

# Role of Fee Based Income in Moderating Relationship of Loan Loss Provision on Income of PT. Regional Development Bank Of Southeast Sulawesi

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**Abstract-**This study aims to examine and analyze the effect of simultaneous and partial Loan Loss Provision (LLP) to Income with Fee Based Income as a Moderation Variable (Study at PT. BPD Sultra). The data of this study are quarterly reports of the PT. BPD Sultra for the period of 2011 - 2017, totaling 28 samples. Data in the study were analyzed using Moderate Regression Analysis with the help of SPSS software ver 22. Results of the research are : 1) Loan Loss Provision (LLP) have a significant positive effect on income at PT. BPD Sultra, 2) Fee Based Income as a moderating variable weakens the relationship of Loan Loss Provision (LLP) to income at PT. BPD Sultra

**Index Terms:** Loan Loss Provision (LLP), Fee Based Income, Income

## 1 INTRODUCTION

Banking is one of the financial institutions as the backbone of national economy. Main function of bank is as intermediation institution connecting any parties with funds and any parties requiring funds. Also, bank assists smoothness of payment system as well as a means for government in monetary policy application.

The main bank income is not only interest, it also makes incomes taken from provisions, commition, derivative transactions, and investment, this is called asfee based Income.Bank has responsibility to maintain public trust so that there will be no risk of loss. To solve this issue, bank forms Loan Loss Provision (LLP) to anticipate uncertainly of income.Moretha (2015) said higher AIL will lead to more number of non performing assets so there will be decreased interest income to influenceNet Interest Margin.To solve this, Sianipar (2015)said that it is necessary for banking to improve its fee based incomecontribution in order not to influence the interest rate at the time of bad credit and as a results, there will be negative bank capital and decreased capital adequacy ratio (CAR).

Anggadini (2010)said Fee based incomecontributes to increased profitability with relatively small risk level compared tonet interest income. Uppal (2010)said fee based incomeplays a role as stabilization of bank income taken from the interest along by increased banking competition. One of the banks trying to increasefee based incomeis PT. BPD Southeast Sulawesi in Southeast Sulawesi having mean incomerate for five recent years by Rp 702.129 (21,65%), cost by Rp 510.566 (28,07%), VDLR Rp 190.055 (72,72%)and net income byRp 141.533 (11,21%). Contribution of Fee Based Income growth on Total Income in Sultra Bank can be described in the following data:

Table 1.1 Growth of Interest Rate, Fee Based Income, Interest Expense and Non Interest Expense in Sultra Bank in Period of 2013 until 2017

Years	Interest income		Non interest income		Interest expense		Non interest expense	
	Total (IDR million)	Growth (%)	Total (IDR million)	Growth (%)	Total (IDR million)	Growth (%)	Total (IDR million)	Growth (%)
2013	347,116	9.13%	60,213	36.04%	92,924	1.84%	161,425	32.09%
2014	413,021	18.99%	148,654	146.88%	111,006	19.46%	291,042	80.30%
2015	515,509	24.81%	241,457	62.43%	175,561	58.15%	402,855	38.42%
2016	586,234	13.72%	255,979	6.01%	187,506	6.80%	430,833	6.94%
2017	633,351	8.04%	309,111	20.76%	218,280	16.41%	474,200	10.07%
Mean	499,046	14.94%	203,083	54.42%	157,055	20.53%	352,071	33.56%

(source: secondary data, Financial Reports of Sultra Bank)

Based on table 1.1, it can be seen that mean of interest income in the period of recent 5 (five) past years was 14,94%, meanwhile, growth of mean fee based income was 54,42%, and from the aspect of expense, mean of interest expense was 20,53% and mean of non interest expense was 33,56%. Based on the data, it can be seen that although currently interest income still dominates the total income of Bank Sultra, but overall over the past 5 (five) years, the mean growth of fee-based income is higher than the mean of interest income growth and the mean of non-interest expense, this indicates that Bank Sultra always makes efforts to increase non-interest income (fee based income) from year to year.

The efforts made by the Southeast Sulawesi Bank in increasing non-interest income (fee based income) are realized in various types of service and product development, including the following:

1. The Southeast Sulawesi Bank supports the Regional Government in the context of implementing Non-Cash transaction through Online work unit product

2. Developing land and building tax payment applications through PBB Online products
3. Developing Motor Vehicle Tax payment applications through Samsat Online products
4. Establishing cooperation with PT. Taspen through Electronic Pension Payment List (eDapen)
5. Increasing opening office networks and developing SMS Banking feature.
6. Developing Hospital Management Information System (SIMRS) services

In addition to efforts to develop services and products, Southeast Sulawesi Bank also strives to collect and resolve existing non-performing loans so that the recovery of Loan Loss Provision as part of fee based income on the Bank's Profit and Loss Statement, continues increasing every year and in the end these, efforts will improve the performance of Southeast Sulawesi Bank. The recovery growth of Southeast Sulawesi Bank's Loan Loss Provision (CKPN) for the period of 2013 to 2017 can be illustrated in the data as follows:

Table 1.2 Growth of Allowance for Impairment Loss Recovery in Southeast Sulawesi Bank in Period of 2013 until 2017

Years	Recovery of Loan Loss Provision	
	Total (million IDR)	Growth (%)
2013	43,359	36.94%
2014	130,095	200.04%
2015	212,508	63.35%
2016	221,340	4.16%
2017	267,632	20.91%
Mean	174,987	65.08%

(Source: secondary data, Financial Reports of Sultra Bank)

Based on table 1.2, it can be seen that the mean recovery growth of Loan Loss Provision (LLP) was 65.08% with a tendency trend to increase from year to year, this illustrates that Southeast Sulawesi Bank always improves its efforts to collect and resolve non-performing loans.

The Southeast Sulawesi Bank's efforts to continuously improve its performance are conducted through increasing operational cost efficiency, increasing fee-based income through development of products and services as well as improving the recovery of reserves formed in previous year and also reducing reserve costs by maintaining credit quality and increasing its efforts to resolve non-performing loans; these lead to results that based on information in the April 2018 edition of Infobank magazine, the Southeast Sulawesi Bank was in the first rank in 2017 for the Book 1 Bank category.

There are some researched conducted on AIL and Non-Interest Income, but there are different results. Calmes & Theoret (2010) stated that share of non-interest income has a positive influence on profitability. This was reinforced by Lepetit (2008) stating that an increase in non interest income has an influence on decreased bank's net interest margin. This research shows that high competition between banks in Europe has potential to cause a risk of default, cause financial disintermediation. Calmes & Liu (2009) stated that share of non interest income has a negative influence on profitability.

Mangunsong and Marpaung (2001) stated that fee based income has a significant influence on earnings per share. However, Susanty (2008) stated that fee based income does

not have a significant influence on profitability as seen from the bank's return on equity. Calmes and Theoret (2010) stated Loan Loss Provision over total assets will reduce bank profits due to deteriorating quality of loan portfolio, there will be increased bank's risk exposure and potentially influence on bank profit negatively. Aktan (2013) suggests that the loan loss provision variable has a positive influence on profitability. Jamal Abdel-Rahman Abu-Serdaneh (2018) found that there was a negative and significant relationship between income and Loan Loss Provision.

In accordance with formulation of above problems, purpose of this research is to find out and analyze: (1). Influence of Loan Loss Provision (CKPN) on the income of PT. Southeast Sulawesi BPD and (2). Fee Based Income role in moderating the relationship of Loan Loss Provision (CKPN) on the income of PT. Southeast Sulawesi BPD.

## 2 THEORITICAL STUDY

### 2.1 Bank Income Concept

Income according to Niswonger (2006), "gross increase in capital owners created from goods sale, implementation of services for clients, leasing properties, borrowing money and all business activities with the purpose to obtain revenue or income". Based on the definition, it can be concluded that bank income is a revenue obtained by bank from sales of its products and other services in the field of finance or other activities with the purpose to add income in order to provide profits for bank. Bank income is an important role to be considered for the sake of bank sustainability since the bank income has some functions, among others (Hasibuan, 2008): (1). It can ensure continuity of bank establishment, (2) it can pay dividend of shareholders, (3) it can pay and improve employee compensation, (4) it can be used as the benchmark of bank health level, (5) it can be used as the benchmark of bank management health, (7) it can improve public trust to the bank, and (8) it can improve the bank status.

Bank income consists of operational income and non operational income (Siamat, 2005). According to Kasmir (2008) bank income can be divided into two groups, namely interest income and Non Interest Income. Operational income is taken from business results and banking activities. Non operational income is the income taken from any businesses outside banking activities. Bank operational income consists of interest income and other non interest income.

Operational income consists of all incomes as direct results of bank business activities that are definitely accepted.

### 2.2 Bank Income Derivation Concept

One of the banking businesses in improving bank profitability is income derivation. The income derivation is a trend in banking world. derivation in the banking world develops very rapidly since derivation is an opportunity in obtaining profits not from net interest income. In each business activity, it is necessary for derivation including banking activity.

According to Kasmir (2010) product derivation tends to improve portion of non interest income. Non interest income is from service income given to customers. According to

Lepetit (2008) income derivation is a combination of net interest income and non interest income as well as other diversification activities that will give more benefits to bank profitability.

The income derivation according to Sianipar (2015), is non interest income calculated with proportion of non interest income to operational income. Non interest income is taken from two types of sources, namely fee income and trading income

- a. Fee Income is the income that is calculated with income proportion of provision, commission, and fee on operational income. Activities giving contribution to fee income are selling insurance, serving payment transaction, cash management, management wealth and investment in bank.
- b. Trading income is calculated with income proportion taken from foreign exchange transaction and security value increase to the operational income.

There are many banks no longer having focus on lending activities, but have expanded their activities to business lines that serve customers in trade and investment in securities, selling insurance, being underwriters, and serving transaction activities, as a result, there are increasingly higher proportion of non-interest operating income compared to any income from lending activities or called interest income. (Sianipar, 2015)

### 2.3. Fee Based Income Concept

Other operating income is non interest operating income. If Interest Income is produced from traditional banking activities, bank's Non Interest Income is actually resulted from non-traditional activities; Hidayat (2012).

According to Ismail (2010), "fee based income is bank income taken from fees for bank services to customers". Non-interest income (fee based income) as a non-traditional activity in bank's profit / loss report is an operational opinion beyond interest and non-operating income. Components of bank non interest operating income are grouped in the income statement as follows (Setiadi, 2010):

1. Provisions, commissions, and fees, are bank income earned from credit and bank services, such as credit provision, bank guarantee provisions, L / C provisions, administrative fees, and others.
2. Income from foreign exchange transactions is income earned by the bank from sale and purchase of foreign exchange.
3. Increased securities are profit earned by the bank and become income because of increased price of initial security purchase price owned by the bank.
4. Other income is bank's income excluding fees and commissions, increased securities, and foreign exchange transactions but still including in bank's operating income consisting of services for corporate services, syndicated loan services, and others.

Fee based income is income earned from other banking service activities. This source is also a quite safe income alternative from risk, because it will not be hit by a Non Performing Loan (NPL) such as interest income from credit (Susilo et al., 2006). There are several products that produce fee-based income, namely transfers, collections, letters of credit (L / C),

safe deposit boxes, credit cards, funds for payment of deposit points, bank guarantees, buying and selling or trading of foreign exchange, and commercial paper (Anggadini, 2010). Fee based income is more known as Non Interest Income (NII).

### 2.4 Concept of Allowances for Impairment Losses

Impairment is seen as a condition in which there is losses on objective evidences as a result of one or more events after credit initial acknowledgment, and the losses events influence on future cash flow estimation on financial asset or groups of financial assets that can be reliably estimated (Guidance of Indonesian Banking Accounting, 2008)

Impairment losses can be found on one group of financial assets with impairment. If there are objective evidences of the impairment as a result of one or more events after credit initial acknowledgment, and the losses events influence on future, then in the company, there will be impairment for its financial asset group. Basically, impairment facing by a company is hardly identified and it is influenced by a combination of some events. According to PSAK 55 paragraph 66, there are 6 events leading to this impairment, namely:

1. Significance financial difficulties faced by loan issuers or borrowers
2. Contract deviation, as default or arrears in principal or interest payments
3. Lender, for economic or legal reasons related to financial difficulties faced by borrower, provides concession to the borrower party which will not be given to the borrower if the party does not face such difficulties
4. There is a possibility that borrower party will be declared bankrupt or carry out other financial reorganizations
5. Loss of active market from financial assets due to financial difficulties
6. Observable data indicate a measurable decrease in the estimated future cash flows of the group of financial assets since asset initial recognition. Including deteriorating payment status of borrowers and national or local economic conditions that correlate with defaults on assets in the group

The provisions of PSAK 55 (revised 2011) concerning recognition of Loan Loss Provision are as follows: "Estimation process of the amount of impairment loss can produce one value of possible losses. In the latter case, the entity recognizes losses due to impairment in the amount of the best estimate by considering all relevant information available before the financial statements are published regarding the conditions faced at the end of the reporting period "PSAK No. 55 (revised 2011) "At the end of each reporting period, the entity evaluates whether there is objective evidence that a financial asset or group of financial assets is impaired."

Based on Bank Indonesia Regulation Number 14/15/PBI/2012 concerning Asset Quality Assessment for Commercial Banks as amended by the Financial Services Authority Regulation Number 14 / POJK.03 / 2018 concerning Asset Quality Assessment for Commercial Bank to encourage the growth of housing sector and increase Loan Loss Provision of foreign exchange which is hereinafter referred to as AIL, is an allowance established if the carrying value of a financial asset

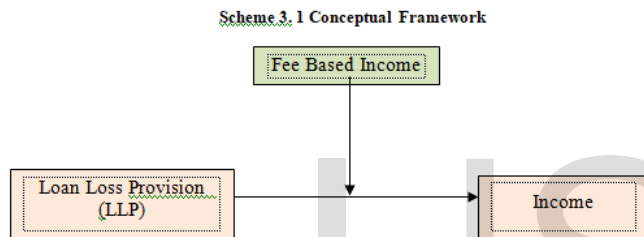
after impairment is less than the initial carrying value.

Loan Loss Provision (LLP) is the amount derived from the carrying value to the amount that can be recovered from assets (Febriati, 2013). AIL is a reflection of risk determination of default credit / financing in the future. Any risk of default credit is anticipated by forming allowance of bad credit risk at present. If the risk is predicted to increase, then it will create greater allowance (Oktaviyanti, 2013).

### 3 CONCEPTUAL FRAMEWORK AND RESEARCH HYPOTHESES

#### 3.1 Conceptual Framework

Research conceptual framework is the arrangement of logic constructs in order to describe the studied variables. This framework is formulated to describe the construction of logic flow to systematically examine empirical facts (Sugiyono, 2010). Based on the existing theoretical framework, the conceptual framework used in this study is as follows:



#### 3.2. Research Hypotheses

The hypothesis is a temporary answer to the formulation of research problems, which the formulation of the research problem has been expressed in the form of a question sentence. It is said temporarily, because the answers given are only based on relevant theories, not based on empirical facts obtained through data collection, so hypotheses can also be stated as theoretical answers to the formulation of research problems, not empirical answers. (Sugiyono, 2010)

Based on the conceptual framework in this study, the proposed hypotheses are:

Hypothesis 1: Influence of AIL on Income

H0: There is no significant influence of AIL on Income

H1: There is a significant influence of AIL on Income

Hypothesis 2: Influence of Fee Based Income on relationships of AIL and Income

H0: There is no influence of Fee Based Income on the relationship of AIL and Income

H1: There is an influence of Fee Based Income on the relationship of AIL and Income

### 4 RESEARCH METHODS

The types of data used in this study are secondary data in the form of Southeast Sulawesi Bank Financial Statements in the Period of 2011-2017, while the Data Sources are taken from Quarterly Publication Reports by the Southeast Sulawesi Bank as well as quarterly financial report documents for the period of 2011-2017. Data collection methods are mainly by documen-

tary study on the Southeast Sulawesi Bank Financial Report published every month by the Southeast Sulawesi Bank and also monthly Southeast Sulawesi Bank financial report documents for the period of 2011 - 2017.

In analyzing the studied problems, there will be conducted quantitative analysis. This research is conducted by collecting data in the form of figures. Data in the form of figures are then processed and analyzed to obtain scientific information behind these numbers (Nanang, 2010). The analysis technique used in the study consists of 2 (two) analysis techniques namely:

1. Linear Regression Analysis to test the first hypothesis, namely the influence of the Loan Loss Provision (LLP) on Income with a linear regression model shown in the following equation:

$$Y = \alpha + \beta_1 X_1 + \epsilon \dots \dots \dots (1)$$

$$\text{Income} = \alpha + \beta_1 \text{CKPN} + \epsilon$$

2. Moderated Regression Analysis (MRA) to test the second hypothesis namely the Influence of Fee Based Income on the relationship of AIL and Income. The Moderated Regression Analysis (MRA) or known as interaction test is a special application of multiple linear regression presenting element of regression equation interaction (multiplication of two or more independent variables).

The multiple linear regression model is shown by the following equation:

$$Y = \alpha + \beta_1 X_1 + \beta_2 X_2 + \beta_3 (X_1 * X_2) + \epsilon \dots \dots \dots (2)$$

$$\text{Income} = \alpha + \beta_1 \text{CKPN} + \beta_2 \text{FBI} + \beta_3 (\text{CKPN} * \text{FBI}) + \epsilon$$

Multiplication of variable X1 and X2 as the moderating variable describes the moderating influence of X2 variable on X1 and Y relationship. Meanwhile, X1 and X2 variables are direct influences of X1 and X2 variables on Y. describing multiplication X1 and X2 as the moderating variable is by making derivative equation of X1 or dY/dX1 from the equation (2).

Results of dY/dX1 is :  $dY/dX1 = \beta_1 + \beta_3 X_2$

This equation means that dY/dX1 is the function of X2 or X2 variable moderates the relationships of X1 and Y.

Notation:

Y = Bank Income

α = determinant regression function Constant

β1-β3 = regression coefficient of independent variables stating relative changes of dependent variable varies with relative changes in its relationship with independent variables

X1 = Allowances of Impairment Lossess (LLP)

X2 = Fee Based Income (FBI)

ε = error component

### V. ANALYSIS RESULTS AND DISCUSSION

#### 5.1 Results of Hypotheses Testing

From the regression equation model used, there are three hypotheses tested, the results of the regression calculation are shown in Table 5.17 as follows:



**Table 5.1**  
**Results of Regression Calculation**

Hypotheses	Equation	Adjusted R <sup>2</sup>	F statistics	Sig	t statistic	Sig	Decision
H1	Income = 184.568,373 + 2.828 AIL	0.877	193.363	0.000	13.905	0.000	Diterima
H2	Income = 35.904,163 + 1.770 AIL + 25.322 FBI - 5.591E5 Moderat FBI	0.963	238.022	0.000	-4.720	0.000	Diterima

- Testing the First Hypothesis (H1)

The first hypothesis examines the influence of AIL variable on income. From table 5.1, it can be seen the significance level of AIL probability by 0,000. Because the significance level of the AIL probability is smaller than 0.05, H0 is rejected and H1 is accepted.

- Testing the Second Hypothesis (H2)

The second hypothesis examines the influence of Fee Based Income variable on the relationship of AIL and Income variables. Table 4.20 shows the significance level of the Fee Based Income and the Fee Based Income Moderation variables, each of which is 0,000 and 0,000. Because the probability significance level of Moderation Fee Based Income is smaller than 0.05, H0 is rejected and H1 is accepted. Beta value that appear in the Moderate\_1 interaction test (AIL \* Fee Based Income) of - 5.591E5 shows that fee-based income as a moderating variable weakens the relationship of Loan Loss Provision (LLP) to income.

**5.2 Discussion Results**

Based on the research results, there will be further discussion on the analysis results. The discussion is conducted by paying attention to the causality relationship as hypothesis verification in this study. Theories or the empirical research results that have been carried out by previous researchers will be used to conduct research discussions, whether the study theory or the results support or conflict with the results of hypothesis testing conducted in this study.

**5.2.1 Influence of Loan Loss Provision (LLP) on Income by PT. BPD Sultra**

From results of the partial test of the Loan Loss Provision (LLP) on income, it can be seen that AIL influences on the income, the result of this study supports a research conducted by Jamal Abdel (2018) which found a negative and significant relationship between income and Loan Loss Provision or LLP, but the formation of Loss Provision Loan or CKPN can also imply positive changes in the future income. In this study, it describes the formation of Loss Provision or LLP as a process of estimating the possibility of loan losses, which the formation costs are charged to current income which reflects loan anticipated loss by bank managers in the future. Therefore, the amount of Loan Loss Provision or LLP must reflect bank's management trust in the quality of the loans they have.

Based on the results of processing financial statement data of PT. Southeast Sulawesi BPD during the period of 2011 to 2017 through the t-test to see the partially significant influence between LLP as an independent variable on income as the de-

pendent variable, it obtains Beta value of 2.828. A positive Beta value signifies a unidirectional relationship between LLP and income, which means that greater LLP will lead to greater income, there will be such condition since PT. BPD Sultra always makes efforts to collect and resolve non-performing loans as the biggest source of formation of Loan Loss Provision (LLP), through these efforts, there will be LLP recovery as non-interest operating income.

**5.2.2 Influence of Fee Based Income on Relationship of Loan Loss Provision (LLP) on Income by PT. BPD Sultra.**

From results of the partial test of the influence of Fee Based Income on the relationship of Loan Loss Provision (LLP) and Income, it can be seen that Fee Based Income influence on the relationship of LLP and income, the results of this study support a research conducted by Devi Setyaningrum, Rini Setyo Witiastuti (2017), this study found that basically banks with high Off Balance Sheet activity as reflected in the share of non interest income will have a low Loan Loss Provision or LLP because the risk due to credit activities has been transferred to the Off Balance Sheet risk which will ultimately influence on the income.

Based on results of processing financial statement data of PT. Southeast Sulawesi BPD during the period of 2011 to 2017 through a statistical test - t in order to see the influence of the Fee Based Income variable on the relationship of LPP and Income variables, the Beta value of - 5.591E5 shows that fee based income as a moderating variable weakens the relationship of Loan Loss Provision (LPP) and the income. In this study, the fee-based income component included in the research data is only fee-based income that comes from provisions, fees, commissions and administration as well as non interest operating income earned from the recovery of the Loan Loss Provision (LLP). PT. Southeast Sulawesi BPD always increases its fee-based income in various types of service and product development, including the following:

1. The Southeast Sulawesi Bank supports the Regional Government in the context of implementing the Non-Cash transaction through the Online Satker product
2. Developing land and building tax payment applications through PBB Online products
3. Developing Motor Vehicle Tax payment applications through Samsat Online products
4. Establishing cooperation with PT. Taspen through Electronic Pension Payment List (eDapen).
5. Increasing the opening of office networks and developing the SMS Banking feature.
6. Developing Hospital Management Information System (SIMRS) services

Development of the service and product is not only to develop third party funds (DPK) increase, but it is also expected to increase fee-based income through fees and administration fees for services and products.

**5.3 Limitation of Research Results**

This research has been attempted and conducted according to scientific procedures, however, it still has limitations as follows:

1. This research is conducted at PT. Southeast Sulawesi BPD as a bank currently in the Book I Bank category so that the development of products and services provided to customers is still very limited which influence on the proportion of operating income which is still dominated by interest income in fact of still limited fee-based income.
2. The income of PT. Southeast Sulawesi BPD, although keeps increasing, its growth rate tends to fluctuate because its operating income is still focused on the interest income, so that it is very vulnerable to changes in the interest and credit risk.

## 6 CONCLUSION AND RECOMMENDATION

### 6.1 Conclusion

Conclusions that can be drawn from the results of research and discussion about "The Influence of Loan Loss Provision on the Bank Income with Fee Based Income as a moderating variable at PT. Southeast Sulawesi BPD are as follows:

1. The Loan Loss Provision (LPP) has a significant positive influence on the income at PT. Southeast Sulawesi BPD. The LPP variable is able to explain its influence on the income variable of 87.7% and the remaining of 12.3% is explained by other factors excluded in this study.
2. Fee Based Income influences on the relationship of LLP and the income, the test results obtaining a Beta value of  $-5.591E5$  shows that fee based income as a moderating variable weakens the relationship of Loan Loss Provision (LPP) to income and based on a comparison of the significance level between Fee Based income on the dependent variable in the form of income of 0,000 ( $<0.05$ ) with a significance level of Moderate\_1 influence on income of 0,000 ( $<0.05$ ), then it illustrates that Fee Based Income is a type of Quasi Moderator (pseudo moderator) moderation.

### 6.2 Recommendations

Based on the results of the discussion of the research and the conclusions above, suggestions can be given as follows:

1. For PT. Southeast Sulawesi BPD, it should always improve the development of services and products in order to maintain the increased fee-based income.
2. In order to invest funds in earning assets, especially granting of credit, it should always apply the principle of prudence (Prudential Banking) as a risk mitigation step in resolving any non-performing loans, thereby it should reduce to form Loan Loss Provision (CKPN).
3. It should also increase the efforts to collect and resolve non-performing loans in order as to improve the Loan Loss Provision (CKPN) as the component of non interest operating income.
4. For any following researchers, it is possible to conduct research on the role of fee-based income in maintaining Third-Party Funds (TPF), given the current development of bank income facing a shift from traditional activities in the form of lending to fee-based income.

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