To:

1. Islamic Commercial Banks; and
2. Conventional Commercial Banks owning Islamic Business Units

COPY OF
FINANCIAL SERVICES AUTHORITY CIRCULAR LETTER
NUMBER 10/SEOJK.03/2014
CONCERNING
RISK-BASED BANK RATING FOR ISLAMIC COMMERCIAL BANKS AND ISLAMIC BUSINESS UNITS

With regards to the enactment of Financial Services Authority Regulation Number 8/POJK.03/2014 concerning Risk-Based Bank Rating for Islamic Commercial Banks and Islamic Business Units (State Gazette of the Republic of Indonesia Number 134 of 2014, Supplement to the State Gazette of the Republic of Indonesia Number 5544), Bank Indonesia Regulation Number 13/23/PBI/2011 concerning Implementation of Risk Management for Islamic Commercial Banks and Islamic Business Units (State Gazette of the Republic of Indonesia Number 103 of 2011, Supplement to the State Gazette of the Republic of Indonesia Number 5247), and Bank Indonesia Regulation Number 8/6/PBI/2006 concerning Implementation of Risk Management in Consolidated Manner for Banks Exercising Control over Subsidiary Companies (State Gazette of the Republic of Indonesia Number 8 of 2006, Supplement to the State Gazette of the Republic of Indonesia Number 4602), it is deemed necessary to stipulate provision concerning Risk-Based Bank Rating for Islamic Commercial Banks and Islamic Business Unitsin a Financial Services Authority Circular Letter as follows:

I. GENERAL

1. The rise in innovations in Islamic banking products, services, and activities influence the rise in Bank business complexity and Risk Profile which if not countered with the implementation of adequate Risk Management can cause various basic problems in the Bank as well as in the overall financial system.
2. To enable Bank to identify problems earlier, undertake appropriate corrective follow-up actions faster, as well as apply Good Corporate Governance principles and Risk

Management better, the Financial Services Authority enhances the system for Bank Rating assessment

3. In principle, Bank rating, management, and business sustainability are solely the responsibility of Bank management. Therefore, Bank is obliged to maintain, improve, and enhance its soundness by implementing the prudential principles and Risk Management in conducting its business activities including periodically undertaking self-assessment on its rating and taking corrective measures effectively. On the other hand, the Financial Services Authority evaluates, assess Bank Rating, and undertakes necessary supervisory actions in the framework of maintaining stability of the banking and financial systems.

II. GENERAL PRINCIPLES IN THE BANK RATING ASSESSMENT OF ISLAMIC COMMERCIAL BANKS AND ISLAMIC BUSINESS UNITS.

Bank management needs to give attention to the following general principles as the basis for assessing Bank Rating.

1. Risk Oriented

   Assessment of bank rating is based on Bank's Risks and their impacts on Bank's overall performance. This is performed by identifying the internal as well as external factors that can raise Risks or influence Bank's financial performance currently and in the future. As such, Bank is expected to be able to detect earlier the roots of Bank's problems and take preventive as well as corrective measures effectively and efficiently.

2. Proportionality

   The use of parameters/indicators in each assessment factor of Bank Rating is performed by giving attention to the characteristics and complexity of Bank's business. Parameters/indicators for Bank Rating assessment in this Circular Letter are the minimum standards that Bank is obliged to use in the assessment of Bank Rating. However, Bank can use additional parameters/indicators in line with its business characteristics and complexity in assessing Bank Rating so that results of the assessment can better reflect Bank's condition.

3. Materiality and Significance

   Bank needs to give attention to materiality and significance of the assessment factors of Bank Rating, namely Risk Profile, Good Corporate Governance, Earnings, and Capital as well as the significance of assessment parameters/indicators in each factor in making conclusions on assessment results and determining factor ranking. Determination of materiality and significance shall be based on analyses that are supported by adequate data and information concerning Bank's Risks and financial performance.

4. Comprehensive and Structured

The assessment process shall be performed thoroughly and systematically as well as is focused on Bank's main problems. The analysis shall be performed in an integrated manner by taking into consideration the interrelation between Risks and assessment factors of the Soundness Level of Bank as well as Subsidiary Companies that need to be consolidated. The analysis should be supported by primary facts and relevant ratios to show the level, trend, and the levels of problems facing the Bank.

III. PROCEDURE FOR ASSESSING BANK RATING

In accordance with Financial Services Authority Regulation Number 8/POJK.03/2014 concerning Risk-Based Bank Rating for Islamic Commercial Banks and Islamic Business Units, Bank is obliged to perform self-assessment of Bank Rating by using Risk-based approach. The Bank Rating assessment of an Islamic Commercial Bank shall be performed individually as well as in a consolidated manner, while the Bank Rating assessment of an Islamic Business Unit shall be performed individually, in the following procedure:

1. **Procedure for Individual Bank Rating Assessment of Islamic Commercial Banks and Islamic Business Units**

Individual Assessment of Bank Rating for Islamic Commercial Banks includes assessment of factors: Risk Profile, Good Corporate Governance, Earnings, and Capital, while for Islamic Business Units, it only includes Risk Profile factor.

a. Assessment of Risk Profile Factor

Assessment of Risk Profile factor is assessment on inherent Risks and Risk Management quality in Bank's operational activities. Risks that Bank is obliged to assess comprise 10 (ten) types of Risks, namely Credit Risk, Market Risk, Liquidity Risk, Operational Risk, Legal Risk, Strategic Risk, Compliance Risk, Reputation Risk, Rate of Return Risk, and Equity Investment Risk.

In assessing Risk Profile, Bank is obliged to also give attention to the scope of Risk Management implementation as stipulated in prevailing regulation concerning Implementation of Risk Management for Islamic Commercial Banks and Islamic Business Units.

1) Assessment of Inherent Risks

   Assessment of inherent Risks is an assessment on Risks that are inherent in Bank's business activities, both those that can be quantified as well as those that cannot, which have the potential impact to Bank's financial position. The characteristics of Bank inherent Risks are determined by internal as well as external factors, among others bank's business strategy, business characteristics, complexity of products and activities, the industries in which Bank conducts business activities, as well as macro economic conditions.

   Assessment of inherent Risks is performed by giving attention to parameters/indicators that are quantitative as well as qualitative.

   Determination of inherent Risk level on each type of Risk shall refer to the general principles for Bank Rating assessment of Islamic Commercial Banks and Islamic Business Units. Determination of inherent Risk level of each type of Risks shall be categorized into 5 (five) ratings, namely rating 1 (low), rating 2 (low to moderate), rating 3 (moderate), rating 4 (moderate to high), and rating 5 (high).

   The following are a number of parameters/indicators that Bank at minimum is obliged to use as reference in assessing inherent Risks. Bank can add other parameters/indicators relevant to the characteristics and complexity of Bank's business by giving attention to the proportionality principle.

   a) Credit Risk

      Credit Risk is defined as the Risk arising from the failure of customer or another party to meet its obligation to the Bank in accordance with agreed terms.

Credit Risk is in general inherent in all fund placement activities undertaken by Bank, which performances depend on the performances of counterparties, issuers or borrowers. Credit Risk also arises from concentration of fund placements on certain debtors, geographic regions, products, types of financing, or certain business fields. This risk is commonly called financing concentratation Risk and should also be taken into account in the assessment of inherent Risk.

In assessing the inherent Risk on Credit Risk, parameters/indicators used are: (i) compositions of asset portfolios and levels of concentration; (ii) quality of fund placements and adequacy of reserves; (iii) strategy of fund placements and sources for fund placements; and (iv) external factors.

In assessing inherent Risk on Credit Risk, Bank shall use inherent Risk parameters/indicators by referring to **Attachment I.1.a**.

b) Market Risk

Market Risk is defined as the Risk of losses im on- and off-balance sheet positions arising form movements in market prices, among others Risk in the form of value changes of assets that can be traded or leased.

Market Risk covers benchmark interest rate Risk, exchange rate Risk, equity Risk, and commodity Risk. Implementation of Risk Management for equity Risk and commodity Risk should be applied by Bank that undertakes consolidation with Subsidiary Companies.

In assessing inherent Risk on Market Risk, parameters/indicators used are: (i) portfolio volumes and compositions; (ii) potential loss from benchmark interest rate Risk in banking book; and (iii) business strategy and policies.

In assessing inherent Risk on Market Risk, Bank shall use inherent Risk parameters/indicators by referring to **Attachment I.1.b**.

c) Liquidity Risk

Liquidity Risk is Risk arises from Bank's inability to meet its obligations that have fallen due from cash inflow and/or high quality liquid assets, without disrupting Bank's activities and financial condition. This Risk is also called funding Liquidity Risk. Liquidity Risk can also be caused by Bank's inability to liquidate assets without incurring material discounts due to absence of an active market or a severe market disruption. This risk is also called market Liquidity Risk.

In assessing inherent Risk on Liquidity Risk, parameters used are: (i) compositions of assets, liabilities, and off-balance sheet transactions; (ii) concentration of assets and liabilities; (iii) susceptibility on funding needs; and (iv) access to sources of funds.

In assessing inherent Risk on Liquidity Risk, Bank shall use inherent Risk parameters/indicators by referring to **Attachment I.1.c**.

d) Operational Risk

Operational Risk is loss Risk arising from inadequate internal process, internal process failure, human errors, system failure, and/or existence of external event that influences Bank's operation.

Sources of Operational Risk can be caused among othes by human resources, process, system, and external events.

In assessing inherent Risk on Operational Risk, parameters/indicators used are: (i) business characteristics and complexity; (ii) human resources; (iii) information technology and supporting infrastructures; (iv) frauds, both internal as well as external, and (v) external events.

In assessing inherent Risk on Operational Risk, Bank shall use inherent Risk parameters/indicators by referring to **Attachment I.1.d**.

e) Legal Risk

Legal Risk is Risk arising from legal claims and/or weaknesses on juridical aspects.

This risk also arises among others from absence of legislations as a basis or weaknesses in the engagements, such as unfulfilment of valid agreement terms or inadequate collaterals.

In assessing inherent Risk on Legal Risk, parameters/indicators used are: (i) litigation factor; (ii) agreement flaws factor; and (iii) absence of/changes in legislations factor.

In assessing inherent Risk on Legal Risk, Bank shall use inherent Risk parameters/indicators by referring to **Attachment I.1.e**.

f) Strategic Risk

Strategic Risk is Risk arising from inappropriate of decision made in and/or implementation of a strategic decision as well as failure in anticipating changes in business environment.

Sources of Strategic Risk among others originate from weakness in the formulation process of strategies and inappropriate in the formulation of strategies, and failure in anticipating changes in business environment.

In assessing inherent Risk on Strategic Risk, parameters/indicators used are: (i) suitability of strategies with business environment condition; (ii) high risk strategies and low-risk strategies; (iii) Bank's business position; and (iv) realization of Bank's business plan.

In assessing inherent Risk on Strategic Risk, Bank shall use inherent Risk parameters/indicators by referring to **Attachment I.1.f**.

g) Compliance Risk

Compliance Risk is Risk arising from Bank not complying and/or not implementing prevailing legislations and regulations, as well as Islamic principles.

Sources of Compliance Risk are among others lack of legal understanding or legal awareness of the regulations, Islamic principles, as well as generally applicable business standards.

In assessing inherent Risk on Compliance Risk, parameters/indicators used are: (i) types and significance of violations occurred ; (ii) frequency of violations occurred or track record of Bank's noncompliance; and (iii) violations of regulations or general business standards for certain financial transactions.

In assessing inherent Risk on Compliance Risk, Bank shall use inherent Risk parameters/indicators by referring to **Attachment I.1.g**.

h) Reputation Risk

Reputation Risk is Risk arising from declining stakeholder trust level that originates from negative perception towards Bank.

One of the approaches used in categorizing sources of Reputation Risk is by dividing the Risk into indirect (below the line) Reputation Risk and direct (above the line) Reputation Risk.

In assessing inherent Risk on Reputation Risk, parameters/indicators used are: (i) influence of negative reputations of Bank owners and related companies; (ii) business ethics violations including Islamic business ethics; (iii) complexity of Bank’s products and business cooperation; (iv) frequency, materiality, and exposure of negative reporting on Bank; and (v) frequency and materiality of customers’ complaints.

In assessing inherent Risk on Reputation Risk, Bank shall use inherent Risk parameters/indicators by referring to **Attachment I.1.h**.

i) Rate of Return Risk

Rate of Return Risk is Risk arising from changes in rates of return paid by Bank to the customers that are caused by changes in rates of return received by Bank from funds channeling, which can influence the behavior of third-party fund customers of Bank.

In assessing inherent Risk on Rate of Return Risk, parameters/indicators used are: (i) composition of third-part funds; (ii) strategy and performance of Bank in gaining profits/revenues; and (iii) behavior of third-party fund customers.

In assessing inherent Risk on Rate of Return Risk, Bank shall use inherent Risk parameters/indicators by referring to **Attachment I.1.i**.

j) Equity Investment Risk

Equity Investment Risk is Risk arising from the situation where Bank participates in bearing customer business losses financed in a profit-sharing based financing, those using the net revenue sharing method as well as those using the profit and loss sharing method.

In assessing inherent Risk on Equity Investment Risk, parameters/indicators used are: (i) composition and level of concentration of profit-sharing financing; (ii) quality of profit-sharing financing; and (iii) external factors.

In assessing inherent Risk on Equity Investment Risk, Bank shall use inherent Risk parameters/indicators by referring to **Attachment I.1.j**.

2) Assessment of The Risk Management quality

Assessment of the Risk Management quality reflects assessment on adequacy of the Risk control system, which includes all pillars of Risk Management implementation and aims at evaluating the effectiveness of Bank Risk Management implementation in accordance with principles stipulated in regulation concerning Risk Management implementation for Islamic Commercial Banks and Islamic Business Units.

Bank's implementation of Risk Management varies highly according to the scales, complexity, and Risk level that can be tolerated by Bank. As such, in assessing the Risk Management quality, Bank need to consider the characteristics and complexity of the Bank's business.

Assessment of the Risk Management quality is assessment on 4 (four) aspects that are very closely interrelated, namely: (i) Risk governance; (ii) Risk Management framework; (iii) Risk Management process, adequacy of human resources, and adequacy of the management information system; as well as (iv) adequacy of the Risk control system, by considering the characteristics and complexity of the Bank's business. Assessment of the Risk Management quality shall be performed in an integrated manner as follows:

a) Risk Governance

Risk governance includes evaluation of: (i) formulation of Risk appetite and Risk tolerance; and (ii) adequacy of active oversight by Board of Commissioners, Board of Directors, and Sharia Supervisory Board, including the execution of the authorities and responsibiolities of Board of Commissioners, Board of Directors, and Sharia Supervisory Board.

b) Risk Management Framework

Risk Management Framework includes evaluation of: (i) Risk Management strategy that is in line with Risk appetite and Risk tolerance; (ii) adequacy of organizational stucture to supporteffective implementation of Risk Management including clarity in authorities and responsibilities; and (iii) adequacy of policies, procedures and limit setting.

c) Risk Management Process, Adequacy of Human Resources, and Adequacy of Management Information System

Risk Management process, adequacy of human resources, and adequacy of Risk management information system include evaluation of: (i) Risk identification, measuring, monitoring, and control processes; (ii) adequacy of Risk management information system; and (iii) adequacy of human resource quantity and quality to supporteffective Risk Management process.

d) Adequacy of Risk Control System

Adequacy of the Risk control system includes evaluation of: (i) adequacy of internal control system and (ii) adequacy of independent reviews within Bank, by Risk Management working unit as well as by Internal Audit working unit. Reviews by Risk Management working unit includes among others the methods, assumptions, variables used in measuring and determining Risk limits, while reviews by Internal Audit working unit includes among others reliability of the Risk Management framework and Risk Management Implementation by business units and/or supporting units.

Assessment of the Risk Management quality is performed on 10 (ten) types of Risks, namely Credit Risk, Market Risk, Liquidity Risk, Operational Risk, Legal Risk, Strategic Risk, Compliance

Risk, Reputation Risk, Rate of Return Risk, and Equity Investment Risk.

The Risk Management quality for each Risk are categorized into 5 (five) ratings, namely rating 1 (strong), rating 2 (satisfactory), rating 3 (fair), rating 4 (marginal), and rating 5 (unsatisfactory).

3) Determination of Risk Ratings

Risk ratings are determined based on assessment of the rating of inherent Risk and the rating of Risk Management quality of each Risk. Determination of the rating of inherent Risk for each Risk shall refer to Attachments III.2.2.a, III.2.3.a, III.2.4.a, III.2.5.a, III.2.6.a, III.2.7.a, III.2.8.a, and III.2.9.a, III.2.10.a, and III.2.11.a. Determination of the rating of Risk Management quality shall refer to Attachments III.2.2.b, III.2.3.b, III.2.4.b, III.2.5.b, III.2.6.b, III.2.7.b, III.2.8.b, III.2.9.b, III.2.10.b, and III.2.11.b.

4) Determination of The Rating of Risk Profile Factor

Determination of the rating of Risk Profile factor shall be performed through the following stages:

a) Determination of Risk rating of each Risk shall refer to number 3);
b) Determination of composite rating of inherent Risk and composite rating of Risk Management quality shall be performed by considering the significance of each Risk on the overall Risk Profile;
c) Determination of the rating of Risk Profile factor on results of Risk rating determination referred to in letter a) and the composite rating of inherent Risk and the composite rating of Risk Management quality referred to in letter b) shall be based on results of a comprehensive and structured analysis, by considering the significance of each Risk on the overall Risk Profile.

Determination of the rating of Risk Profile factor comprises 5 (five) ratings, namely rating 1, rating 2, rating 3, rating 4, and rating 5. Smaller rating sequence of Risk Profile factor reflects lower Risk that Bank faces. Determination of the rating of the Risk Profile factor shall be performed by referring to **Attachment III.2**.

b. Assessment of Good Corporate Governance (GCG) Factor

1) Assessment of Good Corporate Governance factor for Islamic Commercial Banks constitutes assessment of bank management quality on the implementation of 5 (five) Good Corporate Governance principles, namely transparency, accountability, responsibility, professionalism, and fairness. The Good Corporate Governance principles and assessment focus on the implementation of Good Corporate Governance principles shall refer to the regulation on Good Corporate Governance applicable to Islamic Commercial Banks by considering the characteristics and complexity of Bank's business.
2) In assessing the rating of Good Corporate Governance factor, Islamic Commercial Bank shall use parameters/indicators referred to in **Attachment I.2**. until here 08122014
3) In the framework of determining the implementation of 5 (five) Good Corporate Governance principles referred to in number 1), Islamic Commercial Banks should periodically perform self-assessments, which at least cover 11 (eleven) assessment factors of Good Corporate Governance implementation as provided in the regulation concerning Good Corporate Governance applicable for Islamic Commercial Banks as follows:
   a) Implementations of the tasks and responsibilities of Board of Commissioners;
   b) Implementations of the tasks and responsibilities of Board of Directors;
   c) Sufficiency in number of members and implementation of the tasks of Committee;
   d) Implementations of the tasks and responsibilities of Sharia Supervisory Board;

e) Implementation of the Islamic principles in activities related to funds mobilization and funds channeling as well as banking services;

f) Handling of conflicts of interest;

g) Implementation of compliance function;

h) Implementation of internal audit function;

i) Implementation of external audit function;

j) Legal Lending Limit; and

k) Transparency of financial and non-financial conditions of Islamic Commercial Banks, report on Good Corporate Governance implementation as well as internal reporting.

4) Determination of the rating of Good Corporate Governance factor shall be performed based on analyses of: (i) implementation of Good Corporate Governance principles as referred to in number 1); (ii) adequacy of governance on the structure, process, and outcome of Good Corporate Governance; and (iii) other information related to Good Corporate Governance that is based on relevant data and information.

5) Determination of the rating of Good Corporate Governance factor shall be categorized into 5 (five) ratings, namely rating 1, rating 2, rating 3, rating 4, and rating 5. Smaller rating sequence of Good Corporate Governance factor reflects better Good Corporate Governance implementation. The determination of the rating of Good Corporate Governance factor shall be performed by referring to **Attachment III.3**.

6) Islamic Commercial Banks shall periodically perform self-assessments on Good Corporate Governance implementation in accordance with the periods set for assessing Bank Rating and when required at any time, Islamic Commercial Banks are obliged to update its self-assessment on Good Corporate Governance implementation as provided in the Financial Services Authority Regulation concerning Risk-Based Bank Rating for Islamic Commercial Bank and Islamic Business Unit . Self-assessment of Good Corporate Governance implementation shall be performed by developing analysis of adequacy and effectiveness of the Good Corporate Governance principles implementation, which is incorporated into Working Paper of Self-Assessment on Good Corporate

Governance implementation as referred to in **Attachment II**, with the following steps:

a) collect relevant data and information for assessing of the adequacy and effectiveness of Good Corporate Governance principles implementation, such as data on management, ownership, business group structure, minutes of meetings of Board of Commissioners, Board of Directors, Sharia Supervisory Board and Committee, as well as reports such as among others annual reports, reports of the Compliance Director, Internal Audit reports, public accountant reports commenting particularly on the realibility of bank internal control system, reports on self-assessments of Bank Rating, reports of business plan and its realization, reports of Board of Commissioners, reports of Sharia Supervisory Board, and other reports related to Good Corporate Governance principles implementation;

b) assess the adequacy and effectiveness of Good Corporate Governance principles implementation, which shall be performed in a comprehensive and structured manner on three aspects of governance, namely governance structure, governance process, and governance outcome, by considering the significance or materiality principles; and

c) draw conclusions on the positive and negative factors from each aspect of governance.

7) In drawing conclusions on the positive and negative factors of the three aspects of governance, attention should be given among others to the following:

a) Assessment shall focus on the substance of Good Corporate Governance implementation and not only on fulfilment of formal procedural requirements (normative). Assessment of Good Corporate Governance shall also give attention among others to whether the policies and procedures have been well implemented. As such, in undertaking assessment of Good Corporate Governance implementation, Islamic Commercial Banks shall not only answer questions with yes/no answers but should also reveal the substance of those answers.

For example, in undertaking assessment on fulfilment of the completeness of organization structure's organs of Islamic Commercial Banks, assessment shall also be made on whether those organs function as they should.

b) Assessments of governance structure, governance process, and governance outcome should be a series of integrated, comprehensive, and structured assessments so that the conclusion of the result of governance outcome assessment reflects the extent of governance process implementation and adequate support from governance structure, which need to be further tested and proven.

For example, there is a problem in governance structure, which is vacant position of the Compliance Director. The absence of the Compliance Director causes a weakness in governance process, namely in the implementation of bank compliance function, as there are no preventive actions on policies and/or decisions of Business Director that noncomply from prevailing regulations.

Furthermore, that weakness in governance process impacts governance outcome in the form of violations on the Legal Lending Limit.

c) In addition to covering qualitative aspects, assessment of governance outcome also covers quantitative aspects, among others:

(1) bank's performance such as earnings, efficiency, and capital;

(2) increase/decrease in compliance to prevailing regulations and settlement of problems faced by bank such as frauds, violations of Legal Lending Limit, violations of regulations concerning bank reporting to the Financial Services Authority.

In this regard, Islamic Commercial Banks should give attention whether those violations occur repeatedly and/or the materiality/significance of the problems on bank's performance currently as well as in the future.

In addition, Islamic Commercial Banks need to also give attention whether the assessment has covered follow-up actions that bank needs to undertake in order to resolve the problems currently and to anticipate the occurrence of the problems in the future.

d) In determining the Rating of Good Corporate Governance Factor, Islamic Commercial Banks should give attention to balance it with the significance level of the problems facing the bank in accordance with the resulting conclusion from the assessment of Islamic Commercial Bank's Good Corporate Governance implementation.

e) Assessment of governance structure, governance process, and governance outcome should be supported by adequate data/information and documents.

8) Based on Working Paper of Self-Assessment on Good Corporate Governance implementation mentioned above, Islamic Commercial Bank draws conclusions on results of self-assessment on Good Corporate Governance implementation and determines the Rating of Good Corporate Governance Factor referring to the Matrix of Good Corporate Governance Factor Rating referred to in **Attachment III.3**.

In undertaking assessment of Good Corporate Governance implementation, Islamic Commercial Bank should give attention to assessment of the Risk Management quality in the framework of assessing Risk Profile in consideration of the fact that in general Good Corporate Governance factor has interrelation with the Risk Management quality. In general, good implementation of Good Corporate Governance will ensure good risk management as reflected in the assessment of the Risk Management quality.

9) Furthermore, Islamic Commercial Bank prepares Assessment of Good Corporate Governance Factor as referred to in **Attachment IV.4**, which at least includes:

   a) Rating of Good Corporate Governance Factor and Definition of Rating; and

   b) Analysis of Good Corporate Governance factor, which comprises among others:

      (1) identification of problems, in the form of weaknesses and reasons of the problems (root causes); and

      (2) strengths of Good Corporate Governance implementation.

   In the event, based on results of self-assessment on Good Corporate Governance implementation, the Rating of Good Corporate Governance Factor obtained is Rating 3, 4 or 5, the Islamic Commercial Bank is obliged to prepare and submit an action plan that contains corrective actions in a comprehensive and systematic manner as well as the target deadline of the implementation to the Financial Services Authority.

10) Assessment of Good Corporate Governance Factor referred to in Attachment IV.4 should be signed by the Islamic Commercial Bank's Board of Directors.

11) Islamic Commercial Bank submits Assessment of Good Corporate Governance Factor in individual as well as consolidated manner as referred to in Attachment IV.4 to the Financial Services Authority, supplemented by Working Paper of Self-Assessment on Good Corporate Governance Implementation referred to in Attachment II, as part of the result of BankRating self-assessment.

12) The Financial Services Authority performs assessment or evaluation of Self-Assessment on Good Corporate Governance implementation submitted by Islamic Commercial Bank. When there is a material difference in the results of self-assessment on Good Corporate Governance implementation by Islamic Commercial Bank, which causes the results of Good Corporate Governance Factor Rating to be different

than results of assessment or evaluation performed by the Financial Services Authority, the Islamic Commercial Bank should make revisions to the results of self-assessment on Good Corporate Governance implementation in accordance to agreements reached in the prudential meeting. In the event there is still a difference in the results of assessments on Good Corporate Governance implementation, then results of assessment performed by the Financial Services Authority prevail.

13) In addition, when result of assessment of Good Corporate Governance Factor Rating performed by the Financial Services Authority is categorized as Rating 3, 4 or 5, the Financial Services Authority can request Islamic Commercial Bank to submit an action plan that contains corrective actions in a comprehensive and systematic manner as well as the target deadline of the implementation.

14) When required, the Financial Services Authority can request Islamic Commercial Bank to make adjustments to the action plan submitted by the Islamic Commercial Bank.

15) The action plan shall be submitted in accordance with the procedure for submission as provided in the regulation concerning Risk-Based Bank Rating for Islamic Commercial Bank and Islamic Business Unit . However, the Islamic Commercial Bank can submit the action plan earlier, at the same time as the submission of Report of Self Assessment of Good Corporate Governance Factor.

16) Report on implementation of Good Corporate Governance action plan together with time of completion and constraints/obstacles of its completion (if any) shall be submitted to the Financial Services Authority by referring to the procedures for submission of report of action plan implementation as referred to in the regulation concerning Risk-Based Bank Rating for Islamic Commercial Bank and Islamic Business Unit .

17) Documents related to self-assessment of Good Corporate Governance implementation, which include among others Working Paper of Self-Assessment on Good Corporate Governance implementation and Report of Self Assessment of Good Corporate Governance Factor should be administered properly.

c. Assessment of Earnings Factor

1) Assessment of Earnings Factor covers evaluation of Earnings performance, sources of Earnings, sustainability of Earnings, Earnings management, and implementation of social function. Assessment is performed by taking into consideration the Islamic Commercial Bank's Earnings level, trend, structure, stability, and comparison of Islamic Commercial Bank's performance and peer group's performance, both through analysis of quantitative aspects as well as analysis of qualitative aspects.

   In determining the peer group, Islamic Commercial Bank should consider the business scale, characteristics, and/or complexity of Islamic Commercial Bank's business as well as availability of data and information.

   In assessing the Earnings factor, Islamic Commercial Bank shall use parameters/indicators that are referred to in **Attachment I.3**.

2) Determination of the rating of Earnings factor is performed based on a comprehensive and structured analysis on Earnings parameters/indicators as referred to in number 1) by giving attention to the significance of each parameter/indicator as well as by taking into consideration other problems that influence Islamic Commercial Bank's Earnings.

3) Assessment of the rating of Earnings factor is categorized in 5 (five) ratings, namely rating 1, rating 2, rating 3, rating 4, and rating 5. Smaller rating sequence of Earnings factor reflects better Islamic Commercial Bank's Earnings condition. The determination of the rating of Earnings factor shall be performed by referring to **Attachment III.4**.

d. Assessment of Capital Factor

1) Assessment of Capital factor covers evaluation of capital adequacy and adequacy of Capital management. In undertaking calculation of Capital, Islamic Commercial Bank refers to the prevailing regulation concerning obligation to provide minimum capital for Islamic Commercial Banks. In addition, in undertaking assessment of capital adequacy, Islamic Commercial Bank should also correlate capital adequacy with Risk Profile. The higher the Risk, the larger the amount of capital that should be provided to anticipate that Risk.

2) In undertaking assessment, Islamic Commercial Bank needs to take into consideration the level, trend, structure, and stability of Capital by giving attention to peer group's performance as well as adequacy of Islamic Commercial Bank's Capital management. Assessment is performed using quantitative as well as qualitative parameters/indicators. In determining peer group, Islamic Commercial Bank needs to consider the business scale, characteristics, and/or complexity of Islamic Commercial Bank's business as well as availability of data and information.

3) Parameters/indicators used in assessing Capital include:

   a) Capital adequacy

      Assessment of capital adequacy of Islamic Commercial Bank needs to be performed comprehensively and shall at minimum covers:

      (1) Level, trend, and composition of capital;

      (2) Capital Adequacy Ratio that take into account Credit Risk, Market Risk and Operational Risk by referring to prevailing regulation concerning minimum capital requirement for Islamic Commercial Bank; and

      (3) Capital adequacy is correlated with Risk Profile

   b) Management of Capital

      Analysis of the management of Islamic Commercial Bank Capital covers management of Capital and ability to access Capital. In performing assessment of Capital factor, Islamic Commercial Bank shall use parameters/indicators as referred to in **Attachment I.4**.

4) Capital Factor is determined based on a comprehensive and structured analysis on Capital parameters/indicators as referred to in number 3) by giving attention to the significance of each parameter/indicator as well as by taking into consideration other problems that influence Islamic Commercial Bank's Capital.

5) Assessment of the rating of Capital factor is categorized in 5 (five) ratings, namely rating 1, rating 2, rating 3, rating 4, and rating 5. Smaller rating sequence of Capital factor reflects better capital condition. The determination of the rating of Capital factor shall be performed by referring to **Attachment III.5**.

e. Assessment of Composite Bank Rating

1) Composite Bank Rating is determined based on a comprehensive and structured analysis on the rating of each factor and by giving attention to general principles for assessing Bank Rating. In performing comprehensive analysis, Bank also needs to take into consideration Bank's ability to deal with significant changes in external conditions.
2) Determination of Composite Rating is categorized in 5 (five) Composite Ratings, namely Composie Rating 1 (CR-1), Composite Rating 2 (CR-2), Composite Rating 3 (CR-3), Composite Rating 4 (CR-4), and Composite Rating 5 (CR-5). Smaller Composite Rating sequence reflects sounder condition of Bank. The determination of Composite Ratings shall be performed by referring to **Attachment III.1**.
3) The Financial Services Authority has the authority to lower the Composite Bank Rating in the event problems or violations are found that will significantly influence the operation and/or sustainability of Bank. Examples of problems or violations that have significant influence are among others engineered situations including window dressing and internal management disputes that influence the operation and/or sustainability of Bank.

2. **Procedures for Assessing Bank Rating of Islamic Commercial Banks in consolidated manner**

a. Islamic Commercial Bank exercising Control over Subsidiary Companies is obliged to perform assessment of Bank Rating in a consolidated manner, covering assessment of the following factors: Risk Profile, Good Corporate Governance, Earnings, and Capital.

b. Determination of Subsidiary Companies that should be consolidated refers to prevailing regulation concerning Risk Management implementation in consolidated manner for Bank exercising Control over Subsidiary Companies. In performing assessment in consolidated manner, Bank is obliged to pay attention to: (i) materiality or significance of the share of Subsidiary Company in the share or performance of Bank in consolidated manner; and/or (ii) significance of the problems of Subsidiary Company on Bank Risk Profile, Good Corporate Governance, Earnings, and Capital in consolidated manner.

c. Determination of the materiality or significance of the share of Subsidiary Company can be performed through comparison of Subsidiary Company's total asset with Bank's consolidated total asset, or the significance of certain accounts in the Subsidiary Company's financial reports that influence Bank's consolidated performance such as risk-weighted assets, earnings, and capital. Determination of the significance of Subsidiary Company's problems is made among others by taking into consideration problems existing in Subsidiary Company and their impacts on Bank's consolidated performance or condition. For example: problems related to Subsidiary Company's business which might have impacts on Bank's consolidated Reputation Risk, Credit Risk, or Liquidity Risk, problems concerning the governance or weaknesses in Subsidiary Company's Risk Management implementation.

d. Parameters/indicators used in the assessment of Bank Rating in individual manner can be used by Bank when assessing Bank Rating in consolidated manner. These parameters/indicators can be supplemented by other parameters/indicators as long as they are relevant to the business scale, characteristics, and complexity of Bank's business in consolidated manner.

e. Assessment of consolidated Bank Rating for Islamic Commercial Bank exercising control over Subsidiary Company that is an insurance company is performed by taking into account relevant qualitative and quantitative factors, among others fulfilment of capital adequacy by the insurance company in accordance with requirement of the authorized authority and impacts of Risks that are considered to be significant or material that influence Bank's consolidated Risk Profile and financial performance.

f. In assessing Bank Rating in consolidated manner, the mechanism for determining the rating as well as rating category of each assessment factor and the determination of the composite bank rating in consolidated manner shall use as guideline the procedure for assessing Bank Rating individually as referred to in point III.1.

g. Assessment and determination of Risk Profile factor in consolidated manner is performed by giving attention to the following matters:

   1) Analysis performed on Subsidiary Company's Risks that are considered significant or material in influencing Bank Risk Profile in consolidated manner.
   2) The significance or materiality of Subsidiary Company's Risks can be assessed among others from the scale, characteristics, and complexity of Subsidiary Company's business, Risks arising from Subsidiary Company's business activities, and impacts on Bank Risk Profile in consolidated manner.
   3) Determination of the ratings of inherent Risk, Risk Management quality, and Islamic Commercial Bank's Risk level in consolidated manner is performed by taking into account the impacts caused by Subsidiary Company's Risks.
   4) Determination of the rating of Bank Risk Profile factor in consolidated manner is performed by taking into account the impact of all Subsidiary Company's Risks on the Islamic Commercial Bank's Risk Profile in consolidated manner.

h. Assessment and determination of the rating of Good Corporate Governance factor in consolidated manner are performed by giving attention to the following matters:

1) Assessment is performed on problems in Subsidiary Company’s Good Governance implementation that are considered to have significant impact on Bank’s consolidated Good Corporate Governance.
2) Factors in assessment of Subsidiary Company’s Good Corporate Governance used in assessing the implementation of Good Corporate Governance principles in consolidated manner are determined by giving attention to the Subsidiary Company’s business characteristics and supported by adequate data and information.
3) Determination of the rating of Islamic Commercial Bank’s Good Corporate Governance factor in consolidated manner is performed by taking into consideration the impact of Subsidiary Company’s Good Corporate Governance implementation.

i. Assessment and determination of the ratings of Earnings factor and Capital factor in consolidated manner are performed based on comprehensive and structured analyses on certain Earnings and Capital parameters/indicators produced from consolidated financial reports and other financial information, by giving attention to the following matters:
1) Assessment is performed on the performances of Subsidiary Company’s Earnings and Capital that are considered to have significant impacts on the Islamic Commercial Bank’s consolidated Earnings and Capital.
2) Assessment is performed by referring to certain parameters/indicators applicable individually to Bank as long as they are supported by adequate data or information. In performing the assessment, Islamic Commercial Bank can add parameters/indicators relevant to the Subsidiary Company’s scale, characteristics, and complexity.
3) Determination of the ratings of Islamic Commercial Bank’s Earnings factor and Capital factor in consolidated manner is performed by taking into consideration the impacts of Subsidiary Company’s Earnings and Capital performances.

IV. FOLLOW-UP OF BANK RATING ASSESSMENT

1. Board of Directors, Board of Commissioners, and/or controlling shareholders are obliged to submit an action plan to the Financial Services Authority that contains

corrective actions that Bank is obliged to execute in the framework of resolving its significant problems , supplemented by target deadline of completion, when results of Bank Rating assessment show:

a. one or more of the bank ratings factors are determined to be 4 or 5;
b. the composite bank rating is determined to be 4 or 5; and/or
c. the composite bank rating is determined to be 3, but there are significant problems that need to be resolved in order not to disrupt the sustainability of Bank's business.

2. The action plan as referred to in number 1 covers among others actions:
   a. to improve Bank's Risk Management implementation with real corrective measures, supplemented by target time of completion. For example, when Bank has a high level of Credit Risk, Bank can lower that Credit Risk level by correcting the weaknesses in the quality of Credit Risk Management and/or lower the inherent Credit Risk exposure;
   b. to improve Good Corporate Governance implementation with real corrective measures, supplemented by target time of completion.
   c. to improve Bank's financial performance among other by stepping up efficiency if Bank experiences a problem in Earnings; and/or
   d. to make cash injection to capital by Bank's shareholders and/or other parties when Bank experiences a problem in shortage of Capital.

Bank is obliged to report the realization of the action plan to the Financial Services Authority no later than 10 (ten) working days after the action plan target date of completion and/or 10 (ten) days after the end of the month when there are significant problems that prevent on time completion of the action plan. The Financial Services Authority can request the Bank to correct the action plan when necessary. In the event the deadline for submission of the action plan on the results of self-assessment falls on a holiday, the action plan is submitted on the following working day.

V. REPORTING

1. Bank is obliged to submit the self-assessment of individual Bank Rating to the Financial Services Authority no later than 31st July for assessment of Bank Rating for end of June position and 31st January for assessment of Bank Rating for end of December position.
2. Islamic Commercial Bank exercising control over Subsidiary Company is obliged to submit self-assessment on consolidated Bank Rating to the Financial Services Authority no later than 15th August for assessment of Bank Rating for end of June position and no later than 15th February for assessment of Bank Rating for end of December position.
3. In the event the deadline for submission of Bank Rating self-assessment falls on a holiday, the Bank Rating self-assessment shall be submitted on the following working day.
4. Bank is obliged to immediately undertake updating of self-assessment of Bank Rating and submit to the Financial Services Authority, among others in the event of worsening of Bank financial condition, such as Bank is facing problems such as Liquidity or Capital Risk, or other conditions which according to the Financial Services Authority require updating of Bank Rating assessment.
5. Report on self-assessment of Bank Rating and/or updating on self-assessment of Bank Rating shall be submitted to the Financial Services Authority at the following address:
   a. Islamic Banking Department, Radius Prawiro Tower, Jl. M.H.Thamrin No. 2, Jakarta 10350, for Banks whose head offices are located within the work area of Financial Services Authority head office; or
   b. Financial Services Authority local Representative Offices for Banks whose head offices are located outside the work area of Financial Services Authority head office.
6. Self-assessment of Bank Rating is submitted using the report format referred to in **Attachment IV**.

VI. OTHER PROVISION

Attachment I, Attachment II, Attachment III, and Attachment IV are integral and inseparable parts of this Financial Services Authority Circular Letter.

VII. CONCLUDING PROVISION

With the enactment of this Financial Services Authority Circular Letter:

a. Bank Indonesia Circular Letter Number 9/24/DPbS dated 30 October 2007 concerning Bank Rating for Commercial Banks Based on Islamic Principles is declared no longer valid.

b. Letter F concerning Self-Assessment on Good Corporate Governance Implementation number 3, number 4, number 5, number 6, number 7, number 8, number 9, number 10, and number 11 in Bank Indonesia Circular Letter Number 12/13/DPbS dated 30 April 2010 concerning Implementation of Good Corporate Governance for Islamic Commercial Banks and Islamic Business Units are declared no longer valid for Islamic Commercial Banks.

Assessment of Bank Rating in this provision shall be executed effectively since 1 July 2014, namely for assessment of Bank Rating for the position of end of June 2014.

The provisions of this Financial Services Authority Circular Letter are effective starting on the date of enactment.

For the public to be informed, it is ordered that this Financial Services Authority Circular Letter be promulgated in the State Gazette of the Republic of Indonesia.

Enacted in Jakarta
On 11 June 2014
EXECUTIVE HEAD OF BANK
SUPERVISION

NELSON TAMPUBOLON

STATE GAZETTE OF THE REPUBLIC OF INDONESIA NUMBER 51 OF 2014

COPY IN ACCORDANCE WITH THE ORIGINAL
LEGAL DIRECTOR I

LEGAL DEPARTMENT,

Tini Kustini