Capital adequacy in accordance with BASEL II

Basel accords are the international standards for creating regulations about how much capital is needed to put aside to guard against the types of financial and operational risks that Financial Institutions (FIs) face. According to Bangladesh Bank's Prudential Guideline on Capital Adequacy and Market Discipline (CAMD) for Financial Institutions, Fareast Finance & Investment Limited discloses the framework of the company containing the key pieces of information on the assets, risk exposures, risk assessment processes, capital adequacy through qualitative as well as quantitative measures.

All the disclosures are made on the basis of the audited financial statements of Fareast Finance & Investment Limited as at and for the year ended 31 December, 2019 prepared under relevant accounting and financial reporting standards as adopted by the Institute of Chartered Accountants of Bangladesh and related circulars/instructions issued by Bangladesh Bank from time to time.

The disclosures are made to present relevant information on adequacy of capital in relation to overall risk exposures of the company; so that the market participants can assess the position and direction of the company in making economic decisions.

A. Scope of Application

Qualitative Disclosures	a)	Fareast Finance & Investment Limited one of the progressive financial institutions incorporated in Bangladesh as a public limited company with limited liability, on 21 June 2001 under The Companies Act, 1994. The company was authorized to commence business in Bangladesh as per Certificate of Commencement dated 21 June 2001. The company obtained license from Bangladesh Bank as a financial institution under The Financial Institutions Act, 1993 on 3 July 2001 to operate as a leasing and financing company as provided under the relevant law.
	b)	The company obtained permission from Bangladesh Bank on 20 January 2015 for opening its Chattogram and Banani branch. Fareast Finance & Investment Limited applies **"Solo Basis"** framework as there is no subsidiary of the company. Fareast Finance & Investment Limited has an associate company named Fareast Stocks and Bonds Limited which is a brokerage house having membership of both the exchanges in Bangladesh.
	c)	Fareast Finance and Investment Limited is following latest Bangladesh Bank circular in determining maximum amount of finance to all clients of the company.
Quantitative Disclosures	d)	Not Applicable.

B. Capital Structure

Qualitative Disclosures	a)	As per "PRUDENTIAL GUIDELINES ON CAPITAL ADEQUACY AND MARKET DISCIPLINE FOR FINANCIAL INSTITUTIONS" introduced by Bangladesh Bank, Tier-1 and Tier-2 capital consisted as follows: **Tier 1 capital (Core):** i) Paid up capital, ii) Non-repayable share premium account, iii) Statutory reserve vi) General reserve, v) Retained earnings, vi) Minority interest in subsidiaries vii) Non-cumulative irredeemable preference shares, viii) Dividend equalization account. **Tier 2 capital (Supplementary):** i) General provision up to a limit of 1.25%" of Risk Weighted Asset (RWA) for Credit Risk ii) 50% of revaluation reserves for fixed assets and 45% of revaluation reserves for securities, Revaluation reserve for equity instruments up to 10% eligible for Tier 2 capital, iii) All others preference shares. Fareast Finance & Investment Limited complied with Bangladesh Bank's directive as per guidelines, the amount of Tier 2 capital limited to 100% of the amount of Tier 1 capital. FFIL maintains capital to RWA Ratio (CAR) 5.33% where Minimum capital to RWA Ratio (CAR) required 10% as per guidelines.	
Quantitative Disclosures	b)	Fully paid up capital	164.06
		Statutory Reserve	26.89
		Non-repayable Share premium account	
		General Reserve	
		Retained Earnings	-152.22
		Minority interest in subsidiaries	
		Non-Cumulative irredeemable Preferences shares	
		Dividend Equalization account	
		Other (if any item approved by Bangladesh Bank)	
		Tier 1 Capital	38.73
	c)	Tier 2 Capital	12.41
	d)	Other deductions from capital	
	e)	Total Eligible Capital	51.14

C. Capital Adequacy

Qualitative Disclosures	a)	It is mentionable that for assessing Capital Adequacy, Fareast Finance & Investment Limited (FFIL) has adopted standardized approach for credit risk measurement, standardized approach for market risk measurement and basic indicator approach for operational risk measurement. FFIL focused on strengthening risk management and control surroundings rather than increasing capital to cover up weak risk management and control practices. According to BASEL II accord, capital adequacy ratio (CAR) of Fareast Finance stood at 5.33% as well as Tier-1 (Core Capital) was 38.73 crore and Tier-2 (Supplementary Capital) was 12.41 crore. The capital adequacy ratio exhibits our capital strength which is not up to the mark in terms of maintaining adequate capital for minimum capital requirement.
Quantitative Disclosures	b)	Capital requirement for Credit Risk 92.89 crore
	c)	Capital requirement for Market Risk 1.27 crore
	d)	Capital requirement for Operational Risk 1.84 crore
	e)	Tier-1 (Core Capital) 38.73 crore Tier-2 (Supplementary Capital) 12.41 crore Total eligible Capital 51.14 crore Total Risk Weighted Assets (RWA): 960.00 crore **Capital** — **Ratio** Capital Adequacy Ratio (CAR) 5.33% Core Capital to RWA 4.04% Supplementary Capital to RWA 1.29%

D. Credit Risk

Qualitative Disclosures

a) Credit risk is the probability that counterparty fails to meet obligation in accordance with agreed terms. It includes both uncertainty involved in repayment of the dues and repayment of dues on time. The default usually occurs because of inadequate income or business failure. But often it may be willful because the borrower is unwilling to meet its obligations despite having adequate income. Credit risk also denotes the volatility of losses on credit exposures in two forms-the loss in the credit asset's value and the loss in the current and future earnings from the credit.

Fareast Finance & Investment Limited (FFIL) maintains classification and provisioning as per Bangladesh Bank circulars issued from time to time. In this regard, all the loans and advances/investments are grouped: Lease (Less than 5 years), Lease (More than 5 years), Term Loan (Less than 5 years), Term Loan (More than 5 years), Housing Loan, Others Loan, and Share Investment.

The FI follows Bangladesh Bank circular and guidelines to define past due and impairment. It may be necessary to account for a loan that is considered to be impaired for risk mitigation.

Specific provisions for classified loans and general provisions for unclassified loans are measured following BB prescribed provisioning rates as mentioned below:

Rate of Provision:
Unclassified standard loans and advances (except SME) 1.00%
Unclassified standard loans to SME 0.25%
Unclassified SMA loans and advances 5.00%

Substandard loans and advances 20.00%
Doubtful loans and advances 50.00%
Bad & loss loans and advances 100.00%

Fareast Finance management has taken the following steps to manage credit risk at a minimum level:

- Independent credit risk management unit.
- Multi-tier term/lease approval process.
- In depth analysis of the borrower in view of financial strength, managerial capacity, industry prospect and macroeconomic scenario.
- Credit department ensures that all documentations are properly completed and monitor the repayment performance on regular basis.
- Disbursement is made upon independent recommendation by the compliance department.
- The credit committee regularly meets to review new credit proposals as well as performance of existing portfolios.

Quantitative Disclosures

b) Total gross credit risk exposures broken down by major types of credit exposure (Risk Weighted):

Exposure Type	**RWA Taka in crore**
Cash & Cash Equivalents	0.00
Claims on Bangladesh Govt. & Bangladesh Bank	0.00
Claims on Banks and NBFI	10.02
Claims on Corporate	236.66
Claims on Corporate Retail & SME	3.47
Claims fully secured by residential & Commercial Property	4.32
Consumer Finance	0.27
Past Due Claims	572.74
All other assets	101.44
Total:	**928.92**

c) Geographica1 distribution of exposures, broken down in significant areas by major types of credit exposure:

Name of Divisions	**Total portfolio (without netting eligible collateral)**
	Taka in crore
Dhaka	709.42
Chattogram	179.63
Khulna	6.87
Rajshahi	11.71
Barisal	0
Sylhet	0
Rangpur	0
Mymensingh	0
Total	**907.63**

d) Industry or counterparty type distribution of exposures, broken down by major types of credit exposure:

Particulars	**Taka in Crore**
Trade and Commerce	15.06
Industry	
a) Garments and Knitwear	62.24
b) Textile	13.08
c) Jute and Jute-Products	14.21
d) Food Production and Processing Industry	26.82
e) Plastic Industry	3.46
f) Leather and Leather-Goods	0.00
g) Iron, Steel and Engineering	78.24
h) Pharmaceuticals and Chemicals	29.16
i) Cement and Allied Industry	65.99
j) Telecommunication and IT	18.59
k) Paper, Printing and Packaging	14.66
l) Glass, Glassware and Ceramic Industry	20.38
m) Ship Manufacturing Industry	43.63
n) Electronics and Electrical Products	21.04

o) Power, Gas, Water and Sanitary Service	35.72
p) Transport and Aviation	41.11
Agriculture	18.52
Housing	35.23
Others	
a) Merchant Banking	0.00
b) Margin Loan	300.49
c) Others	50.0
Total	**907.63**

e) Residual contractual maturity break down of the whole portfolios, broken down by major types of credit exposure of Fareast Finance and Investment Limited as follows:

Particulars	**Taka in Crore**
Repayable on Demand	0.00
Not more than 3 months	122.79
Over 3 month but not more than 1 year	8.96
Over 1 year but not more than 5 years	403.80
Over 5 years	372.08
Total	**907.63**

f) General provision 11.66 crore and Specific provision 112.99 as on December 31, 2019

g) **Movement of Non-Performing Assets (NPAs)**

Particulars	**Taka in Crore**
Opening balance	152.55
Addition during the year	380.46
Reduction during the year	(19.17)
Closing balance	**513.84**

Movement of specific provision for NPAs

Particulars	**Taka in Crore**
Opening balance	76.79
Provision made during the year	36.20
Write-off	0
Write-back of excess provisions	0
Closing balance	**112.99**

E. Equities: Banking Book Positions.

<table>
<tr><td>Qualitative Disclosures</td><td>a)</td><td>Investment in equity securities are broadly categorized into two parts:

i) Quoted Securities (Common or Preference Shares & Mutual Fund) and
ii) Unquoted securities include shares of Central Depository Bangladesh Limited (CDBL)

Fareast Finance & Investment Limited (FFIL) invests in these equity securities for the purpose of capital gain by selling them in future or held for dividend income. Dividends received from these equity securities are accounted for as and when received.
Both Quoted and Un-Quoted equity securities are valued at cost and necessary provisions are maintained as per Bangladesh Bank directives if the prices fall below the cost price.</td></tr>
</table>

<table>
<tr><td rowspan="4">Quantitative Disclosures</td><td>b)</td><td>Amount in crore
<table>
<tr><th>Particulars</th><th>Cost price</th><th>Market price</th></tr>
<tr><td>Total Equity Investment in Unquoted Share</td><td>22.90</td><td>62.01</td></tr>
<tr><td>Total Investment in Quoted Share excluding Director Equity Shares</td><td>12.22</td><td>6.34</td></tr>
<tr><td>Total Equity Investment in Unquoted Share as Director Share</td><td>0.00</td><td>0.00</td></tr>
</table>
</td></tr>
<tr><td>c)</td><td>The cumulative realized gains (losses) arising from sales and liquidations in the reporting period: 0.25 crore.</td></tr>
<tr><td>d)</td><td>Total unrealized gains (losses): (5.72) crore
Total latent revaluation gains (losses) : 00
Any amounts of the above included in Tier 2 capital : 00</td></tr>
<tr><td>e)</td><td>Capital Charges for Specific Risk (10% of market value of shares) 0.63 crore
Capital Charge for General Market Risk (10% of market value of shares) 0.63 crore</td></tr>
</table>

F. Interest Rate Risk in the Banking Book Position

<table>
<tr><td>Qualitative Disclosures</td><td>a)</td><td>Interest rate risk is concerned with borrowed funds of short term and long term maturity. Volatility in money market and increased demand for loan/investment raise the rate of interest. Increase in interest rate of borrowings could narrow or eliminate the spread, or result in a negative spread and could adversely affect the business and future financial performance resulting from high cost of fund of a company.

Company’s investments are generally structured at fixed rates for a specified term. But, in case of exigency like unusual and abrupt increase in borrowing rate, the company has a scope to increase the lending rate which mitigates the risk. Again company always tries to reduce the interest rate risk by diversifying the borrowing from different sources at different rates.</td></tr>
<tr><td>Quantitative Disclosures</td><td>b)</td><td>Amount in Crore
<table>
<tr><th></th><th>Up to 3 months</th><th>Over 3 months to 6 months</th><th>Over 6 months to 1 year</th><th>Above 1 year</th></tr>
<tr><td>Rate Sensitive Assets (RSA)</td><td>158.73</td><td>52.57</td><td>9,714.00</td><td>410.79</td></tr>
<tr><td>Rate Sensitive Liabilities (RSL)</td><td>96.69</td><td>46.60</td><td>11,443.00</td><td>490.69</td></tr>
<tr><td>Net gap [RSA-RSL]</td><td>62.04</td><td>5.97</td><td>(1,729.00)</td><td>(79.90)</td></tr>
<tr><td>Cumulative gap</td><td>62.04</td><td>68.01</td><td>5,072.00</td><td>(29.18)</td></tr>
<tr><td>1% interest rate increase</td><td>0.62</td><td>0.06</td><td>(0.17)</td><td>(0.80)</td></tr>
<tr><td>1% interest rate decrease</td><td>0.62</td><td>0.06</td><td>(0.17)</td><td>(0.80)</td></tr>
<tr><td>2% interest rate increase</td><td>1.24</td><td>0.12</td><td>(0.35)</td><td>(1.60)</td></tr>
<tr><td>2% interest rate decrease</td><td>1.24</td><td>0.12</td><td>(0.35)</td><td>(1.60)</td></tr>
</table>
</td></tr>
</table>

G. Market Risk

Qualitative Disclosures

a) Market risk is the risk that may hamper Fareast Finance's earnings and capital due to changes in the market level of interest rates, securities, equities as well as the volatilities of those prices. Volatility of money market, which ultimately imposes upward pressure on interest rate structure, may erode the Company's profitability. Devaluation of local currency against major international currencies affects business performance of import based companies or companies borrowed in foreign currency adversely. Inability to offer on to a proactive and competitive posture due to lack of market access and inability to offer competitive products will hinder the Company's growth potential.

The Company is trying to be less dependent on short-term borrowings rather depends on term deposit and line of credit facilities from commercial banks or other sources for funding its business activities. The renewal rate of its maturing deposits mitigates the interest rate risk. As far as interest on term loan is concerned, rise in interest rate of borrowing results in increase of lending rate to clients. Fareast Finance does not have any foreign currency loan. Moreover, since it is a leasing company it can import equipment, plant & machinery etc. to lease out to the prospective clients. In case of currency fluctuation it is the prospective client who ultimately takes the risk. The treasury department reviews and prepares a report on the trend of market interest rate movement and carry out asset liability gap analysis. To manage the market risk, Fareast Finance has managed to arrange the funding facilities with competitive interest rate to match with maturity. Fareast Finance with its strong earning capacity, favorable credit rating and market goodwill can access to money market with a competitive rate.

Quantitative Disclosures

b) Amount in crore

Details	**Capital Charges for Specific Risk (10% of market value of shares)**	**Capital Charge for General Market Risk (10% of market value of shares)**	**Total Capital Charge for Market Risk**
1	**2**	**3**	**4=(2+3)**
A. Interest Rate Related Instruments	0.00	0.00	0.00
B. Equities	0.63	0.63	1.27
C. Foreign Exchange Position	0.00	0.00	0.00
Total (A+B+C):			**2.26**

H. Operational Risk

Qualitative Disclosures

a) Operational risk is the risk of loss resulting from inadequate or failed internal processes, people and systems or from external events. It includes legal risk, but excludes strategic and reputation risk. Operational risk occurs in all day to day company's activities. This risk arises in almost all the department of a financial institution like credit, investment, treasury, information technology etc. Operational risk addresses the risk associated with fraud, forgery, unauthorized activities, error, omission, system failure and external events among others. Some more operational events are including operational errors, non compliance with internal regulations, non-compliance of legal requirements, launching new products without adequate operational support etc.

In order to monitor and manage the risk arising from all operational activities, an appropriate organizational structure is second to none. The Board of Directors (BoD) sets policies and delegates authority to the management for setting procedures, which together has structured the risk management framework in the FI. The Credit Policy Manual contains the core principles for identifying, measuring, approving, and managing credit risk in the FI. Fareast Finance's Management manages to place proper organizational structure with proper segregation of duties and delegation of authorities. Fareast Finance has independent Credit Risk Management (CRM) Department, independent Treasury Department, independent Compliance Department, independent Finance & Administration Department and independent Information technology Department for technical services to operate the organization smoothly as per Bangladesh Bank's directives.

Fareast Finance & Investment Limited always believes that overcoming the challenges are not a hard works for the company rather depends on the move forward collectively. Existence of the correlation of the human capital of the company from top to bottom level is the strength of Fareast Finance & Investment Limited which will produce quality business for the shareholders, increase the assets of the company.

Quantitative Disclosures

b) **Capital Charge on Operational Risk:** Taka in Crore

Operational Risk	2017	2018	2019	Capital Charge
Gross Income	16.37	8.18	-12.59	**1.84**

Fareast Finance & Investment Limited measures the capital charge for operational risk with a fixed percentage (denoted by alpha) of average positive annual gross income of the FI over the past three years under the Basic Indicator Approach (BIA). Figures for any year in which annual gross income is negative or zero, should be excluded from both the numerator and denominator when calculating the average. The capital charge may be expressed as follows:

$K = [(GI\ 1 + GI2 + GI3) * \alpha]/n$

Where,

K = capital charge under the Basic Indicator Approach

GI = only positive annual gross income over the previous three years (i.e. negative or zero gross income if any shall be excluded)

α = 15%, n = number of the previous three years for which gross income is positive.

		Gross income: Gross Income (GI) is defined as "Net interest income" plus "net noninterest income". It is intended that this measure should - a) be gross of any provisions (includes interest suspense) b) be gross of operating expenses, including fees paid to outsourcing service providers c) exclude realized profits/losses from the sale of securities held to maturity in the banking book. d) exclude extraordinary or irregular items as well as categorize e) exclude income derived from insurance.