

**Disclosures under Pillar-III Market Discipline as on 31 December 2017**

**Background:** These disclosures under Pillar III are made following “Prudential Guidelines on Capital Adequacy and Market Discipline” (CAMD) for Financial Institutions (FIs) issued by Bangladesh Bank in December 2011. These qualitative and quantitative disclosures are intended to comply the Minimum Capital Requirement (MCR) under Pillar I and Supervisory Review Process (SRP) under Pillar II of Basel II. The purpose of these disclosures is to present relevant information on adequacy of capital in relation to overall risk exposures of First Finance Limited (FFL) so that the market participants can assess the position and direction of FFL in making economic decisions.

**A) Scope of Application:**

**Qualitative Disclosures:**

- a) The framework applies to First Finance Limited on the reporting date i.e. 31 December 2017. As there is no subsidiary of this company, the solo basis information has been presented here.
- b) Any restrictions or other major impediments on transfer of funds or regulatory capital within the group:
  - Not applicable.

**Quantitative Disclosures:**

- c) The aggregate amount of capital deficiencies in all subsidiaries not included in the consolidation that are deducted and the name(s) of such subsidiaries.
  - Not applicable.

**B) Capital Structure:**

- (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.

- **Tier 2 Capital includes:**

- i) General provision up to a limit of 1.25% of Risk Weighted Asset (RWA) for Credit Risk;
- ii) Revaluation reserves:
  - 50% Revaluation reserve for fixed assets;
  - 45% Revaluation reserve for securities;
- iii) All other preference shares.

- **Conditions for maintaining regulatory capital:**

The calculation of Tier 1 capital, and Tier 2 capital shall be subject to the following conditions:



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- i) The amount of Tier 2 capital will be limited to 100% of the amount of Tier 1 capital.
- ii) 50% of revaluation reserves for fixed assets and 45% of revaluation reserves for securities are eligible for Tier 2 capital.

**Quantitative Disclosures:**

(b) The amount of Tier 1 capital, with separate disclosure of:

Particulars	Amount in crore Taka
Paid Up Capital	116.22
Non-Repayable share premium account	-
Statutory Reserve	34.30
General Reserve	-
Retained Earnings	(24.13)
Minority Interests in subsidiaries	-
Non-cumulative irredemable preference shares	-
Dividend equalization account	-
<b>Total Tier 1 capital</b>	<b>126.39</b>

(C) The total amount of Tier 2 capital	10.18
(d) Other deductions from capital	-
(e) Total eligible capital	136.57

**C) Capital Adequacy**

**Qualitative Disclosures**

(a) A summary discussion of the FI's approach to assessing the adequacy of its capital to support current and future activities.

**• Risk Weighted Assets (RWA) and Capital Adequacy Ratio (CAR)**

First Finance Limited has adopted Standardized Approach for computation of Capital Charge for Credit Risk and Market Risk while Basic Indicator Approach for Operational Risk. Total Risk Weighted Assets (RWA) of the Company is determined by multiplying the capital charge for market risk and operational risk by the reciprocal of the minimum capital adequacy ratio i.e. 10% and adding the resulting figures to the sum of risk weighted assets for credit risk. Total RWA is then used as denominator while total Eligible Regulatory Capital as on numerator to derive Capital Adequacy Ratio.

**Strategic actions for the achievement of capital adequacy**

**Immediate actions at operational level:**

- All the unrated clients are asked for the external credit assessment (ECAIs) recognized by Bangladesh Bank;
- Proper monitoring by the officials of the company to reduce the overdue clients;



- Assessing incremental effect of capital charge over the expected net income from financing before sanctioning any appraisal, which could be one of the criteria for taking financing decision.

**Other actions:**

- Concentrating on SME clients having exposure up to Taka 1 crore as this will carry 75% fixed risk weight (for regular contracts only);
- Financing clients having good credit rating;
- Using benefit of credit risk mitigation by taking eligible financial collaterals against transactions;
- Focusing more on booking high spread earning assets and thus increasing retained earnings.

**Strategic level:**

- Injecting fresh capital by issuing right shares, if required.

Quantitative disclosures	Amount in crore Taka
(b) Capital requirement for Credit Risk	1095.43
(c) Capital requirement for Market Risk	6.16
(d) Capital requirement for Operational Risk	28.44
(e) Total and Tier 1 capital ratio	
CAR on Total capital basis (%)	12.04
CAR on Tier 1 capital basis (%)	11.14

**D) Credit Risk:**

a) The general qualitative disclosure requirement with respect to credit risk, including:

- Definitions of past due and impaired (for accounting purposes)

As per the Bangladesh Bank’s Prudential Guideline on Capital Adequacy and Market Discipline for Financial Institutions, 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) will be risk weighted as per risk weights of respective balance sheet exposures. For the purpose of defining the net exposure of the past due loan, eligible financial collateral (if any) may be considered for Credit Risk Mitigation.

- Description of approaches followed for specific and general allowances and statistical methods;

Specific and General provisions are maintained according to the relevant Bangladesh Bank guideline. For Example, 0.25% provision is maintained against SME-Standard loan/ lease, 1% provision is maintained against good loans (other than SME-Standard loan/ lease, 5% against SMA loan/ lease, 20% against sub-standard loan/ lease, 50% against doubtful loan/ lease and 100% against bad/loss



loan/ lease after deducting the amount of interest expenses and value of eligible securities from the outstanding balance of classified accounts.

- Credit risk management policy

# Implementation of various strategies to minimize risk:

To encounter and mitigate credit risk the following control measures are taken place at FFL:

- Looking into payment performance of customer before financing;
- Annual review of clients;
- Adequate insurance coverage for funded assets;
- Vigorous monitoring and follow up by Special Assets Management and collection Team;
- Strong follow up of compliance of credit policies by Credit Administration Department;
- Taking collateral and performing valuation and legal vetting on the proposed collateral;
- Seeking legal opinion from internal and external lawyer for any legal issues;
- Maintaining neutrality in politics and following arm's length approach in related party transactions;
- Regular review of market situation and industry exposure;
- Sector-wise portfolio is maintained within specific limits to ensure diversification of loan assets.

In addition to the industry best practices for assessing, identifying and measuring risks, FFL also considers guidelines for Managing Core Risks of financial institutions issued by the Country's Central Bank, Bangladesh Bank; vide FID Circular No. 10 dated September 18, 2005 for management of risks.

- Approved Credit Policy by the Board of Directors

The Board of Directors has approved the Credit Policy for the company where major policy guidelines, growth strategy, exposure limits (for particular sector, product, individual company and group) and risk management strategies have been described/stated in detail. Credit Policy is regularly updated to cope up with the changing global, environmental and domestic economic scenarios.

- Separate Credit Risk Management (CRM) Department

An independent Credit Risk Management (CRM) Department is in place, at FFL, to scrutinize projects from a risk-weighted point of view and assist the management in creating a high quality credit portfolio and maximize returns from risk assets. Research team of CRM regularly reviews market situation and exposure of FFL in various industrial sub-sectors. CRM has been segregated from Credit Administration Department in line with Central Bank's Guidelines. CRM assess credit risks and suggest mitigations before recommendation of every credit proposal while Credit Administration confirms that adequate security documents are in place before disbursement.

- Special Collection & Monitoring Team

A strong Law and Recovery Team monitors the performance of the loans and advances, identify early signs of delinquencies in portfolio, and take corrective measures to mitigate risks, improve loan quality and to ensure recovery of loans in a timely manner including legal actions.

- Independent Internal Control and Compliances Department (ICC)

Appropriate internal control measures are in place at FFL. FFL has also established Internal Control and Compliances Department (ICC) to ensure, Bangladesh Bank guidelines, operational procedures, adequacy of internal control and documentation procedures. ICC frames and implements policies to encounter such risks.

- Credit Evaluation

The Credit Evaluation Committee (CEC) regularly meets to review the market and credit risk related to lending and recommend and implement appropriate measures to counter associated risks. The CEC critically reviews projects considering the current global financial crisis and its probable impact on the project.

Risk Grading Model (RGM) helps a Financial Institution to understand the various dimensions of risks involved in transactions related to small business clients who are plying their businesses in various geographical locations across the country. FFL has been developing and managing RGM to promote the safety and soundness of the Company by facilitating informed decision-making. This model measures credit risk and differentiate individual credits and groups of credits by the risk they pose. This allows management and examiners to monitor changes and trends in risk levels. The process also allows the management to manage risk to optimize returns.

To mitigate credit risk, FFL search for credit report from the Credit Information Bureau (CIB) of Bangladesh Bank. The report is scrutinized by CRM and CEC to understand the liability condition and repayment behavior of the client. Depending on the report, banker's opinions are taken from client's banks. Suppliers' and buyers' opinion are taken to understand the market position and reputation of our proposed customers.

- Credit Approval Process

To ensure both speedy service and mitigation of credit risk, the approval process is maintained through a multilayer system. Depending on the size of the loan, a multilayer approval system is designed. As smaller loans are very frequent and comparatively less risky, lower sanctioning authority is set to improve the turnaround time and associated risk. Bigger loans require more scrutiny as the associated risk is higher. So sanctioning authority is higher as well.

- Credit Quality and Portfolio Diversification

FFL believes in diversification in terms of products as well as sectors. To mitigate the Credit Risk, the company diversifies its loan exposure to different sectors confirming the Central Bank's requirements. Threshold limit is set for any sector so that any adverse impact on any industry has minimum effect on FFL's total return. Central Bank's instructions are strictly followed in determining Single Borrower/Large Loan limit. Significant concentration of credit in terms of groups or geographical location is carefully avoided to minimize risk.

- Early Warning System

Performance of loans is regularly monitored to trigger early warning system to address the loans and advances whose performance show any deteriorating trend. It enables the company to grow its credit portfolio with ultimate objective to protect the interest of stakeholders.

- NPL Management

FFL measures its loan portfolio in terms of payment arrears. The impairment levels on the loans and advances are monitored regularly.

As per FID Circular No.3 dated March 15, 2007:

1. Loan/Lease, classified as bad/loss and with 100% provision, can only be written-off.
2. Approval from the Board of Directors has to be taken before write-off.
3. The financial institutions should constantly try to recover the loan/lease written-off amount. If legal action has not been taken against the client, legal charges should be placed before the write off.
4. To expedite the legal settlement or collection of the due amount, third party agents can be appointed by the financial institutions.
5. A separate ledger should be maintained for the written off loans/leases and the accumulated written off value should be disclosed separately under the heading of “notes to the account” in the annual report/balance sheet of the financial institutions.
6. Even if the loan/lease has been written off, the client should be classified as defaulter and reported to CIB accordingly.

Detail records for all such write off accounts are meticulously maintained and followed up.

- Counter party Credit Rating

FFL is taking initiatives to rate the Corporate Clients of the company immediately by the External Credit Assessment Institutions (ECAIs)/Rating Agencies duly recognized by the Central Bank.

- Methods used to measure Credit Risk

As per the directives of Bangladesh Bank, ‘The Standardized approach’ is applied by the company to measure its Credit Risk.

- Quantitative Disclosures

(b) Total gross credit risk exposures broken down by major types of credit exposure.

<b>Particulars</b>	<b>Amount in crore Taka</b>
Lease finance	169.21
Term finance	785.32
Home loan refinance scheme	0.95
<b>Total</b>	<b>955.48</b>

- d) Geographical distribution of exposures, broken down in significant areas by major types of credit exposure.

<b>Location</b>	<b>Amount in crore Taka</b>
Dhaka	701.78
Chittagong	226.11
Sylhet	27.59
<b>Total</b>	<b>955.48</b>

- e) Industry or counter party type distribution of exposures, broken down by major types of credit exposure.

<b>Industry</b>	<b>Amount in crore Taka</b>
Agricultural	31.99
Readymade garments	18.82
Jute & Jute related	10.00
Plastic	0.54
Leather & leather goods	1.34
Service sector	442.66
Textile	5.25
Food & allied	48.49
Chemical & Pharmaceuticals	8.72
Cement	-
Electronics	6.89
Steel	59.28
Paper	9.77
Real estate	185.83
Telecommunication & IT	18.36
Glass & ceramic	0.65
Shipping and ship building	10.22
Transport and communication	30.05
Power, gas, water and sanitary	7.79
Others	58.83
<b>Total</b>	<b>955.48</b>

- f) Residual contractual maturity of credit exposure (without netting eligible financial collateral) of 31 December 2017:

Repayable:

<b>Maturity Grouping</b>	<b>Amount in crore Taka</b>
on demand	210.52
over 1 month but not more than 3 months	281.65

over 3 months but not more than 1 year	160.39
over 1 year but not more than 5 years	229.23
over 5 years	73.69
<b>Total</b>	<b>955.48</b>

	<u>Amount in crore Taka</u>
g) Gross Non-Perfing Loans (NPLs)	307.44
Non-Perfing Loans (NPLs) to Outstanding Loans & Advances	32.88%

### **Movement of Non-Performing Loans (NPLs)**

Particulars	Amount in crore Taka
Opening Balance as on 01.01.2017	324.10
Addition during the year	142.85
Reduced during the year	159.51
Closing Balance as on 31.12.2017	307.44

### **Movement of specific provisions for NPLs**

Particulars	Amount in crore Taka
Opening Balance as on 01.01.2017	38.69
Addition during the year	3.28
Write-off	-
Write-back of excess provision	-
Closing Balance as on 31.12.2017	41.97

### **E) Equities: FI's book positions**

#### **Qualitative Disclosures**

- (a) The general qualitative disclosure requirement with respect to equity risk, including:

Differentiation between holdings on which capital gains are expected and those taken under other objectives including for relationship and strategic reasons; and

- Total equity shares holdings are for capital gain purpose.

Discussion of important policies covering the valuation and accounting of equity holdings in the banking book positions. This includes the accounting techniques and valuation methodologies used, including key assumptions and practices affecting valuation as well as significant changes in these practices.

- Quoted shares are valued at cost prices and if the total cost of a particular share is lower than the market value of that particular share, then provision are maintained as per terms and



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conditions of regulatory authority. On the other hand, unquoted share is valued at cost price or book value as per latest audited accounts.

## Quantitative Disclosures

- (b) Value disclosed in the balance sheet of investments, as well as the fair value of those investments; for quoted securities, a comparison to publicly quoted share values where the share price is materially different from fair value.

Particulars	Amount in crore Taka
Listed Shares	3.08
Un-Listed Shares	0

- (c) The cumulative realized gains (losses) arising from sales and liquidations in the reporting period 0.39 Crore

- (d) Capital requirements broken down by appropriate equity groupings, consistent with the FI's methodology, as well as the aggregate amounts and the type of equity investments subject to any supervisory provisions regarding regulatory capital requirements.

- Specific Risk- Market value of investment in listed equities is BDT 3.08 crore. Capital Requirement is 10% of the said value which stand to BDT 0.31 crore.
- General Risk- Market value of investment in listed equities is BDT 3.08 crore. Capital Requirement is 10% of the said value which stand to BDT 0.31 crore.

## F) Interest rate in the FI's book

### Qualitative Disclosures

The general qualitative disclosure requirement includes the nature of interest risk and key assumptions, including assumptions regarding loan prepayments and behavior of non-maturity deposits.

Interest rate risk in the banking book arises from mismatches between the future yield of an assets and their funding cost. Assets Liability Committee (ALCO) monitors the interest rate movement on a regular basis. FFL measure the Interest Rate Risk by calculation Duration Gap i.e. a positive Duration Gap affect company's profitability adversely with the increment of interest rate and a negative Duration Gap increase the company's profitability with the reduction of interest rate.

### Quantitative Disclosures

The increase (decline) in earnings or economic value (or relevant measure used by management) for upward and downward rate shocks according to management's method for measuring interest rate risk broken down by currency (as relevant).

### Interest Rate Risk-Increase in Interest Rate: (BDT in crore) Where applicable

Particulars	1 to 30/31 day (One Month )	Over 1 to 2 Months	Over 2 Months to 3 Months	Over 3 Months to 6 Months	Over 6 Months to 1 Year
A. Total Rate Sensitive Liabilities (A)	96.37	115.63	171.44	131.84	144.69
B. Total Rate Sensitive Assets (B)	145.88	68.48	151.24	95.20	145.27
C. Mismatch (B-A)	49.51	-47.15	-20.19	-36.64	0.58
D. Cumulative Mismatch	49.51	2.36	-17.83	-54.47	-53.89
E. Mismatch (%)	51.38%	-40.78%	-11.78%	-27.79%	0.40%

<b>Interest Rate Risk</b>			
Magnitude of Shock	Minor	Moderate	Major
	2%	4%	6%
Change in the Value of Bond Portfolio	0.00	0.00	0.00
Net Interest Income	-1.08	-2.16	-3.23
Revised Regulatory Capital	151.11	150.03	148.96
Risk Weighted Assets	1130.03	1130.03	1130.03
Revised CAR (%)	13.37%	13.28%	13.18%

## G) Market Risk

### Views of the Board of Directors (BoD) on trading/investment activities

All the Market Risk related policies/guidelines are duly approved by the BoD. The BoD sets limit and review and updates the compliance on regular basis aiming to mitigate the Market risk.

### Methods used to measure Market risk

Market Risk is the probability of losing assets in balance sheet and off - balance sheet position arising out of volatility in market variables i.e. interest rate, exchange rate and prices of securities. In order to calculate the market risk for trading book purposes the company uses Standardized (rule based) Approach where capital charge for interest rate risk, price and foreign exchange risk is determined separately.

### Market Risk Management system

### Policies and processes for mitigating market risk

A Policy for managing Market Risk has been set out by the Board of Directors of the company where clear instructions has been given on Loan Deposit Ratio, Whole Sale Borrowing Guidelines, Medium



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Term Funding, Maximum Cumulative Outflow, Liquidity Contingency Plan, Local Regulatory Compliance, Recommendation / Action Plan etc.

Treasury manages the Market Risk with the help of Asset Liability Management Committee (ALCO) and Asset Liability Management (ALM) Desk in the following fashion:

### **Market analysis**

Market analysis over interest rate movements are reviewed by the Treasury of the company. The type and level of mismatch interest rate risk of the company is managed and monitored from two perspectives, being an economic value perspective and an earning perspective.

### **GAP analysis**

ALCO has established guidelines in line with central Bank's policy for the management of assets and liabilities, monitoring and minimizing interest rate risks at an acceptable level. ALCO in its regular weekly meeting analyzes Interest Rate Sensitivity by computing GAP i.e. the difference between Rate Sensitive Assets and Rate Sensitive Liability and take decision of enhancing or reducing the GAP according to prevailing market situation aiming to mitigate interest rate risk.

### **Continuous Monitoring**

Company's treasury manages and controls day-to-day trading activities under the supervision of ALCO that ensures continuous monitoring of the level of assumed risks.

### **Equity Risk Management**

Equity Risk is the risk of loss due to adverse change in market price of equities held by the Company. Equity Risk is managed by the following fashion:

FFL minimizes the Equity Risks by Portfolio diversification as per investment policy of the company. The entire portfolio is managed by FFL's Investment Division under Accounts & Finance Department.

### **Quantitative Disclosures**

#### **(b) The capital requirements for Market Risk:**

Particulars	Amount in crore Taka
Interest rate risk	0.00
Equity position risk	6.16
Foreign exchange position and commodity risk (if any)	0.00

#### **H) Operational Risk:**

#### **Qualitative disclosure:**



**a) Views of Board on system to reduce Operational Risk:**

All the policies and guidelines of internal control and compliances are duly approved by the Board. The Board delegates its authority to Executive Committee and to ManCom as per company policy of delegation of authority. Audit Committee of the Board directly oversees the activities of internal control and compliance as per good governance guideline issued by Securities and Exchange Commission.

**Performance gap of executives and staffs**

FFL’s recruitment strategy is based on retaining and attracting the most suitable people at all levels of the business and this is reflected in our objective approach to recruitment and selection. The approach is based on the requirements of the job (both now and in the near future), matching the ability and potential of the individual. Qualification, skills and competency form our basis for nurturing talent. We are proud to state that favorable job responsibilities are increasingly attracting greater participation from different level of employees in the FFL family. We aim to foster a sense of pride in working for FFL and to be the employee of choice. As such there exists no performance gap in FFL.

**Potential external events**

No such potential external event exists to rise operational risk of FFL at the time of reporting.

**Policies and procedures for mitigating operational risk:**

FFL has also established Internal Control and Compliances Department (ICC) to address operational risk and to frame and implement policies to encounter such risks. ICC assesses operational risk across the Company as a whole and ensures that an appropriate framework exists to identify, assess and manage operational risk.

**Approach for calculating capital charge for operational risk:**

Operational risk is defined as the risk of loss resulting from inadequate or failed internal processes, people and system or from external events. FFL uses basic indicator approach for calculation capital charge against operational risk i.e. 15% of average positive annual gross income of the company over last three years.

**Quantitative Disclosures:**

b) Capital requirement for operational risk:

Particulars	Amount in crore Taka
Capital requirement for operational risk:	2.84