>
<b>2020</b>	
Cash and cash equivalents	39,712
Investment at fair value through other comprehensive income	2,080
Investment at fair value through statement of income (FVSI) non-current	3,833
Islamic financing receivables	-
Margin lending and Murabaha financing	274,859
Due from related parties	6,695
Prepaid expenses and accrued income	11,373
Other receivables, net*	6,828
Property and equipment	65,921
<b>Total</b>	<b>411,301</b>
<b>2019</b>	
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
<b>Total</b>	<b>250,094</b>

\*The Company has built a provision for other account receivables that amounted to SAR 575,000 as of December 31, 2020.

6.1.6 Residual Contractual Maturity Breakdown

<b>2020</b>			
	<b>Less than 12 months</b>	<b>More than 12 months</b>	<b>Total</b>
	<i>SAR'000</i>		
Cash & Cash Equivalent	39,712	-	39,712
Other Receivable	6,828	-	6,828
Due from related parties	6,695	-	6,695
Prepaid expenses and other assets	11,373	-	11,373
Investments at fair value	5,591	5,914	11,505
Islamic financing receivables	-	-	-
Margin lending and Murabaha financing	274,859	-	274,859
<b>Total Assets</b>	<b>345,058</b>	<b>5,914</b>	<b>350,972</b>
Accounts Payable	22,336	-	22,336
Due to a related party	211,310	-	211,310
Provision for Zakat	2,894	-	2,894
Employees' termination benefits	-	10,299	10,299
<b>Total Liabilities</b>	<b>236,540</b>	<b>10,299</b>	<b>246,839</b>
<b>Net</b>	<b>108,518</b>	<b>(4,385)</b>	<b>104,133</b>

<b>2019</b>			
	<b>Less than 12 months</b>	<b>More than 12 months</b>	<b>Total</b>
	<i>SAR'000</i>		
Cash & Cash Equivalent	80,222	-	80,222
Other Receivable	5,522	-	5,522
Due from related parties	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
<b>Total Assets</b>	<b>194,825</b>	<b>2,035</b>	<b>196,860</b>

	<b>2019</b>		
	<b>Less than 12 months</b>	<b>More than 12 months</b>	<b>Total</b>
	<i>SAR'000</i>		
Accounts Payable	8,906	-	8,906
Due to a related party	86,784	-	86,784
Provision for Zakat	3,105	-	3,105
Employees' termination benefits	-	9,342	9,342
<b>Total Liabilities</b>	<b>98,795</b>	<b>9,342</b>	<b>108,137</b>
<b>Net</b>	<b>96,030</b>	<b>(7,307)</b>	<b>88,723</b>

#### 6.1.7 Performing, Under- performing and Impaired Exposures

**Performing exposures:** these represent the financial assets where customers have a low risk of default and a strong capacity to meet contractual cashflows, the balances which are less than 60 days past due.

**Under- performing:** these represent the financial assets where there is a significant increase in credit risk but not impaired yet, the balances have 61-89 days past due.

**Impaired exposures:** these represent defaulted financial assets; the customers fail to make contractual payments within 90 days after they fall due. Non-performing balances amounted to SAR 575 thousand as of Dec 31, 2020 were outstanding for more than 360 days and the Company's has built full provision amounted to SAR 575 thousand.

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, 2020 (2019: SR Nil).

#### 6.1.8 Credit Risk Protection

Exposure amounts before and after credit risk protection associated with each credit quality step in regard to non-trading activities, as well as the exposure amounts that are deducted from the 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	
2020								
<b>On and Off-balance-sheet Exposures</b>		-	-	-	-	-	-	-
Governments and Central Banks		-	-	-	-	-	-	-
CMLs and Banks		39,669*	-	-	-	-	-	-
Corporates		-	-	-	-	-	-	10,279
Retail		-	-	-	-	-	-	3,209
Investments		-	-	-	-	-	-	-
Securitization		-	-	-	-	-	-	-
Margin Financing		-	-	-	-	-	-	274,859
Other Assets		-	-	-	-	-	-	-
<b>Total</b>		<b>39,669</b>	-	-	-	-	-	<b>288,347</b>
Exposure Class	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		<b>57,512</b>	-	-	-	-	-	<b>117,676</b>
*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 are provided in the 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	
							2020	2019
<i>SAR '000</i>								
<b>On-balance Sheet Exposures</b>								
Governments and Central Banks		-	-	-	-	-	-	-
Administrative bodies and NPO		-	-	-	-	-	-	-
CMLs and Banks		39,669	-	-	-	-	39,669	80,179
Corporates		10,279	-	-	-	-	10,279	9,425
Securitization		-	-	-	-	-	-	-
Margin Financing		274,859	-	-	-	-	274,859	83,896
Other Exposures	<i>1</i>	80,583	-	-	-	-	80,583	74,559
High risk investment		-	-	-	-	-	-	-
Listed Shares		-	-	-	-	-	-	-
Investment funds		5,914	-	-	-	-	5,914	2,035
<b>Total On-Balance Sheet Exposures</b>		<b>411,304</b>	-	-	-	-	<b>411,304</b>	<b>250,094</b>
<b>Off-balance Sheet Exposures</b>								
OTC/Credit Derivatives		-	-	-	-	-	-	-
Repurchase agreements		-	-	-	-	-	-	-
Securities borrowing/lending		-	-	-	-	-	-	-
Commitments		-	-	-	-	-	-	-
<b>Other off-balance sheet exposures</b>		-	-	-	-	-	-	-
<b>Total Off-Balance Sheet Exposures</b>		-	-	-	-	-	-	-
<b>Total On and Off-Balance Sheet Exposures</b>		<b>411,304</b>	-	-	-	-	<b>411,304</b>	<b>250,094</b>

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	
							2020	2019
							<b>SAR '000</b>	
Notes								
1 Other Exposures include retail exposure (SAR 3,209), deferred expenditure / accrued income (SAR 11,371), tangible assets (SAR 65,921), cash or gold (SAR 43) and other assets (SAR 37) [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 is 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 changes 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 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 are 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	
			2020	2019
SAR '000				
	Net long	Net Short		
Interest Rate Risk	-	-	-	-
Equity Price Risk	-	-	-	-
Investment Fund Risks	5,591	-	895	2,172
Securitisation/Re-securitisation positions	-	-	-	-
Excess exposure risk; and	-	-	-	-
Settlement Risk	-	-	-	-
Counterparty risk	-	-	-	-
Total Capital Requirement			895	2,172

### 7.1.2 Business Activities

Risk	Position Subject to Capital Charge		Capital Requirements	
			2020	2019
SAR '000				
	Net long	Net Short		
Foreign Exchange Rate Risk	122	-	2	2
Commodity Risk	-	-	-	-

Risk	Position Subject to Capital Charge	Capital Requirements	
		2020	2019
		SAR '000	
Total Capital Requirement		2	2

## 8 Operational Risk

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

Currently, FALCOM uses the capital calculated under the Basic Indicator Approach (BIA) as well as the Expenditure Based Approach (whichever is higher) for calculating its internal capital requirement for operational risk. The Company has established guidelines that 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 Risk Management Department and the compliance Department. Risk Management department is responsible for identifying the potential sources of risks that can arise because of the different 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. Compliance departments is responsible for identifying and dealing with all compliance risks and monitoring all relevant developments, it is also responsible for reporting any irregularities and/ or violations to the risk and compliance committee.
- The third line of defense is Audit. The Company's internal audit is responsible for assessing compliance with the policies, regulations and for providing an independent evaluation of the adequacy and effectiveness of the Risk Management Frameworks. The Internal Auditor reports to the Board Audit Committee.

In addition to the above frameworks, 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 how 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 14,111 (amount in thousands).

### 8.2.1 Basic Indicator Approach

Operational Risk	Gross Operating Income			Average Gross Operating Income	Risk Capital Charge	Capital Requirement	
	2018	2019	2020			2020	2019
	SAR'000			%	SAR'000		
Basic Indicator Approach	34,282	49,364	95,200	59,615	15	8,942	6,116

### 8.2.2 Expenditure Based Approach

Operational Risk	Overhead Expenses (Year-1)	Average Gross Operating Income	Risk Capital Charge	Capital Requirement	
	2020			2020	2019
	SAR'000		%	SAR'000	
Expenditure Based Approach	56,442	N/A	25	14,111	10,026

## 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 of 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 a 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 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 to assess the Company's ability to maintain adequate cashflow positions 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 the availability of funding – in order to assess the ability to meet commitments.
- Residual contractual mismatch – in order to assess the mismatch in the 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

A 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, 2020 are highly liquid in nature with a maturity period between 1 day to three months. 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 a set of scenarios and assumptions that are used on an annual basis to measure liquidity risk over a 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 a periodic basis. It is then reviewed by the 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 a liquidity plan to control margin lending financing and in case of a severe condition, Management may opt to use the Murabaha fund to place it in FALCOM or use bank financing.

#### 9.3.1 Liquidity Risk – Ratio Analysis

FALCOM has demonstrated comparatively a decrease in the liquidity position during 2020. As at December 31, 2020, the liquidity ratio (Current Assets/ Current Liabilities) was 1.46 times (SAR 345,058,000 / SAR 236,540,000), (2019: 1.97 times).

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