# First Security Islami Bank Ltd.
# Disclosure on Risk Based Capital under Basel II
# Risk Based Capital Adequacy as on 31.12.2013

## Risk Management

### Capital Management

The Bank's capital management approach is driven by its desire to maintain a strong capital base to support the development of its business, to meet regulatory capital requirements at all times and to maintain good credit ratings. Strategic business and capital plan ensure that adequate levels of capital and an optimum mix of the different components of capital are maintained by the Bank to support the strategy. The capital plan takes the following into account:

- regulatory capital requirements;
- forecast demand for capital to support the credit ratings;
- increases in demand for capital due to business growth, market shocks or stresses;
- available supply of capital and capital raising options; and
- Internal controls and governances for managing the Bank's risk and performance.

The Bank assesses the capital demand for material risks, and supports its internal capital adequacy assessment. Each material risk is assessed; relevant risk mitigation is considered and an appropriate level of capital is determined. The capital adequacy is a key part of the Bank's management disciplines.

**Pillar–2** (Supervisory Review Process) intends to ensure that the banks have adequate capital to address all the risks in the business commensurate with Bank's risk profile and control environment. As required, the bank has put in place a Board approved policy on Internal Capital Adequacy Assessment Process (ICAAP).

**Pillar-3** refers to market discipline. As directed by the Risk Based Capital Adequacy (RBCA) guidelines on Basel II framework, a set of disclosures (both qualitative & quantitative) as per Basel-II guideline are annexed with regard to risk management in the bank, which will enable market participants to access key information on the scope of application, capital risk exposures, risk assessment processes, bank's risk profile and level of capitalization etc. This would also provide the market participants with the necessary data to evaluate the performance of the bank in various parameters.

# (a) Scope of Application

**Qualitative Disclosures:**

| | | |
|---|---|---|
| **a)** | The name of the top corporate entity in the group to which this guidelines applies | First Security Islami Bank Limited (FSIBL) |
| **b)** | An outline of differences in the basis of consolidation for accounting and regulatory purposes, with a brief description of the entities*1 within the group (a) that are fully consolidated; (b) that are given a deduction treatment; and (c) that are neither consolidated nor deducted (e.g. where the investment is risk-weighted). | The Financial Statement of the bank includes the financial statements of (i) First Security Islami Bank Limited and (ii) First Security Islami Capital & Investment Limited.<br><br>A brief description of the Bank and its subsidiary is given below:<br><br>**<u>First Security Islami Bank Limited</u>**<br>The First Security Islami Bank Limited (FSIBL)' was incorporated in Bangladesh on 29th August 1999 as a banking company under Companies Act 1994 to carry on banking business. It obtained permission from Bangladesh Bank on 22 September 1999 to commence its business. The Bank went for public issue on 20th July 2008. The Bank converted its banking operation into Islamic Banking based on Islamic Shari´ah from traditional banking operation on 01st January 2009 after obtaining approval from honorable High Court, Ministry of Finance and Bangladesh Bank. Presently the Bank is operating its business through head office having 117 branches including 05 (Five) Agri branches, 55 (Fifty Five) ATM booths (Own) and 2369 employees all over Bangladesh. The Bank is listed with both the Stock Exchanges of the country, i.e. Dhaka Stock Exchange Limited (DSE) and Chittagong Stock Exchange Limited (CSE).<br>The principal activities of the bank are all kinds of commercial banking services to its customers through its branches following the provisions of the Bank Companies Act 1991, Bangladesh Bank´s Directives and the principles of the Islamic Shari´ah. |

| | | |
|---|---|---|
| | | **First Security Islami Capital & Investment <u>Limited</u>.**<br>First Security Islami Capital & Investment Limited a private company limited by shares has been formed and registered under the Companies Act, 1994 with the Registrar of Joint Stock Companies, Dhaka vide certificate of incorporation No. C- 88567/10 dated 02nd December 2010. The Securities and Exchange Commission vide its certificate No. MB-65/2011 dated 27 March 2011 has accorded approval to the bank for a full fledged Merchant Banking operation under the Securities and Exchange Commission Act, 1993. The First Security Islami Bank Limited holds 51% shares and 49% shares are held by other individuals. The company's reporting period is January To December. The main objective of the company is carry on business of stock broker/dealers in relation to shares and securities dealings and other services as mentioned in the Memorandum and Articles of Association of the Company. |
| **c)** | Any restrictions, or other major impediments, on transfer of funds or regulatory capital within the group | Not applicable. |

**Quantitative Disclosures:**

| | | |
|---|---|---|
| **d)** | The aggregate amount of capital deficiencies*2 in all subsidiaries not included in the consolidation that are deducted and the name(s) of such subsidiaries. | There is no deficiency of the Capital in any Subsidiary. |

# b) Capital Structure

**Qualitative Disclosures:**

| | | |
|---|---|---|
| a) | Summary information on the terms and conditions of the main features of all capital instruments, especially in the case of capital instruments eligible for inclusion in Tier 1 or in Tier 2. | Bangladesh Bank has issued guideline for issuing subordinated debt. In accordance with that guideline, We have already issued Mudaraba Subordinated Debt/ Bond to the tune of Tk. 250.00 (Two Hundred Fifty) crore which has been included in Tier 2 Capital. |

**Quantitative Disclosures:** **Taka in Crore**

**Eligible Capital**
**As on 31 December 2013**

| **1. Tier-1 (Core Capital )** | | **Solo** | Cons |
|---|---|---|---|
| 1.1 | Fully Paid-up Capital/Capital Deposited with BB | 411.44 | 411.44 |
| 1.2 | Statutory Reserve | 131.04 | 131.04 |
| 1.3 | Non-repayable Share premium account | - | - |
| 1.4 | General Reserve | 11.40 | 11.40 |
| 1.5 | Retained Earnings | 50.24 | 50.64 |
| 1.6 | Minority interest in Subsidiaries | - | 17.54 |
| 1.7 | Non-Cumulative irredeemable Preferences shares | - | |
| 1.8 | Dividend Equalization Account | - | |
| 1.9 | Other (if any item approved by Bangladesh Bank) | - | |
| 1.9 | **Sub-Total: (1.1 to 1.8)** | **604.12** | **622.06** |
| **Deductions from Tier-1 (Core Capital )** | | - | - |
| 1.10 | Book value of Goodwill and value of any contingent assets which are shown as assets | | |
| 1.11 | Shortfall in provisions required against classified assets irrespective of any relaxation allowed | - | |
| 1.12 | Deficit on account of revaluation of investment in AFS Category | - | |
| 1.13 | Shortfall in provisions required against investment in Shares | 8.61 | 8.61 |
| 1.14 | Any investment in TFCs of other banks exceeding the prescribed limit | - | |
| 1.15 | Eligible Capital | - | |
| 1.16 | **Sub Total (1.10-1.16)** | **-** | |
| 1.17 | **Total Eligible Tier-1 Capital (1.9-1.16)** | **595.51** | **613.45** |

**Taka in Crore**

| | 2 .Tier-2 (Supplementary Capital) | Solo | Cons |
|---|---|---|---|
| 2.1 | General Provision (Unclassified loans +SMA+ off Balance Sheet exposure) Limited to 1.25% of RWA | 132.34 | 132.34 |
| 2.2 | Assets Revaluation Reserves up to 50% | 19.62 | 19.62 |
| 2.3 | Revaluation Reserves for Securities up to 50% | - | - |
| 2.4 | Revaluation Reserve for equity instruments up to 10% | - | - |
| 2.5 | All other preference shares | - | - |
| 2.6 | Subordinated debt | 178.65 | 184.04 |
| 2.7 | Other (if any item approved by Bangladesh Bank) | - | - |
| **2.8** | **Sub-Total (2.1 to 2.7)** | **330.61** | **336.00** |
| 2.9 | Deductions if any | - | - |
| 2.10 | **Total Eligible Tier-2 Capital (2.6-2.7)** | **330.61** | 336.00 |

| | 3. Tier-3 (eligible for market risk only) | Solo | Cons |
|---|---|---|---|
| 3.1 | Short-term subordinated debt | - | - |
| | | | |
| 4.0 | Total Supplementary Capital (2.10+3.1)<br>(Maximum up to 100% of Total eligible tier-1 Capital) | **330.61** | 336.00 |
| | **5.Total Eligible Capital (1.17+4)** | **926.12** | **949.45** |

# c) Capital Adequacy

**Qualitative Disclosures:**

a. **A summary discussion of the bank's approach to assessing the adequacy of its capital to support current and future activities:**

As banks in Bangladesh are now in a stage of developing risk management models, Bangladesh Bank suggested the banks for using Standardized Approach for credit risk capital requirement for banking book and Standardized (rule based) Approach for market risk capital charge in their trading book. FSIBL used the Basic Indicator Approach (BIA), as prescribed by Bangladesh Bank in determining capital charge against operational risk. Under the Basic Indicator Approach (BIA), the capital charge for operational risk is a fixed percentage (denoted by alpha) of average positive annual gross income of the bank over the past three years.

**Quantitative Disclosures:** **Taka in Crore**

| Sl. No. | Particulars | Solo | Cons |
|---|---|---|---|
| a. | Capital requirement for Credit Risk | 851.17 | 850.19 |
| b. | Capital requirement for Market Risk | 10.78 | 15.99 |
| c. | Capital requirement for Operational Risk | 52.38 | 52.97 |
| d. | Total and Tier 1 capital ratio (For the consolidated group and for stand alone) | | |
| | **Total CAR** | **10.13%** | **10.33%** |
| | **Tier-I CAR** | **6.51%** | **6.67%** |
| | **Tier-II CAR** | **3.62%** | **3.66%** |

# d) Investment (Credit Risk)

**Qualitative Disclosures:**

**1. Investment (Credit) Risk:**

Investment (Credit) risk is the risk of loss that may occur from the failure of any counterparty to abide by the terms and conditions of any financial contract with the Bank, principally the failure to make required payments. Investment (Credit) Risk is broadly the possibility of losses associated with iminution in the credit quality of borrowers or counterparties.

Investment (Credit) Risk or default risk involves inability or unwillingness of a customer or counterparty to meet commitments in relation to investing, trading, settlement and other financial transactions. The Investment (Credit) Risk is generally made up of transaction risk or default risk and portfolio risk.

Past due is the unsecured portion of any claim or exposure (other than claims secured by residential property) that is past due for 90 days or more, net of specific provisions (including partial write-off). For the purpose of defining the net exposure of the past due investment, eligible financial collateral (if any) may be considered for Investment (Credit) Risk Mitigation. General provision maintained against Special Mention Account (SMA) investment will not be eligible for such net off.

**2. Investment (Credit) Risk Management Policies**

Credit risk is one of the major risks faced by the Bank. This can be described as potential loss arising from the failure of a counter party to perform according to contractual arrangement with Bank. The failure may arise due to unwillingness of the counter party or decline in economic condition etc. Bank's risk management has been designed to address all these issue.

FSIBL recognizes the importance in having effective risk management systems to address these risks. The system involves a framework for measuring and monitoring profit rate, liquidity, investment and foreign currency risk on a continuous basis. It involves the assessment of the risk and altering the assets and liability portfolio to confirm to exposure and tolerance levels set by the management committee.

**Quantitative Disclosures:**

| SL.No. | Particulars | Figure in Crore |
|---|---|---|
| 1 | Total gross Investment (Credit) risk exposures, Fund based and Non-fund based separately. | |
| | 1.1 Fund Based | 11460.18 |
| | 1.2 Non Fund Based | 1186.56 |
| 2 | Geographic distribution of exposures | |
| | 2.1 Overseas: | - |
| | 2.1.1 Fund Based | - |
| | 2.1.2 Non-Fund Based | - |
| | 2.2 Domestic: | - |
| | 2.2.1 Fund Based | 11460.18 |
| | 2.2.2 Non-Fund Based | 1186.56 |
| 3 | Amount of Non Performing Assets (NPAs) | |
| | 3.1 SMA | 2.97 |
| | 3.2 Substandard | 85.09 |
| | 3.3 Doubtful | 24.12 |
| | 3.4 Bad & Loss | 139.17 |
| 4 | Non Performing Assets (NPAs) to outstanding Investments | 2.17% |
| 5 | Movement of Non Performing Assets (NPAs) | |
| | 5.1 Opening balance | 178.54 |
| | 5.2 Additions | 82.24 |
| | 5.3 Reductions | 12.40 |
| | 5.4 Closing balance | 248.38 |
| 6 | Movement of specific provisions for NPAs | |
| | 6.1 Opening balance | 79.00 |
| | 6.2 Provisions made during the period | 21.51 |
| | 6.3 Write-off/Write-back of excess provisions | - |
| | 6.4 Recovery from write-off | - |
| | 6.5 Closing Balance | 100.51 |

# e) Equity Position Risk

**Qualitative Disclosures:**

**Equity risk:** Equity risk is the risk that one's investments will depreciate because of stock market dynamics causing one to lose money. The capital charge for equities would apply on their current market value in bank's trading book. This capital charge for both specific risk and the general market risk will be at the rate of the required minimum capital adequacy ratio. This is applied to all instruments that exhibit market behavior similar to equities. The instruments covered include equity shares, whether voting or non-voting, convertible securities that behave like equities, for example: units of mutual funds, and commitments to buy or sell equity.

**Quantitative Disclosures:**

**Bank's Holdings of Shares**

| Sl. No. | Particulars | Market Value of Shares | Total Liabilities | % of value of shares to Total Liabilities |
|---|---|---|---|---|
| a) | Own Portfolio | 68.34 | | 0.44% |
| b) | Market value of lien ed shares | - | | |
| c) | Custody | - | | |
| | **Total Holdings** | **68.34** | | |

**Capital requirements for equity position risk:**

| Sl. No. | Particulars | Amount (Market Value) | | Weight | Capital Charge | |
|---|---|---|---|---|---|---|
| | 1 | 2 | | 3 | 4=(2X3) | |
| | | **Solo** | Cons | | **Solo** | Cons |
| a) | Specific Risk : | 42.31 | 68.34 | 0.10 | 4.23 | 6.83 |
| b) | General Market Risk: | 42.31 | 68.34 | 0.10 | 4.23 | 6.83 |
| | **Total** | **84.62** | **136.68** | | **8.46** | **13.66** |

# f) Profit Rate Risk

**Qualitative Disclosures:**

**Profit Rate Risk in the Banking Book:**

Profit Rate Risk is the risk which affects the Bank's financial condition due to changes in the market Profit rates. Changes in Profit rates affect both the current earnings (earnings perspective) as also the net worth of the Bank (economic value perspective). The risk from earnings perspective can be measured as impact in the Net Investment Income (NII) or Net Investment Margin (NIM). Similarly, the risk from economic value perspective can be measured in the Economic Value of Equity (EVE).

The Bank identifies the risks associated with the changing Profit rates from short term (Earnings perspective). The impact on income (Earnings perspective) is measured through use of Gap analysis by applying notional rate shock.

# g) Market Risk

**Qualitative Disclosures:**

Trading book consists of positions in financial instruments held with trading intent. A capital charge is applicable for financial instruments which are free from any restrictive covenants on tradability in line with Basel II guidelines issued by Bangladesh Bank.

**Market Risk:**
Market Risk is defined as the possibility of loss to a Bank caused by changes/movements in the market variables such as Profit rates, foreign currency exchange rates, equity prices and commodity prices. The objective of the market risk management is to minimize the impact of losses on earnings and equity.

**Policies for Management of Market Risk:**

The policies set various risk limits for effective management of Market Risk and ensuring that the operations are in line with Bank's expectation of return to market risk through proper Asset Liability Management.

Asset Liability Management is the key success of any financial intermediary especially for Banks. Asset Liability Committee (ALCO) of the Bank monitors Balance Sheet Risk and liquidity risks of the bank. The Balance Sheet Risk encompasses most part of the Asset Liability risk and deal with change in earnings due to change in rate of profit, foreign exchange rates which are not of trading nature on the other hand, liquidity risk can be defined as the risk or chance of failure to meet up any withdrawal /disbursement request by a counterparty/customer. Asset Liability Committee (ALCO) reviews Liquidity requirement of the bank, the maturity of assets and liabilities, deposits and investments pricing strategy and the Liquidity contingency plan. The primary objective of the Asset Liability Committee (ALCO) is to monitor and avert significant volatility in Net Investments Income (NII), investment value and exchange earnings for the purpose of taking future action plan for better interest of the organization.

**Quantitative Disclosures:**

| | **The Capital Requirements for** | **Solo** | Cons |
|---|---|---|---|
| 1 | 1.1 Profit (Interest) rate risk | - | - |
| | 1.2 Equity position risk | 8.46 | 13.67 |
| | 1.3 Foreign exchange risk | 2.32 | 2.32 |

## h) Operational Risk

**Qualitative Disclosures:**

Operational risk is FSIBL's exposure to potential losses that may be caused from inadequate internal processes or systems, inadequate employee performance, external events and may also cause from the breach of compliance, contracts or internal regulation.

### Operational Risk includes:

- IT (back up), interface, information and other system failures and deficiencies, including viruses.
- Confidentiality or security breaches
- human error
- fraud and theft
- weakness in internal controls/supervision
- physical disasters involving people, premises or equipment
- delivery failures
- regulatory/ compliance requirements
- third party payments

**Quantitative Disclosures:**

In line with the final guidelines issued by Bangladesh Bank, the Bank has adopted the Basic Indicator Approach for computing capital for operation risk.

As per the guidelines, the capital for operational risk is equal to 15% of average positive annual Gross Income of the previous three years, as defined by the Bangladesh Bank.

| **Year** | **Gross Income (GI)** | **Average (GI)** | **Capital charge @ 15% of Average Gross Income** |
|---|---|---|---|
| 2013 | 424.80 | 353.14 | 52.97 |
| 2012 | 369.01 | | |
| 2011 | 265.61 | | |
| **Total** | **1059.42** | | |

**END**