Bank Guidelines

Capital Adequacy Standards

Standardised Approach

CENTRAL BANK OF THE UNITED ARAB EMIRATES

November, 2009

1. Introduction

The Central Bank of the United Arab Emirates (CBUAE) is pleased to issue guidelines for implementation of the Basel II Capital Accord, effective from the date of this circular. This follows on from previous direction outlining expectations including Notice 3735/2006 “Basel II Implementation in the UAE” dated 27 August, 2006 and Notice 4004/2009 “Capital Adequacy”.

This circular will focus on specific issues of relevance for the UAE banking community, with the complete Basel II guidelines including the following documents:

- “International Convergence of Capital Measurement and Capital Standards”, June 2006, Bank for International Settlements
- “Enhancements to the Basel II Framework”, July 2009, Bank for International Settlements

(collectively referred to as “the Accord”).

Note that although the Bank for International Settlements (BIS) standards on Basel II is generally applicable – specific guidelines as given by the CBUAE are to prevail. National Discretions, where applicable, are outlined in Appendix 6.

The Standardised Approach for Credit Risk is to apply effective immediately, and CBUAE expects internationally active UAE banks – and larger institutions as notified on a case by case basis - to migrate to the Foundation Internal Rating Based (FIRB) in due course.

Banks can select any of the Market Risk and Operational Risk approaches, with the advanced options requiring explicit approval by the CBUAE.

In line with Pillar 2 requirements of the Accord, CBUAE expects each bank to develop and document its own Internal Capital Adequacy Assessment Process (ICAAP) that is commensurate to the banks activities and risk profile. The ICAAP will be a key component of our supervisory review and your attention is drawn to the July 2009 Enhancements to the Basel II Framework paper and the added detail around Pillar 2 expectations. The CBUAE, as recommended by the BIS, will expect banks to address this added detail immediately.

2. Capital Ratio

The minimum capital adequacy ratio will be set at 11%, rising to 12% as at 30 June 2010 as specified in Notice 4004/2009.

Capital Adequacy Ratio (CAR) is measured as a ratio of capital against the risk weighted asset values for Credit, Market and Operational risk, where capital includes Tier 1 and Tier 2 capital. Tier 2 capital will only be considered to a maximum of 67% of Tier 1 capital.

Quarterly Prudential Reporting by bank's of their capital calculations under the Standardised Approach are expected to apply from the quarter ending 30 September 2009. Prudential Return Templates are included in Appendix 7.

3. Pillar 1 – Calculation of Credit Risk

These guidelines pertain to the Standardised Approach of Basel II only. Internal Ratings Based guidelines will be issued in due course following discussion with banks, on a case by case basis, for whom this is expected to be pertinent.

One of the largest differences between existing guidelines and the Standardised Basel II approach is the ability to apply, on an asset class basis, risk weightings determined from ratings provided by External Credit Assessment Institutions (ECAI) approved by CBUAE. A list of approved ECAIs is included in Appendix 1 along with applicable rating to risk weight mappings.

Export Credit Agency provided country scores may not be used for risk weighting purposes.

3.1.Central Banks & Sovereigns

Claims on Central Banks and Sovereigns in the GCC may have a 0% risk weighting applied. Other Central Banks and Sovereigns exposures to be risk weighted in line with paragraphs 53 to 56 of the Accord.

3.2.Public Sector Entities (PSE)

Claims on a PSE in the GCC, in their local currency, may be risk weighted at 0% if treated as a PSE by the local regulator. Foreign currency claims on a GCC PSE are to be weighted at one grade less favourable, being 20%.

All other PSE risk weightings (i.e. non GCC) to be risk weighted at one grade less favourable than their sovereigns.

3.3.Multilateral Development Banks (MDB)

Provisions of the Accord as per paragraph 59 are to apply.

A list of MDBs where a risk weighting of 0% may be applied is included in Appendix 8.

3.4.Banks

CBUAE will adopt risk weightings specified in Option 2 as per paragraph 63 of the Accord, as follows:

Credit assessment of Banks	AAA to AA-	A+ to A-	BBB+ to BBB-	BB+ to B-	Below B-	Unrated
Risk Weight	20%	50%	50%	100%	150%	50%
Risk Weight Short Term claims	20%	20%	20%	50%	150%	20%

Concessions for short term claims should be considered in light of CBUAE guidance on ECAI classifications as per Appendix 1.

3.5.Securities Firms

Where these entities are regulated as banks, they may be treated as per the above process for banks. If they are not regulated as banks, Corporate treatment as below is to apply.

3.6.Corporates

Risk weightings for Corporates rated by approved ECAIs may be applied as per paragraph 66 of the Accord, as follows:

Credit assessment of Banks	AAA to AA-	A+ to A-	BBB+ to BB-	Below BB-	Unrated
Risk Weight	20%	50%	100%	150%	100%

UnRated corporate exposures must be risk weighted at 100%. CBUAE may, at it’s sole discretion, require a higher risk weighting for some corporates as advised to banks directly where appropriate.

3.7.Regulatory Retail Portfolios

A 75% risk weighting may apply for exposures classified as Retail. For this classification to apply the CBUAE will need to be satisfied that each of the four Basel II criteria are met:

- Orientation criterion – Exposure to a person or persons, or small business.

- Product criterion – Eligible products included are credit cards, revolving credit, personal lending and small business products. Mortgage products are also excluded as these are treated separately.
- Granularity criterion –No exposure to any one counterparty is able to exceed 0.20% of the total retail portfolio being evaluated.
- Value criterion – Maximum aggregated exposure to one counterparty may exceed the value of AED 2,000,000.

3.8.Claims Secured by Residential Property

A 35% risk weighting may apply to exposures secured by residential property where:

- Loan to Value (LTV) ratio is less than 85%; and
- The exposure does not exceed AED 10 million.

If the above LTV and Exposure cap criteria cannot be definitively established, then the applicable Risk Weighting for the counterparty type is to apply.

3.9.Past Due Loans

The unsecured portion of any loan (other than a qualifying residential mortgage loan) that is past due for more than 90 days, net of specific provisions (including partial write-offs), will be risk-weighted as follows:

- 150% risk weight when specific provisions are less than 20% of the outstanding amount of the loan;
- 100% risk weight when specific provisions are 20% and above of the outstanding amount of the loan;

3.10. High Risk & Other Assets

Refer to paragraphs 79 through 81 of the Accord for treatment of these exposures., as well as the July 2009 Enhancements paper from the Committee.

3.11. Off Balance Sheet Credit Risk

Under Basel II, off-balance sheet items under the standardised approach (Para 82 to 87 of Basel II) will be converted into credit exposure equivalents through the use of credit conversion factors in a similar manner to Basel I.

Credit Conversion Factor of 100%

- All direct credit substitutes, including general guarantees of indebtedness and all guarantee type instruments, such as standby letters of credit and acceptances, backing the financial obligations of other parties

- Credit derivatives such as credit default swaps where bank provides credit protection (other more complex derivatives will be assessed on a case-by-case basis and should be brought to the attention of Head of Banking Supervision at the CBUAE)
- Sale and repurchase agreements and asset sales with recourse, where the credit risk remains with the bank
- Forward asset purchases, forward deposits and commitments for the unpaid portion of partly-paid shares and securities which represent commitments with certain draw-downs

Credit Conversion Factor of 50%

- Transaction-related contingent items e.g. performance bonds, bid bonds warranties and standby letters of credit related to particular transactions
- Underwriting commitments under note issuance and revolving underwriting facilities (after deduction for own holdings of notes underwritten)
- Other commitments -Not unconditionally cancellable with an original maturity exceeding one year

Credit Conversion Factor of 20%

- Other commitments not unconditionally cancellable with an original maturity of one year or less
- Short-term self-liquidating trade-related contingent items e.g. documentary credits collateralised by underlying shipments.

Credit Conversion Factor of 0%

- Any commitment that is unconditionally cancellable

The book amounts of commitments should be entered in the Form CR3 by type and CR2 by counter-party (Appendix 7).

Foreign exchange and interest rate-related items

The treatment of foreign exchange and interest rate-related contracts needs special attention because banks are not exposed to credit risk for the full face value of these contracts, but only to the extent of potential cost of replacing the cash-flow (on contracts showing positive value) if the counter-party defaults.

The instruments that are captured in the risk-weighting framework include the following:

Foreign exchange contracts

(a) Forward foreign exchange contracts (swaps and outrights)

(b) Cross-currency interest rate swaps

(c) Foreign currency futures

(d) Foreign currency options purchased

Interest rate-related contracts

(a) Single currency interest rate swaps

(b) Basis swaps

(c) Forward rate agreements

(d) Interest rate futures

(e) Interest rate options purchased

For calculating the foreign exchange and interest rate-related risk, banks should use the current exposure method. Under this method, banks should calculate the current replacement cost of foreign exchange and interest rate-related contracts by “marking to market” all contracts with positive value. A factor (the” add-on") is then added to the replacement cost to reflect potential credit exposure over the remaining life of the contracts. The total potential credit exposure must then be analysed according to the types of counter-party in order to reflect the different risks.

No 'add-on' is required in the particular case of single currency floating interest rate swaps.

Since exchange rate contracts involve an exchange of principal on maturity as well as being generally more volatile, higher conversion factors are set for those instruments that feature exchange rate risk. Exchange rate contracts with an original maturity of 14 calendar days or less are excluded from risk weight requirements.

Instruments traded on exchanges may be excluded where they are subject to daily margin requirements. Once the credit equivalent amounts have been calculated by this method, they can then be weighted according to the usual risk weights assigned to the underlying nature of the counter-party, as for on-balance sheet items.

The exposure to each type of counter-party has to be risk weighted as 0%, 20%, 50% or 100% respectively to arrive at the total weighted exposure.

The method of calculating the risk-weighted exposure regarding foreign exchange and interest rate-related contracts is reflected in the attached return form CR2a.

3.12. Credit Risk Mitigation

Only the following Credit Risk Mitigation techniques will be considered as effective credit risk reduction for Pillar 1 calculation purposes:

- Netting – Applicable only with legally enforceable netting agreements in place. An ability to systematically calculate net exposure must be demonstrated.
- Collateral – Either the Simple or Comprehensive approaches may be applied, with banks looking to apply the Comprehensive approach requiring explicit approval from CBUAE.

- Guarantees & Credit Derivatives – These tools can be used to mitigate credit risk provided they are direct, explicit, irrevocable and unconditional. CBUAE must be satisfied that the bank has suitable risk management tools in place to adopt use of these tools.

Full details are as per paragraphs 109 to 210 of the Accord.

4. Pillar 1 Market Risk

Banks are required to allocate capital in respect of market risk under the general guidelines and framework set out under Basel II Section VI, Market Risk, which defines this risk as the risk of losses in on and off-balance sheet positions arising from movements in market prices'.

This section deals with the Standardised Approach of measurement as most banks will not be in a position to base their calculations on a models approach which may be accepted on a case-by-case basis.

The market risks subject to a capital charge are as follows: -

- Interest Rate Risk,
- Foreign exchange Risk,
- Equity Exposure Risk,
- Commodity Risk, and
- Options Risk

The scope of the charges is restricted to 'trading book' only for interest rate risk and equity positions whilst the remaining will apply to the banks entire positions.

A trading book consists of positions in financial instruments and commodities held either with trading intent or in order to hedge other elements of the trading book. To be eligible for trading book capital treatment, financial instruments must either be free of any restrictive covenants on their trading ability or able to be hedged completely. In addition, positions should be frequently and accurately valued, and the portfolio should be actively managed. This definition may equate to the application of IAS 39 to 'Mark-to-market' positions.

Banks must have clearly defined policies and procedures for determining which exposures to include/exclude from the trading book for purposes of calculating regulatory capital as detailed in Paragraphs 687 and 688 of Basel II. Compliance with these policies must be fully documented and subject to periodical audit.

4.1. Interest Rate Risk

Banks must calculate two separate charges for determining the minimum capital requirement.

Instruments in the trading book, such as debt securities of fixed or floating rate and non-convertible preference shares and other convertible debt that trades like debt securities, will attract a calculation for 'specific risk' of each security and 'general risk' in the portfolio (where long and short positions in different securities or instruments can be offset). General risk may be calculated using either the 'Maturity method' utilising a maturity ladder or 'Duration method',

which is considered more accurate and is based on calculating price sensitivity of each position separately. Details of calculation methodology can be found in Paragraphs 709 to 718(iv) of Basel II.

4.2.Foreign Exposure Risk

Banks must calculate a capital charge for foreign exchange risk by computing the net open positions (greater of sum of the net short positions or sum of the net long positions) for currencies and gold. The capital charge would be applied to the higher of the net long positions or the net short positions (including gold). Details of calculation methodology can be found in Paragraphs 718(xxx) to 718(xLii) of Basel II. Banks will be permitted to treat US$ open positions equal to AED positions as long as the AED remains pegged to the US$, the same treatment is permitted for GCC currencies similarly pegged to the US$.

Banks that have little or no foreign currency business may be exempt from capital requirements under this section provided the following is met: -

- The greater of the sum of the gross long positions and sum of gross short positions in foreign currencies must not exceed 100% of the capital base described above.
- Overall net open position (as explained above) does not exceed 2% of the capital base.

4.3.Equity Risk

Banks must calculate a capital charge for equity risk by computing the specific risk charge and general risk charge as per the table in Appendix 7 labelled MR6. Capital charges for specific risk may be reduced by 50% for a liquid and well-diversified portfolio. Details of calculation methodology can be found in Paragraphs 718(xix) to 718(xxix) of Basel II.

4.4.Commodities Risk

Banks must calculate a capital charge for commodity risk in respect of physical holdings which can be, or are, traded, including precious metals but excluding gold (covered under foreign exchange risk). For banks that only conduct a limited amount of commodities business the Maturity Ladder Approach or the Simplified Approach would be expected. Major traders would be expected to follow a models approach and are outside the scope of this paper and therefore should approach CBUAE for specific guidance.

Under the maturity ladder approach, banks should calculate the net position in each commodity in its unit of measurement and then convert to AED at prevailing spot rate. Using a maturity ladder as in MR7 (Appendix 7) for each commodity, these should then be aggregated onto MR7 the consolidated table. A lower risk charge will apply to matched long and short positions within each maturity band or matched positions between bands, a capital charge of 15% will apply to residual unmatched positions. Details of calculation methodology can be found in Paragraphs 718(xLiii) to 718(Li) of Basel II.

Under the Simplified Approach, the capital charge will be 15% of the net position, long or short, in each commodity. In order to account for any basis risk and additional capital charge of 3% of the bank's gross positions, long plus short in each commodity. Details of calculation methodology can be found in Paragraphs 718(Liv) and 718(Lv) of Basel II.

4.5.Options Risk

Banks must calculate a capital charge for options risk based on the Simplified Approach applicable only to banks that solely use purchased options (do not write options) which is outline below: -

Position	Treatment
Long Cash and Long Put Or Short Cash and Long Call	The capital charge will be the market value of the underlying security multiplied by the sum of specific and general market risk charges for the underlying less the amount the option is in the money (if any) or zero
Long call Or Long put	The capital charge will be the lesser of: a) The market value of the underlying security multiplied by the sum of specific and general market risk charges for the underlying b) The market value of the option

Banks not falling into the above category should approach CBUAE for specific guidance and agreement to use intermediate approaches as set out in Paragraphs 718(Lix) to 718(Lxix) or the comprehensive risk management model detailed in paragraphs 718 (Lxx) to 718 (xcix) of Basel II.

5. Pillar 1 Operational Risk

Operational risk is defined as the risk of loss resulting from inadequate or failed internal processes, people and systems, or from external events. This definition includes legal risk but excludes strategic and reputational risk.

Basel II framework outlines three methods for calculating the risk charge for operational risk: -

1. Basic Indicator Approach
2. Standardised Approach/Alternative Standardised Approach (ASA)
3. Advanced Measurement Approach

CBUAE permits banks to use any of the above approaches provided they meet the criteria laid down under Basel II and subject to approval for the Advanced Measurement Approach (AMA) for which banks would need to demonstrate to CBUAE the appropriateness of the chosen approach. This document focuses on all approaches excluding AMA.

In addition to complying with the criteria in Paragraph 663 of Basel II, Banks are encouraged to refer to and comply with the recommendations of the Basel Committee in their paper 'Sound Practices for the Management and Supervision of Operational Risk, February 2003'.

Banks should use any one of the approaches in (1) or (2) above to report the operational risk capital charge in the returns included in Appendix 7 headed OR1.

Once a bank has been allowed to use the ASA it would not be allowed to revert to the Standardised Approach without the permission of CBUAE.

Details on these three approaches are as per "UAE Basel II Guidelines for Banks Standardised Approach", July 2009.

6. Pillar 2 – Supervisory Review

CBUAE considers the Pillar 2 requirements of the Accord to be particularly relevant for banks in its jurisdiction. Consequently, notwithstanding Pillar 1 capital calculations and implied capital requirements determined there from, the supervisory review process will focus on each bank's Internal Capital Adequacy Assessment Process (ICAAP).

The ICAAP must be documented and fully integrated with the enterprise wide risk management framework. It should be undertaken annually, have the explicit involvement and approval of both Board and Senior Management, and be presented to the CBUAE as a key point of discussion between the bank and regulator.

As a minimum, the ICCAP should include a risk based, forward looking view of Credit, Market and Operational risk capital. Other risks that may require capital such as Liquidity, Interest Rate Risk in the Banking Book and Others (such as reputational) must be explicitly and demonstrably considered.

Pillar 2 requirements are intended to be proportionate, but CBUAE considers an ICAAP capability as demonstrated in Appendix 3 to be a minimum standard of capability. For banks that are systematically significant &/or engaged in riskier and more sophisticated assets, a higher standard of capability will be expected as advised on a case by case basis.

Following recent market turmoil, it is noteworthy that the Basel Committee issued enhancements to the Accord in July 2009 that included significant changes to Pillar 2 requirements. Banks should be aware of these in their entirety as the CBUAE fully endorses these enhancements and expects them implemented immediately. Aspects that are noteworthy for our environment include:

- Firm Wide Risk Oversight –A Risk framework endorsed by the Board and Senior Management that is aligned to organisational risk appetite, implemented via effective policies, procedures and systems. The framework must include measures of credit risk that are applied in day to day business and supported by suitable MIS. Key aspect of this requirement is the “use test “principle. CBUAE will be looking for demonstrable evidence that the risk framework is applied across the organisation.
- Governance – Board and Senior Management must assume explicit responsibility for the risk framework. A Chief Risk Officer (CRO) function must exist, it must be independent of the business lines, and must report directly to the CEO and Board.
- Risk Concentration – Risk, as measured on an aggregated basis to borrower groups, must be considered in the context of set concentration limits at borrower group, industry and country level. In addition, sectoral analysis across property and money market concentrations is required. Where there are excesses on internal limits, as distinct from existing prudential standards, these should be reported and noted at a Board level.

- Liquidity – Each bank must consider it's sources of funding in the context of a liquidity risk tolerance statement from the Board. Liquidity risk must be analysed across the organisation including all products and subsidiaries, with the ICAAP explicitly allowing for stressed scenarios appropriate to the nature of funding.
- Stress Testing – Banks must have an established forward looking stress testing framework for all risk types. Results should be reported at regularly scheduled intervals to the Board for review in the context of the organisations risk appetite and capital levels. The robustness of the stress testing process must be commensurate with the bank's risk appetite and activities, as advised on a case by case basis.

Pillar 2 Summary

The CBUAE expects banks' management to become much more focused on the following areas:-

1. To understand what their bank is doing with respect to Pillar 1 and Pillar 2 risks.
2. To identify "other risks" under Pillar 2 relevant to their bank and to assess the risk mitigants available to set against those "other risks" under Pillar 2.
3. To take steps to plan their internal capability to calculate capital requirements under Pillar 2.
4. At a minimum, please refer to the following BIS documents:
    a. Part 3 of Basel II June 2006
    b. Enhancements to the Basel II framework July 2009
    c. Principles for Sound Stress Testing Practices and Supervision May 2009
    d. Principles for Sound Liquidity Risk Management and Supervision September 2008
    e. Sound Practices for the Management and Supervision of Operational Risk February 2003

7. Pillar 3 – Market Discipline

The purpose of Pillar 3 market discipline is to complement the minimum capital requirements (Pillar 1) and the supervisory review process (Pillar 2). The CBUAE supports enhanced market discipline by developing a set of disclosure requirements which will allow market participants to assess key pieces of information on the scope of application, capital, risk exposures, risk assessment processes, and hence the capital adequacy of the institution.

In principle, banks' disclosures should be consistent with how senior management and the board of directors assess and manage the risks of the bank.

Under Pillar 1, banks use specified approaches/methodologies for measuring the various risks they face and the resulting capital requirements. The CBUAE believes that providing disclosures that are based on a common framework is an effective means of informing the market about a bank's exposure to those risks and provides a consistent and understandable disclosure framework that enhances comparability.

7.1.Interaction with accounting disclosures

The CBUAE recognises the need for a Pillar 3 disclosure framework that does not conflict with requirements under accounting standards, which are broader in scope. Where banks face difficulties, CBUAE will consider each issue on a case-by-case basis.

Banks are encouraged to provide all related information in one location to the degree feasible. In addition, if information is not provided with the accounting disclosure, institutions should indicate where the additional information can be found.

7.2.Materiality

A bank should decide which disclosures are relevant for it based on the materiality concept. Information would be regarded as material if its omission or misstatement could change or influence the assessment or decision of a user relying on that information for the purpose of making economic decisions. This definition is consistent with International Accounting Standards and with many national accounting frameworks.

The CBUAE recognises the need for a qualitative judgement of whether, in light of the particular circumstances, a user of financial information would consider the item to be material (user test). The CBUAE is not setting specific thresholds for disclosure as these can be open to manipulation and are difficult to determine, and it believes that the user test is a useful benchmark for achieving sufficient disclosure.

7.3.Proprietary and confidential information

Proprietary information encompasses information (for example on products or systems), that if shared with competitors would render a bank's investment in these products/systems less valuable, and hence would undermine its competitive position.

Information about customers is often confidential, in that it is provided under the terms of a legal agreement or counterparty relationship. This has an impact on what banks should reveal in terms of information about their customer base, as well as details on their internal arrangements, for instance methodologies used, parameter estimates, data etc.

The CBUAE believes that the requirements set out below strike an appropriate balance between the need for meaningful disclosure and the protection of proprietary and confidential information.

In exceptional cases, disclosure of certain items of information required by Pillar 3 may seriously prejudice the position of the bank by making public information that is either proprietary or confidential in nature. In such cases, a bank need not disclose those specific items, but must disclose more general information about the subject matter of the requirement, together with the fact that, and the reason why, the specific items of information have not been disclosed.

This limited exemption is not intended to conflict with the disclosure requirements under the accounting standards.

7.4.Disclosure requirements

Banks should have a formal disclosure policy approved by the board of directors that addresses the bank's approach for determining what disclosures it will make and the internal controls over the disclosure process. In addition, banks should implement a process for assessing the appropriateness of their disclosures, including validation and their frequency.

The general disclosure requirements as detailed in Para 821 of Basel II will be applied at the top consolidated level of a banking group by all licensed banks, i.e., at the level of the parent licensed bank.

Disclosures related to individual banks within a UAE banking group would not generally be required, branches of foreign banks would not be exempted. An exception to this arises in the disclosure of total and Tier I capital ratios of subsidiary banks by the top consolidated bank where an analysis of significant subsidiary banks within the group is appropriate in order to recognise the need for these subsidiaries to comply with the relevant capital adequacy framework and other applicable limitations on the transfer of funds within the group.

Banks should refer to Basel II June 2006 section covering Pillar 3 for detailed requirements under this pillar along with Enhancements to the Basel II framework July 2009.

Disclosure by banks is expected to include both General Disclosures and Specific disclosures included in financial statements published for the year 2008. Therefore, the annual report for 31 December 2008 would be expected to comply with the Basel II disclosure requirements. Reports must be audited/reviewed in accordance with International Auditing Standards.

The tables as detailed in Appendix 7 of the UAE Basel II Guidelines for Banks Standardised Approach", July 2009, may serve as guidance in considering format of disclosures that are fully explained in the Pillar 3 section of Basel II.

8. Capital

The capital base serving as a basis for calculating each bank's capital adequacy ratio is defined as follows:

8.1.Tier 1 capital

Core capital:

- Paid-up share capital,
- Published reserves (including post-tax retained earnings),
- Share premium,
- Legal reserves,
- General reserves,
- Hybrid Tier 1 Instruments (requires prior approval from Central Bank)
- Minority interests in the equity of subsidiaries less than wholly-owned

Profits of the current period are not allowable in the calculation of core capital, other than in exceptional circumstances at the discretion of the Central Bank. This would be determined in conjunction with reviews by a bank's external auditors as to their fairness.

The following deductions must be made from Tier 1 core capital:

- Goodwill and other intangibles at net book value,
- Adjustments for the cumulative effect of foreign currency translation
- Own shares held - at net book value taking account of any provisions made against the acquisition value,
- Current year loss/retained losses,
- Shortfall in provisions,
- Other deductions:
- Loans to directors:
    - A deduction must be made for loans to directors which are not granted on market terms or which are not properly secured. Loans' are not granted on market terms where interest charged for such loans is significantly below that of comparable loans to other customers and/or below the bank's refinancing costs for such loans or on terms more favourable than for similar loans to other customers.
- Other deductions -to be determined by CBUAE

* Any assets deducted from capital, in computing the numerator of the ratio, are not to be included in weighted risk assets in computing the denominator of the ratio. Loans are

inadequately secured where they would not have been granted to other customers for lack of adequate security.

8.2.Tier 2 Capital (supplementary capital)

The following elements are eligible for inclusion in the calculation of tier 2 capital:

General Provisions

Under the standardised approach to credit risk, general provisions, as explained in Basel II paragraphs 381 to 383, can be included in Tier 2 capital subject to the limit of 1.25% of risk-weighted assets. For further details, banks must refer to paragraph 49(vii) to 49(x) of Basel II.

Un-disclosed reserves

These reserves must have the same high quality and characteristics as a disclosed capital reserve before they will be accepted by the CBUAE. They must be unencumbered and completely free of any lien or commitment. For further details, banks must refer to paragraph 49(iv) of Basel II.

Asset revaluation reserves/Cumulative changes in Fair Value

Revaluation surpluses arising from the revaluation of fixed assets or other long-term investments can be included as supplementary capital; provided they are subject to a substantial discount in order to reflect concerns both about market volatility and notional tax charges which may arise were such gains to be realised. Accordingly, the Central Bank of the U.A.E. accepts that banks may include a figure up to a maximum of 45% of the excess of market value over the net book value of these items within supplementary capital. Unrealised reserves arising in respect of the excess of market value over the net book value of the banks' property assets may not be included. For further details, banks must refer to paragraph 49(vi) of Basel II.

Hybrid (debt/equity) capital instruments

Certain capital instruments combine characteristics of both equity and debt, but vary from one country to another. Where these instruments have close similarities to equity, in particular, where they are able to support losses on an on-going basis without triggering liquidation, they may be included in supplementary capital. They must, however, meet the following requirements:

- Must be unsecured, subordinated and fully paid-up,
- Must not be redeemable without the prior consent of the CBUAE,
- Must be available to participate in losses without the bank being obliged to cease trading (unlike conventional subordinated debt);

Although these capital instruments may carry an obligation to pay interest that cannot permanently be reduced or waived (unlike dividends on ordinary shareholders' equity), they should allow service obligations to be deferred (as with cumulative preference shares) where the profitability of the bank would not support payments.

Subordinated term loans

Subordinated loan capital with a minimum original term to maturity of more than five years may be included within supplementary capital. During the last five years to maturity, cumulative amortization of 20% per annum on a straight-line basis will be applied to reflect the diminishing value of these instruments as a continuing source of strength. The amount of such instruments will be allowable only up to a maximum of 50% of tier 1 capital.

8.3.Tier 3 Capital

The principal form of eligible capital to cover market risks consists of shareholders' equity and retained earnings (Tier 1 capital) and supplementary capital (Tier 2 capital). But, subject to prior approval from the CBUAE, banks may employ a third tier of capital (Tier 3), consisting of short-term subordinated debt as defined in paragraph 49(xiv) of Basel II, for the sole purpose of meeting a proportion of the capital requirements for market risks, subject to the conditions in paragraph 49(xiii) and 49(xiv).

Deductions from total of tier 1 capital and tier 2 capital

Normal accounting practice prescribes the consolidation of the assets and liabilities of all members of a group when preparing group accounts. Where a group excludes subsidiaries, deduction from capital is essential to prevent the multiple use of the same capital resources in different parts of a group.

The following deductions should be made from the sum of tier 1 and tier 2 capital to take account of this and in those instances where banks have cross shareholdings in other banks:

Banking, securities and other financial subsidiaries

Under Basel II, banking and financial subsidiaries should be consolidated, and if not consolidated, the investment should be deducted from the capital base.

International Accounting Standards define subsidiaries as companies incorporated in their home-country or abroad which the bank controls (i.e. directly or indirectly holds 50% or more of the ordinary share capital) or in which the bank has a controlling influence (for example, via the composition of the board of directors) where it holds less than 50% of the ordinary share capital.

All banking and financial subsidiaries should be consolidated, except in certain cases as described in International Accounting Standard No.27, Consolidated Financial Statements and Accounting for Investments in Subsidiaries (issued by the International Accounting Standards Committee) which requires or permits exclusion from consolidation, for example, when:

- Control of the subsidiary is temporary; or
- Control does not exist in reality; or
- Control is impaired by restrictions on the transfer of funds.
- Significant minority investments in banking and other financial entities

Investments in banking and other financial entities of 20% and above, up to 50% should normally be deducted from the capital base. Alternatively, such investments may, under certain conditions,

be consolidated on a pro rata basis. For example, pro rata consolidation may be appropriate for joint ventures or where the CBUAE is satisfied that the parent is legally or de facto expected to support the entity on a proportionate basis only and the other significant shareholders have the means and the willingness to proportionately support it.

Investments in other banks or financial institutions

This represents cross shareholdings between two or more banks or financial institutions wherein they hold a similar amount of each other's Capital. In such circumstances, these amounts must be deducted from the total of the capital base.

Investments in insurance entities

For investments in insurance entities, an investment in such an entity of 10% or above would lead to deduction from the capital base. Banks may recognise surplus capital in insurance subsidiaries as per the criteria and disclosure requirements explained in Paragraph 33 and footnote 10 of Basel II.

Significant investments in commercial entities

Significant minority and majority investments in commercial entities that exceed materiality levels of 15% of the bank’s capital for individual significant investments in commercial entities, and 60% of the bank’s capital for the aggregate of such investments will be deducted from the capital base. The amount deducted would be the portion of the investment above the materiality level.

Investments in significant minority-owned /majority-owned and controlled commercial entities below the materiality levels noted above will be risk-weighted at no lower than 100% for banks using the standardised approach.

As a transitional arrangement, banks holding such investments at 1January 2008, that exceed the materiality levels stated above, will be permitted to reduce the excess of their investments over a period not extending beyond 1 January 2011. The impact would be that banks with these investments will not be required to deduct the excess over 15% from capital but will risk weight at 100%

Other Deductions - Securitised Assets

Exposures to securitised assets under the Standardised Approach are detailed under Paragraph 538 to 605 of Basel II. Such exposures that are rated B+ and below (Long-Term), below A-3/P-3 (Short-term), or are un-rated must be deducted from the capital base.

Deduction of investments in accordance with above requirements

Where deductions of investments are made pursuant to this part on scope of application, the deductions will be 50% from Tier 1 and 50% from Tier 2 capital.

APPENDICES

Appendix 1: External Credit Assessment Agencies

Appendix 2: Securatisation Mappings

Appendix 3: ICAAP Submission Suggested Format

Appendix 4: Pillar 3 Suggested Formats

Appendix 5:Frequently Asked Questions

Appendix 6: National Discretions

Appendix 7: Prudential Returns

Appendix 8: List of Multilateral Development Banks

APPENDIX 1: External Credit Assessment Agencies

The revised framework, allows banks to use external credit assessments to determine the risk weight of certain credit provided the External Credit Assessment Institutions ("ECAI"s) (rating agencies) that produce those assessments have been recognised as eligible for that purpose by the relevant national supervisor. ECAIs may be considered eligible for recognition if they meet the six criteria of:

- Objectivity;
- Independence;
- International access / Transparency;
- Disclosure;
- Resources; and,
- Credibility.

National supervisory authorities are responsible for establishing a mapping process i.e. assigning eligible ECAIs' assessments to the risk weights available under the standardised risk weighting framework and the securitisation framework for the standardised approach.

Objective of the Methodology

ECAI's should have a methodology of assigning a credit rating that is rigorous, systematic, continuous and subject to validation. To establish that an ECAI fulfils this primary component of eligibility criteria, it must demonstrate that it meets minimum standards given below:

1. It has an established rating definition, criteria and methodology.
2. The methodology, systems and procedures for assigning risk rating shall be consistent across the board.
3. The ECAI should have a robust procedure of rating assignment based on published information, market data, interviews with management and any other means that provide reasonable assurance for assigning the risk ratings.
4. While assigning risk ratings, the ECAI should take into account all major features of credit quality and ensure that the ratings are assigned taking into account all risk factors of the related entity.
5. The ECAI should demonstrate that the rating methodologies are subject to quantitative back testing. For this purpose, ECAI should calculate and publish default studies, recovery studies and transition matrices. For the purpose, the ECAI should have a definition of default that is equivalent to international standard and is relevant to domestic markets.

6. The assessment methodology for each market segment including rigorous back testing must have been established for at least one year.
7. All rating decision's should be made by the rating committee utilizing ECAI's established criteria and methodology.
8. The ECAI should have a mechanism to review its procedures and methodologies to adapt them to changing environment.
9. The ECAI should maintain adequate system /internal records to support its assigned ratings.

Independence

The ECAI should be independent, free from economic or any external pressures that may influence its credit assessments. The independence of an ECAI shall be assessed on the basis of the following four parameters:

1. Ownership: The ownership structure should not be such that could jeopardize the objectivity of the rating process. E.g. the owners have other businesses or are members of businesses or associations that are rated by the ECAI.
2. Organisational structure and Corporate Governance: The ECAI should demonstrate that their organisational structure minimizes the scope of external influence that can negatively impact the rating process. The ECAI have in place high standards of Corporate Governance that safeguard independence of its risk assessment and promote integrity.
3. Financial Resources: Since the core earning of an ECAI is the Issuer fee, this commercial pressure may give rise to conflict of interest. The ECAI must demonstrate that their business is financially viable and is able to sustain any commercial pressure exerted by rated entities. Also, ECAI should not be providing any other service to the rated entities.
4. External conflict of interest: The risk assessment process of ECAI should have ability to withstand external pressure. The ECAI should demonstrate that it is free from all sorts of external conflicts of interest.

International Access and Transparency

The risk assessment of the ECAI should be made available to both domestic and foreign institutions on equivalent terms and the same fees should be charged for the rating/risk assessments.

In order to promote transparency and enable its stakeholders to make decisions about the appropriateness of its risk assessment methods, ECAI should disclose enough information e.g. rating definition, methods of arriving at the rating, rating process, time horizon of the rating and the surveillance and review procedure.

Disclosure

The ECAI should demonstrate that it provides access to information that are sufficient to enable its stakeholders to make decision about the appropriateness of risk assessments. The purpose of this disclosure requirement is to promote transparency and bring in market discipline. ECAI is expected to make public the following information:

- Code of conduct.
- Definition of default
- Use of time horizons
- Rating definitions
- Assessment methods
- Actual default rates experienced in each assessment category
- Transition matrices
- Whether rating was solicited or unsolicited
- The date of last review and update

Resources

ECAI should possess sufficient human and technical resources to carry out high quality credit assessment

1. Technical expertise of the people should be sufficient to carry out risk assessment and maintain contact with management of entities that are rated.
2. With respect to technical resources, ECAI is expected to have quantitative techniques and models that can process and analyse large quantities of data.

Credibility

The ECAI must demonstrate that it enjoys credibility in the market where it operates. The credibility is gauged on the basis of:

1. The extent to which it meets the resources requirements.
2. The extent to which independent parties (investors, insurers etc..) rely on the ECAI's risk assessment.
3. Existence of internal procedures to prevent misuse of confidential information.

Recognition of External Credit Assessment Institutions (ECAIs)

Supervisory authorities across the GCC have agreed that the home regulator is free to choose from the following internationally recognised ECAIs:

- Standard & Poor's Ratings Services
- Moody's Investors Service
- Fitch Ratings; and

- Capital Intelligence

On the basis of information provided by the above ECAIs, CBUAE has reached the view that banks applying Basel II could use the ratings of the above ECAIs, and also reached agreement on the mapping process. Additional agencies may be approved in due course.

Mapping of ECAIs' ratings to risk weights

The general rule within Basel II is that banks should use solicited ratings from ECAIs. The GCC national supervisory authorities have agreed at their discretion, not to allow banks to use unsolicited ratings in the same way as solicited ratings.

Banks must use the chosen ECAIs and their ratings consistently for each type of claim, for both risk weighting and risk management purpose. Banks will not be allowed to "cherry-pick" the assessments provided by different ECAIs, and must disclose the ECAIs that they intend to use for the risk weighting of their assets by type of claim as per the mapping process in Appendix 2. Further guidance is provided below.

Long-term mapping –Assessments and Risk weights

	ASSESSMENTS				RISK WEIGHTS			
						Banks		
						Credit assessment method (Option 2)		
Risk Grade	S & P	FITCH	Moody's	Capital Intelligence	Corporate	Maturity > 3 months	Maturity 3 months or less (Domestic currency only)	Sovereign
1	AAA to AA-	AAA to AA-	Aaa to Aa3	AAA	20%	20%	20%	0%
2	A+ to A-	A+ to A-	A1 to A3	AA to A	50%	50%	20%	20%
3	BBB+ to BBB-	BBB+ to BBB-	Baa1 to Baa3	BBB	100%	50%	20%	50%
4	BB+ to BB-	BB+ to BB-	Ba1 to Ba3	BB	100%	100%	50%	100%

5	B+ to B-	B+ to B-	B1 to B3	B	150%	100%	50%	100%
6	CCC+ and below	CCC+ and below	Caa1 and below	C and below	150%	150%	150%	150%
7	Unrated	Unrated	Unrated	Unrated	100%	50%	20%	100%

UAE Dirham denominated and funded sovereign exposures to the Federal and Local Emirate governments attract a risk weighting of 0%. Similarly, all GCC sovereign exposures attract a risk weighting of 0%.

For the mapping of ratings to risk weights for exposures to banks and securities firms, only the risk weights associated with Option 2 are shown. The GCC exercised this Option for the standardised approach, rather than Option 1, which is based on the sovereign rating.

Short-term mapping (applied to exposures to banks and corporate entities)

For risk weighting purposes, short-term assessments are deemed to be issue-specific. They can only be used to derive risk weights for claims arising from the rated facility. They cannot be generalised to other short-term claims, except under the conditions as outlined below, which relate to short-term inter-bank claims under Option 2 of the standardised approach to credit risk.

Short-term ratings cannot be used to support a risk weight for an unrated long-term claim, and may only be used for short-term claims against banks and corporate entities.

Conditions for the use of short-term ratings for short-term bank exposures under Option 2 of the standardised approach to credit risk

The interaction between short-term bank exposures under Option 2 of the standardised approach to credit risk and short-term assessments of ECAIs is as follows:

- The general preferential treatment for short-term claims, as defined under paragraphs 62 and 64 of Basel II, applies to all claims on banks of up to three months original maturity when there is no specific short-term assessment (i.e. apply the long-term ratings and associated risk weights as defined in Appendix 2 for short-term claims-maturity of 3 months or less);
- Where there is a short-term assessment, and such an assessment maps into a risk weight that is more favourable (i.e. lower) or identical to that derived from the general preferential treatment, the short-term assessment should be used for the specific claim only; and
- Where a specific short-term assessment for a short-term claim on a bank maps into a less favourable (i.e. higher) risk weight, the general preferential treatment for inter-bank claims

cannot be used. All un-rated short-term claims should receive the same risk weighting as that implied by the specific short-term assessment.

Risk Grade	S&P	Fitch	Moody's	Capital Intelligence	Risk weight
1	A-1+, A-1	F1+, F1	P-1	A1	20%
2	A-2	F2	P-2	A2	50%
3	A-3	F3	P-3	A3	100%
4	All short-term ratings below A-3	Below F3	Not prime (NP)	All short-term ratings below A3	150%

Banks nomination of ECAIs

For the purpose of applying ECAI ratings to derive risk-weights for exposures under the portfolio of claims on sovereigns, claims on banks, claims on securities firms and claims on corporate entities under the standardised approach, a bank should satisfy the following four steps:

(a) Nominate one or more ECAI(s) (the "nominated ECAI(s)") whose assigned ratings will be used by the bank for deriving risk weights for exposures in each of the external ratings-based portfolios, provided that the nominated ECAI(s) can provide a reasonable coverage on the bank's exposures within the portfolios in terms of the types of counterparties and different geographical regions covered by the ECAI(s);

(b) Notify the CBUAE of its nominated ECAI(s) and the application of the ratings of such ECAI(s) on each of the bank's external ratings-based portfolios;

(c) Use the ratings of the nominated ECAI(s) within each of the external ratings-based portfolios consistently, and seek the consent of the CBUAE on any subsequent changes to such ECAI(s) and the application of its/their ratings; and

(d) Treat a relevant exposure or the person to whom the bank has a relevant exposure as "unrated" for risk weighting purposes if that exposure or that person does not have a rating assigned to it by any ECAI chosen by the bank.

The above requirements are to ensure that a bank applies the ratings of its nominated ECAI(s) consistently and avoid any possible cherry picking of ratings provided by different ECAIs.

In determining its nominated ECAI(s), a bank should pay special attention to the criterion of "reasonable coverage". Where a bank has significant exposures within the external ratings-based portfolios to a particular type/set of counter-parties or a particular country that is not rated by the bank's nominated ECAI(s) but by other recognised ECAI(s) the bank should include such ECAI as a nominated ECAI to comply with the "reasonable coverage" requirement.

Multiple assessments

If there is only one assessment by a nominated ECAI chosen by a bank for a particular claim, that assessment should be used to determine the risk weight of the claim.

If there are two assessments by nominated ECAIs chosen by a bank that map into different risk weights, the higher risk weight will be applied.

If there are three assessments with different risk weights, the assessments corresponding to the two lowest risk weights should be referred to and the higher of those two risk weights will be applied.

Level of application of assessments

External assessments for one entity within a corporate group cannot be used to risk weight other entities within the same group.

Issue versus issuer assessment

Where a bank invests in a particular issue that has an issue-specific assessment, the risk weight of the claim will be based on this assessment. Where a bank's claim is not an investment in a specific, assessed, issue the following principles apply:

- In circumstances where the borrower has a specific assessment for an issued debt, but the bank's claim is not an investment in this particular debt, a high quality credit assessment (that being one which maps into a risk weight lower than that which applies to an unrated claim) on that specific debt may only be applied to the bank's un-assessed claim if this claim ranks pari passu or senior to the claim with an assessment in all respects. If not, the credit assessment cannot be used and the un-assessed claim will receive the risk weight for unrated claims; and
- In circumstances where the borrower has an issuer assessment, this assessment typically applies to senior unsecured claims on that issuer. Consequently, only senior claims on that issuer will benefit from a high quality issuer assessment. Other un-assessed claims of a highly assessed issuer will be treated as unrated. If either the issuer or a single issue has a low quality assessment (mapping into a risk weight equal to or higher than that which applies to unrated claims), an un-assessed claim on the same counterparty will be assigned the same risk weight as is applicable to the low quality assessment.

Where a bank intends to rely on an issuer or an issue specific assessment, the assessment must take into account and reflect the entire amount of credit risk exposure a bank has with regard to all amounts owed to it.

Export Credit Agencies (“ECA”s)

Basel II (Para 55) allows supervisors to recognise the country risk scores assigned by ECAs in respect of the risk weighting of sovereign and central bank exposures. This is in addition to banks being able to use ECAIs for such exposures. The GCC regulators have exercised this National Discretion and agreed that banks are not permitted to use the consensus risk scores of ECAs participating in the “OECD Arrangement on Officially Supported Export Credits”.

APPENDIX 2: Securatisation Mappings

Long-term rating

Risk Grade	*S & P*	FITCH	Moody's	Capital Intelligence	Risk Weights			
					Securitisation	Resecuritisation	Credit Default Swaps	
							First to default	Second to default
1	AAA to AA-	AAA to AA-	Aaa to Aa3	AAA	20%	40%	20%	20%
2	A+ to A-	A+ to A-	A1 to A3	AA to A	50%	100%	50%	50%
3	BBB+ to BBB-	BBB+ to BBB-	Baa1 to Baa3	BBB	100%	225%	100%	100%
	BB+ to BB-	BB+ to BB-	Ba1 to Ba3	BB	350%	650%	350%	350%
5	B+ and below Unrated	B+ and below Unrated	B1 and below Unrated	B and below Unrated	Deduction		Aggregate of risk weights of each obligor in basket Up to 1000%	Aggregate of risk weights of each obligor in basket (excluding asset with lowest risk weight) Up to 1000%

Short-term rating

Risk Grade	S & P	Fitch's	Moody's	Capital Intelligence	Risk weights			
					Securitisation	Resecuritisation	Credit Default Swaps	
							First to default	Second to default
1	A-1+, A-1	F1+, F1	P-1	A1	20%	40%	20%	20%
2	A-2	F2	P-2	A2	50%	100%	50%	50%
3	A-3	F3	P-3	A3	100%	225%	100%	100%
4	All others or unrated	All others or unrated	All others or unrated	All others or unrated	Deduction		Aggregate of risk weights of each obligor in basket Up to 1000%	Aggregate of risk weights of each obligor in basket (excluding asset with lowest risk weight) Up to 1000%

Deduction is required for unrated positions with the exception of the circumstances described in Paragraphs 571 to 575 Basel II

Refer to Enhancements to the Basel II framework July 2009

APPENDIX 3: ICAAP Submission Suggested Format

Banks' business and risk profiles differ and the ICAAP should be proportionate to the size, nature and complexity of a bank's business.

Adopting this format may be convenient for banks as it covers most of the matters which typically would be reviewed by the CBUAE under the SREP. However, other formats may be acceptable.

Executive Summary

The purpose of the Executive Summary is to present an overview of the ICAAP methodology and results. This overview would typically include:-

1. The purpose of the report and which bank(s) is (are) covered by the ICAAP;
2. The main findings of the ICAAP eg:-
   - how much and what composition of internal capital the bank considers it should hold as compared with the Pillar 1 minimum capital requirement (details explained with calculations in appendices); and
   - an assessment of the adequacy of the bank's risk management processes;
3. Brief descriptions of the capital and dividend plan; how the bank intends to manage capital going forward and for what purposes;
4. Commentary on the key businesses, most material risks, why the level of risk is acceptable or, if it is not, what mitigating actions are planned;
5. Commentary on major issues where further analysis and decisions are required; and
6. Who has carried out the assessment, how it has been challenged, and who has approved it.

	PILLAR 1 **Min Regulatory Capital** **AED000's**	**Pillar 2 Capital** **Required capital as derived from ICAAP** **AED 000's**
Credit Risk		
Market Risk		
Operational Risk		
Total Pillar 1		
Pillar 2- Credit Concentration Risk		
Pillar 2- Int. Rate Risk in Bank. book		
Pillar 2 - Other Risks		
Total Pillar 2		
Capital derived from Stress testing		
Required Capital as per ICAAP		
Current capital		

Surplus/(additional required)		

Background

This section would cover the relevant organisational and historical financial data for the bank. e.g. group structure and key data and trends drawn from the bank's quarterly returns.

Capital Adequacy

This section might start with a description of the risk appetite used in the ICAAP. Where economic capital models are used this would include details of the assumptions behind that model. Where scenario analyses or other means are used, then some other description of how the severity of scenario has been chosen would be included.

The section would then include a detailed review of the capital adequacy of the bank including:-

1. Timing
    - The effective date of the ICAAP calculations together with consideration of any events between this date and the date of submission which would materially impact the ICAAP calculation together with their effects; and
    - Details of, and rationale for, the time period over which capital has been assessed.
2. Risks analysed

An identification of the major risks faced in each of the following categories:-

- Credit risk,
- Market risk,
- Operational risk,
- Liquidity risk,
- Concentration risk
- Reputational risk
- Regulatory risk
- Insurance risk
- Residual risk
- Securitisation risk
- Business risk
- Interest rate risk, and
- Any other risks identified

For each risk, an explanation of how the risk has been assessed and the quantitative results of that assessment;

A clear articulation of the bank's risk appetite by risk category, for example, strong appetite, modest appetite or conservative appetite; and

An explanation of any other methods apart from capital used to mitigate the risks e.g. risk management or control structures.

3. Methodology and assumptions

A description of how assessments for each of the major risks have been approached and the main assumptions made. The description would make clear which risks are covered by which approach.

Where stress tests or scenario analyses have been used to validate, supplement, or probe the results, then this section would provide details.

Capital transferability

Details of any restrictions on the management ability to transfer capital into, or out of the bank (for example, contractual, commercial, regulatory or statutory restrictions that apply)

ICAAP comparisons

An analysis of significant movements in available capital and capital required since the latest ICAAP and a comparison of the overall level and quality of capital required under Pillar 1 as compared with the overall capital requirement identified by the ICAAP.

Key Sensitivities and Future Scenarios

This section would detail the sensitivity tests undertaken to key assumptions and factors that have a significant impact on the broader financial condition of the bank. Material changes in the financial risks to which the business is exposed would be explained and quantified as far as possible in this section. The analysis would include financial projections forward for, three or five years, based on business plans and capital adequacy calculations. These would take account of expected capital requirements over economic and business cycles.

Typical scenarios may include:-

- How an economic downturn would affect the bank's capital resources, capital requirements and its future earnings taking into account the bank's business plan;
- How would a significant correction in local equity and/or real estate markets impact the bank’s capital requirements
- How changes in the credit quality of the bank's credit risk counter-parties affect the bank’s capital and its credit risk capital requirement (note that this scenario stress test is a requirement for IRB);
- An assessment by the bank of how it would continue to meet its regulatory capital requirements throughout a recession;
- Projections of cash inflows and outflows under stressed conditions.

Aggregation

This section would describe how the results of the various separate risk assessments are brought together and an overall view taken on capital adequacy. This requires some sort of methodology to be used to quantify the capital required to support individual risks so that they can be aggregated into a total figure.

As regards the overall assessment, this would describe how the bank has arrived at its overall assessment of the capital it needs taking into account such matters as:-

- The inherent uncertainty in any modeling approach;
- Weaknesses in the bank's risk management procedures, systems or controls;
- The differences between regulatory capital and internal capital; and
- The differing purposes that capital serves: shareholder returns, rating objectives for the bank as a whole, avoidance of regulatory intervention (e.g. on large exposure notifications), customer perception, protection against uncertain events, working capital, capital held for strategic acquisitions etc.

Challenges and Adoption of the ICAAP

This section would describe the extent of challenge and testing of the ICAAP. It would include the testing and control processes applied to the ICAAP calculations, and the senior management or board review and sign off procedures.

A copy should be attached of any relevant report to senior management or the board and their response.

Details of the reliance placed on any external suppliers/advisers/consultants would also be detailed here e.g. for generating economic scenarios or for assistance in preparation of the ICAAP. In addition, a copy of any report obtained from an external reviewer or internal audit would also be included.

Use of the ICAAP within the Bank

This would demonstrate the extent to which capital management is embedded within the bank including the extent and use of capital modelling or scenario analysis and stress testing within the bank's capital management policy, e.g. in setting pricing and charges. This would also include a statement of the actual operating philosophy on capital management and how this links to the ICAAP submitted. For instance differences in risk appetite used in the ICAAP as compared to that used for business decisions should be discussed.

APPENDIX 4: PILLAR 3 SUGGESTED FORMATS

TABLE (1)

INFORMATION ON SUBSIDIARIES AND SIGNIFICANT INVESTMENTS AS ON ______________

Basis of Consolidation[1] : __

	Country of Incorporation	% Ownership	Description [2]	Accounting Treatment [3]	Surplus Capital[4]	Capital Deficiencies[5]	Total Interests[6]
Subsidiaries:							
Significant Investments:							

Restrictions on transfer of regulatory capital within the group:

1. Include an outline of differences in the basis of consolidation of subsidiaries for accounting and regulatory purposes.
2. A brief description of the entities within the group such as securities, insurance, other financial subsidiaries, commercial subsidiaries, significant minority equity investments in insurance, financial and commercial entities.
3. Report the accounting treatment as:
   - that are fully consolidated;
   - that are pro-rata consolidated;
   - that are given a deduction treatment;
   - those from which surplus capital is recognized, and
   - that are neither consolidated nor deducted (e.g. where the investment is risk weighted)
4. The aggregate amount of surplus capital of insurance subsidiaries (whether deducted or subjected to an alternative method) included in the capital of the consolidated group. Surplus capital in unconsolidated regulated subsidiaries is the difference between the amount of investment in those entities and their regulatory capital requirements.
5. The aggregate amount of capital deficiencies in all subsidiaries not included in the consolidation i.e. they are deducted.
6. The aggregate amounts (e.g. current book value) of the licensed bank's total interests in insurance entities, which are risk-weighted rather than deducted from capital or subjected to an alternate group-wide method, as well as, if different, the proportion of voting power in these entities. In addition, indicate the quantitative impact on regulatory capital of using this (it's required to method) versus using the deduction or alternate group-wide method

TABLE (2)
(AED OOO's)

CONSOLIDATED CAPITAL STRUCTURE AS ON ___________________________________ _

	Summary terms and conditions of main features of all capital instruments	**Amount**
Tier 1 Capital		
1. Paid up share capital/common stock 2. Reserves		
a. Statutory reserve		
b. Special reserve c. General reserve [2]		
3. Minority interests in the equity of subsidiaries 4. Innovative capital instruments [1]		
5. Other capital instruments		
6. Surplus capital from insurance companies		
Sub-total		
Less: Deductions for regulatory calculation		
Less: Deductions from Tier 1 capital		
Tier 1 Capital - Subtotal		
Tier 2 capital		
Less: Other deductions from capitals		
Tier 3 capital		
Total eligible capital after deductions		

1. Include minority interests in equity accounts of consolidated subsidiaries that take form of SPVs and moderate step-ups in instruments issued through SPV's, as well as directly issued Tier I instruments, subject to stringent conditions (refer to Basel Committee's press release, Instruments eligible for inclusion in Tier I capital- 27 October 1988) and limited to a maximum of 15% of Tier I capital.
2. Including undisclosed reserves, revaluation reserves, general provisions/general loan loss reserves Hybrid debt capital instruments and subordinated debt.

TABLE (3a and 3b)

CAPITAL ADEQUACY AS ON ______________________________

<table>
<tr><td colspan="4">a) Qualitative Disclosures</td></tr>
<tr><td colspan="4">Include here a description of the approach taken by the bank to assess the adequacy of its capital to support current and future activities. For each separate risk area (e.g. credit, market, operational, banking book interest rate risk, equity) banks must describe their risk management objectives and policies as per Para 824 of Basel II.</td></tr>
<tr><td colspan="2">b) Quantitative Disclosures</td><td>Capital Charge (AED 000's)</td><td>Capital Ratio (%)</td></tr>
<tr><td colspan="2">Capital Requirements</td><td></td><td></td></tr>
<tr><td></td><td>1. Credit Risk</td><td></td><td></td></tr>
<tr><td></td><td>a. Standardised Approach</td><td></td><td></td></tr>
<tr><td></td><td>b. Foundation IRB</td><td></td><td></td></tr>
<tr><td></td><td>c. Advanced IRB</td><td></td><td></td></tr>
<tr><td></td><td>2. Market Risk</td><td></td><td></td></tr>
<tr><td></td><td>a. Standardised Approach</td><td></td><td></td></tr>
<tr><td>or</td><td>b. Models Approach</td><td></td><td></td></tr>
<tr><td></td><td>3. Operational Risk</td><td></td><td></td></tr>
<tr><td></td><td>a. Basic Indicator Approach</td><td></td><td></td></tr>
<tr><td>or</td><td>b. Standardised Approach/ASA</td><td></td><td></td></tr>
<tr><td>or</td><td>c. Advanced Measurement Approach</td><td></td><td></td></tr>
<tr><td></td><td>Total Capital requirements</td><td></td><td></td></tr>
<tr><td></td><td>Capital Ratio</td><td></td><td></td></tr>
<tr><td></td><td>a. Total for Top consolidated Group</td><td></td><td></td></tr>
<tr><td></td><td>b. Tier 1 ratio only for top consolidated Group</td><td></td><td></td></tr>
<tr><td></td><td>c. Total for each significant bank subsidiary</td><td></td><td></td></tr>
</table>

TABLE 4(a)

Qualitative Disclosures

<table>
<tr><td colspan="3">Definition of past due and impaired (for accounting purposes)</td></tr>
<tr><td colspan="3"></td></tr>
<tr><td colspan="3">Description of approaches followed for specific and general allowances and statistical methods</td></tr>
<tr><td colspan="3">Specific

General</td></tr>
<tr><td colspan="3">Discussion of Bank’s credit risk management policy</td></tr>
<tr><td colspan="3"></td></tr>
<tr><td colspan="3">Partial adoption of foundation IRB/advanced IRB</td></tr>
<tr><td>Approach</td><td>Description of exposures</td><td>Plans and timing of migration to implement fully higher approach</td></tr>
<tr><td>Standardised Approach</td><td></td><td></td></tr>
<tr><td>Foundation IRB</td><td></td><td></td></tr>
<tr><td>Advanced IRB</td><td></td><td></td></tr>
</table>

TABLE 4(b)

GROSS CREDIT EXPOSURES BY CURRENCY TYPE AS ON

(AED OOO's)

	Loans	Debt Securities	Total Funded	Commitments	OTC Derivatives	Other Off-Balance Sheet exposures	Total Non-Funded	Total
Foreign Currency								
AED								

TABLE 4(c)

GROSS CREDIT EXPOSURES BY GEOGRAPHY AS ON (AED OOO's)

GEOGRAPHIC DISTRIBUTION	Loans	Debt Securities	Total Funded	Commitments	OTC Derivatives	Other Off-Balance Sheet exposures	Total Non-Funded	Total
United Arab Emirates								
GCC excluding UAE								
Arab League (excluding GCC)								
Asia								
Africa								
North America								
South America								
Caribbean								
Europe								
Australia								
Others								
Total								

1. Concerning independent institutions insert the figures opposite the country which licensed them.
2. Concerning institutions that operate as branches for their H.O. insert the figures opposite the country where the H.O. are licensed.

TABLE 4(d)

GROSS CREDIT EXPOSURE BY INDUSTRY SEGMENT AS ON

(AED OOO's)

INDUSTRY SEGMENT	Loans	Debt Securities	Total Funded	Commitments	OTC Derivatives	Other Off-Balance Sheet exposures	Total Non-Funded	Gross
Agriculture, Fishing & related activities[1]								
Crude Oil, Gas, Mining & Quarrying[2]								
Manufacturing[3]								
Electricity& Water								
Construction [4]								
Trade [5]								
Transport, Storage & Communication[6]								
Financial Institutions [7]								
Services[8]								
Government[9]								
Retail/Consumer banking[1o]								
All Others								
Total								

1. Agriculture, Fishing and Allied Activities includes cultivation of crops, dairy and poultry farming, fishing & other activities (sheep rearing, etc).
2. Crude Oil, Gas, Mining and Quarrying include crude petroleum, natural gas and others.
3. Manufacturing includes food, tobacco, beverages, textile, leather, footwear, clothing, furniture, fixtures, other wood products, paper, paper products, printing presses, chemical, chemical products, petroleum refining, petrochemicals, basic metal products including aluminum, fabricated metal products, machinery, equipment, construction materials (brick tiles, etc.), cement, ship building, engineering works, saw mills, marble tiles and other manufacturing.
4. Construction includes construction of buildings, contractors and other construction.
5. Trade includes wholesale trade in construction materials, consumer durables, motor vehicles, non-durables and retail trade.
6. Transport and communication includes taxies, and other land transport, water transport, air transport, warehousing, storage and others.
7. Financial institutions include insurance companies, money and exchange dealers, NBFCS and other financial institutions.
8. Services include hotel and restaurants, professional services, repair work (repair of motor vehicles, a/cs, etc.), recreation services (cinemas, sports club, etc.) and other services.
9. Government includes federal government and local government.
10. Retail/consumer lending includes personal loan installments, residential mortgage loans, car loans, credit cards, other retail products, loans for investments in shares etc.

TABLE 4(e)

GROSS CREDIT EXPOSURES BY RESIDUAL CONTRACTUAL MATURITY AS ON ______________________

(AED OOO's)

RESIDUAL CONTRACTUAL MATURITY	Loans	Debt Securities	Total Funded	Commitments	OTC Derivatives	Other Off-Balance Sheet exposures	Total Non-Funded
Less than 3 months							
3 months to one year							
One to five years							
Over five years							
Grand Total							

TABLE 4(f)

(AED OOO's)

IMPAIRED LOANS BY INDUSTRY SEGMENT AS ON

INDUSTRY SEGMENT	OVERDUE			PROVISIONS		ADJUSTMENTS		Total Impaired Assets
	Less than 90 days	90 days and above	Total	Specific	General	Write-offs	Write-backs	
Agriculture, Fishing & related activities[1]								
Crude Oil, Gas, Mining & Quarrying[2]								
Manufacturing[3]								
Electricity& Water								
Construction [4]								
Trade[5]								
Transport, Storage & Communication[6]								
Financial Institutions[7]								
Services[8]								
Government[9]								
Retail/consumer banking[10]								
All Others								
Grand Total								

1. Agriculture, Fishing and Allied Activities includes cultivation of crops, dairy and poultry farming, fishing other activities (sheep rearing, etc).
2. Crude Oil, Gas, Mining and Quarrying include crude petroleum, natural gas and others.
3. Manufacturing includes food, tobacco, beverages, textile, leather, footwear, clothing, furniture, fixtures, other wood products, paper, paper products, printing presses, chemical, chemical products, petroleum refining, petrochemicals, basic metal products including aluminium, fabricated metal products, machinery, equipment, construction materials (brick tiles, etc.), cement, ship building, engineering works, saw mills, marble tiles and other manufacturing.
4. Construction includes construction of buildings, contractors and other construction.
5. Trade includes wholesale trade in construction materials, consumer durables, motor vehicles, non-durables and retail trade.
6. Transport and communication includes taxies, and other land transport, water transport, air transport, warehousing, storage and others.
7. Financial institutions include insurance companies, money and exchange dealers, NBFCS and other financial institutions.
8. Services include hotel and restaurants, professional services, repair work (repair of motor vehicles, a/cs, etc.), recreation services (cinemas, sports club, etc.) and other services.
9. Government includes federal government and local government.
10. Retail/consumer lending includes personal loan instalments, residential mortgage loans, car loans, credit cards, other retail products, loans for investments in shares etc.

TABLE 4(g)

IMPAIRED LOANS BY GEOGRAPHIC DISTRIBUTION AS ON ________________________________ (AED OOO's)

Geographic Region	OVERDUE			PROVISIONS		ADJUSTMENTS		Total Impaired Assets
	Less than 90 days	90 days and above	Total	Specific	General	Write-offs	Write-backs	
United Arab Emirates								
GCC (excluding UAE)								
Arab League (excluding GCC)								
Asia								
Africa								
North America								
South America								
Caribbean								
Europe								
Australia								
Others								
Grand Total								

Note: Jurisdictions should not be included more than once under the geographic region

TABLE 4(h)

RECONCILIATION OF CHANGES IN PROVISION FOR IMPAIRED LOANS FOR THE PERIOD TO

	Description	**AED 000's**
	Opening Balance of Provisions for Impaired Loans	
Add:	Charge for the year	
	• Specific provisions	
	• General provisions	
Add:	Write-off of impaired loans to income statement	
Less:	Recovery of loan loss provisions	
Less:	Recovery of loans previously written-off	
Less:	Write-back of provisions for loans	
	Adjustments of loan loss provisions	
	Closing Balance of Provisions for Impaired Loans	

TABLE 4(i)

LOAN PORTFOLIO AS PER STANDARDISED APPROACH AS ON

(AED OOO's)

ASSET CLASSES	ON BALANCE SHEET	OFF BALANCE SHEET	CREDIT RISK MITIGATION (crm)			RISK WEIGHTED ASSETS
See Basel II, June 2006, Para 50 to 81, and Central Bank National Discretions	GROSS OUTSTANDING	NET EXPOSURE AFTER CREDIT CONVERSION FACTORS (CCF)	EXPOSURE BEFORE CRM	CRM	AFTER CRM	
CLAIMS ON SOVEREIGNS						
CLAIMS ON NON-CENTRAL GOVERNMENT PUBLIC SECTOR ENTITIES (PSEs)						
CLAIMS ON MULTI LATERAL DEVELOPMENT BANKS						
CLAIMS ON BANKS						
CLAIMS ON SECURITIES FIRMS						
CLAIMS ON CORPORATES						
CLAIMS INCLUDED IN THE REGULATORY RETAIL PORTFOLIO						
CLAIMS SECURED BY RESIDENTIAL PROPERTY						
CLAIMS SECURED BY COMMERCIAL REAL ESTATE						
PAST DUE LOANS						
HIGH RISK CATEGORIES						
OTHER ASSETS						

CLAIMS ON SECURITISED ASSETS						
CREDIT DERIVATIVES (Banks Selling protection)						
TOTAL CLAIMS						

TABLE 5 (a & b)

a) Qualitative Disclosures

- For each portfolio, name of ECAIs used, plus reasons for any changes
- Types of exposure for which each agency is used

LOAN PORTFOLIO AS PER STANDARDISED APPROACH AS ON (AED OOO's)

b) Quantitative	Gross Credit Exposures					Exposures Subject to Deduction				
Asset Class	**Rated**	**Unrated**	**Total**	**Post CRM**	**RWA Post CRM**	**Rated**	**Unrated**	**Total**	**Post CRM**	**RWA Post CRM**
Claims on Sovereigns										
Claims on Public Sector Entities										
Claims on Multilateral Development Banks										
Claims on securities firms										
Claims on Banks										
Claims on Corporate										
Regulatory & other retail exposure										
Residential retail exposure										
Commercial Real Estate										
Other assets										
Claims on Securitised Assets										
Credit Derivatives (Banks selling protection)										
Grand Total										

TABLE 7 (a, b & c)

CREDIT RISK MITIGATION: DISCLOSURES FOR STANDARDIZED APPROACH AS ON __________ _

a) Qualitative Disclosures

Policies and processes covering credit risk mitigation, including summary of:

- Policies and processes for, and an indication of the extent to which the bank makes use of, on- and off-balance sheet netting;
- Policies and processes for collateral valuation and management;
- Description of the main types of collateral taken by the bank;
- The main types of guarantor/credit derivative counter-party and their credit worthiness; and
- Information about (market or credit) risk concentrations within the mitigation taken.

(AED OOO's)

b) Quantitative Disclosures		Exposures	Risk Weighted Assets
	Gross Exposure prior to Credit Risk Mitigation		
Less:	Exposure covered by on-balance sheet netting		
Less:	Exposures covered by Eligible Financial Collateral		
Less:	Exposures covered by Guarantees		
Less:	Exposures covered by Credit Derivatives		
	Net Exposures after Credit Risk Mitigation		

TABLE 10

TOTAL CAPITAL REQUIREMENT FOR MARKET RISK UNDER STANDARDISED APPROACH AS ON __________

(AED OOO's)

Market Risk	**Amount**
Interest rate risk	
Equity position risk	
Foreign exchange risk	
Commodity risk	
Total Capital Requirement	

TABLE 13
(AED OOO's)

EQUITY POSITION IN THE BANKING BOOK AS OF ____ _

a) Qualitative Disclosures

The general qualitative disclosure requirement (Paragraph 824 of Basel II) with respect to equity risk, including:

- Differentiation between holdings on which capital gains are expected and those taken under other objectives including for relationship and strategic reasons; and
- Discussion of important policies covering the valuation and accounting of equity holdings in the banking book. This includes the accounting techniques and valuation methodologies used, including key assumptions and practices affecting valuation as well as significant changes in these practices

As at _______, the bank's total equity investment portfolio in the banking book amounted to AED_____ % of which represents quoted investments. For details of the accounting policies and valuation methodology, please refer to Note X to the consolidated financial statements under 'Significant Accounting Policies' Details of cost, market and fair value are reported in Note y to the consolidated financial statements under the heading of "Non- Trading investments.

b) Quantitative Disclosures

1. QUANTITATIVE DETAILS OF EQUITY POSITION:

Type	Current Year		Previous Year	
	Publicly Traded	Privately Held	Publicly Traded	Privately Held
Equities				
Collective investment schemes				
Any other investment				
Total				

2. REALISED, UNREALISED AND LATENT REVALUATION GAINS (LOSES) DURING THE YEAR:

Gains (Losses)	Amount
Realised gains (losses) from sales and liquidations	
*Unrealised gains (losses) recognised in the balance sheet but not through profit and loss account	
**Latent revaluation gains (losses) for investment recorded at cost but not recognised in balance sheet or profit and loss account	
Total	

3. ITEMS IN (2) ABOVE INCLUDED IN TIER 1/TIER 2 CAPITAL:

Tier Capital	Amount
Amount included in Tier I capital	
Amount included in Tier II capital	
Total	

TABLE 13
(CON'T)

EQUITY POSITION IN THE BANKING BOOK AS OF _________ _

4. CAPITAL REQUIREMENTS BY EQUITY GROUPINGS:

(AED OOO's)

Grouping	**Amount**
Strategic investments	
Available for sale	
Held for trading	
Total capital requirement	

Table 14

INTEREST RATE RISK IN THE BANKING BOOK (IRRBB) AS OF

Interest rate risk arises from the possibility that changes in interest rates will affect future profitability, cash flows or the fair values of financial instruments. The Bank is exposed to interest rate risk as a result of mismatches or gaps in the amounts of assets and liabilities and off balance sheet instruments that mature or reprice in a given period. The Board of Directors has established acceptable levels of interest rate risk by setting limits on the interest rate gaps for stipulated periods. The Bank manages interest rate risk by matching the repricing of assets and liabilities through risk management strategies and monitors the positions on a daily basis to ensure they are maintained within established limits. Adherence to these limits is monitored by ALCO.

Interest rate risk is also assessed by measuring the impact of defined movements in interest yield curves on the Bank's net interest income. The following impact on the net interest income and regulatory capital for the year of an immediate and permanent movement in interest yield curves as at _

Shift in Yield Curves	Net Interest Income	Regulatory Capital
+200 basis point		
- 200 basis point		

The above interest rate sensitivities are illustrative only and adopt simplified scenarios. The sensitivities do not incorporate actions that could be taken by management to mitigate the effect of interest rate movements.

APPENDIX 5: Frequently Asked Questions

Capital Base

Q How is a 'Retained Loss' treated when calculating core/tier 1 capital?

A Retained earnings are added if they are positive, however, negative retained earnings or 'retained loss' are deducted from core capital

Q How are 'cumulative changes in fair value' treated?

A These may be included as tier 2 capital under Asset Revaluation Reserve, but are subject to a discount of 55% as per Basel II Para 49 (vi)

Q How are negative reserves treated? for example negative balance arising from Foreign Currency Translation of overseas investments

A These would be deducted from Tier 1 capital in the same manner as goodwill

Claims on Sovereigns

Q Which type of UAE exposures would be included in claims on sovereigns?

A A UAE Government exposure includes the Federal and Local government ministries, municipalities, all government departments and the UAE Central Bank. Excludes all other entities owned by the government which may be included under Public Sector Entities.

Q Are government owned entities also included in Government?

A No, please see below.

Claims on Non-Central Government Public Sector Entities (PSE)

Q Which type of UAE exposures would be included in claims on Public sector entities?

A A UAE entity may be considered a PSE for the relevant asset class under the Standardised Approach to Credit Risk under Basel II, if it meets the following Criterion.

- Entities where direct government (Federal/Emirate) ownership is more than 50% directly or through a qualifying PSE that itself is majority owned by government.

Q Would all UAE Public sector entities qualify for 0% risk weight?

A No, entities that satisfy the above criteria should be classified as either;

a. Non-commercial PSE (attracting a 0% risk weight), or

b. Commercial PSE (risk weighted according to external ratings, e.g. Moody's, S&P)

Q Which entities would be included under non-commercial PSEs?

A Refer to foot note 23 of Basel II. In addition, a UAE entity must also satisfy the following criteria to be considered a non-commercial PSE, otherwise would be of commercial in nature.3

- Entities whose complete activities are the functions of the Government.
- Authorities established by a decree, so long as they don't change their nature.
- Not listed on any stock exchange.
- Does not sell services or products to the public, except utilities e.g. Electricity/water.
- Provides internal services to the parent or sister companies ONLY, and the parent company is itself a non-commercial PSE.
- Public importance even when selling services to the public (e.g. electricity and water).
- Foreign strategic partner for technical expertise ONLY.
- Does not operate in a competitive market.
- Does not operate overseas.

CLAIMS ON BANKS

Q What is the definition of short-term exposures?

A Refer to foot note 26 of Basel II, where short-term claims in option 2 are defined as having an original maturity of three months or less.

Q Do we apply risk weights of short-term exposures using short term rating?

A No, long term ratings must be used according to paragraphs 62 of Basel II. Under option 2, a preferential risk weight that is one category more favourable may be applied to claims with an original maturity of three months or less and denominated in the domestic currency

(such claims in a foreign currency will use the long term weights, and report under short-term).

Please refer to Appendix 1 of this document, and use the table "Long-term mapping – Assessments and Risk weights".

CLAIMS INCLUDED IN THE REGULATORY RETAIL PORTFOLIO

Q Do we report all claims under AED 2M at the preferential risk weight of 75%?

A No, banks should consider the granularity criterion which states that no exposure reported under the preferential risk weight constitutes above 0.2% of the total regulatory retail portfolio. In other words, the threshold to qualify for the 75% risk weight is the lower of AED 2M and 0.2% of R.R.P.

CLAIMS SECURED BY RESIDENTIAL PROPERTY

Q What can be included under "Claims secured by residential property"?

A Only residential mortgages (i.e. where the purpose of the loan is to buy the property primarily for own use-as a discretion maximum of mortgages on 4 individual properties that will be rented out by a retail borrower may also be included) should be reported under this asset class, all other exposures must be reported under respective asset class, in the main being commercial real estate.

Q Do exposures to finance an entire residential building qualify?

A Not necessarily, the criteria is purpose of loan, so if the loan is to build/buy a building which is clearly to be let then this would be commercial real estate.

Q Can we take benefit of the preferential risk weight for claims exceeding CBUAE criteria of AED 10 million, for the portion of the mortgage that does?

A Yes, the 35% risk weight applies to the portion of the loan below 85% LTV up to AED10M; the balance receives 100% risk weight.

CLAIMS SECURED BY COMMERCIAL REAL ESTATE

Q Do we include all claims that are collateralised by commercial property?

A No, this asset class is for exposures specifically made for the purpose of buying/constructing commercial property, i.e. real estate loans (includes residential towers/mixed use towers). All other exposures must be reported under the respective asset class.

PAST DUE LOANS

Q How can we determine if the provision is above or below 20% of the loan amount?

A The provision coverage is calculated at a counter party level as follow:

$$\frac{\text{Specific provision}}{\text{(Outstanding Loan – Interest in suspense)}}$$

OTHER ASSETS

Q Do we use the issuer's long-term rating to map EQUITY investments to the respective risk weight?

A No, for credit risk ALL "Banking Book" equity investments fall into the criteria for 'Other Assets' and therefore must be reported at 100% risk weight.

"Trading Book" equity investments are to be reported at 0% risk weight in the CR2 form for completeness purposes only.

Q How do we risk weight our investments in a Sukuk?

A The first matter to determine is if the Sukuk falls under the Securitisation Framework of Basel II as per Section IV of Basel II. If the 'Sukuk' offers the investors two or more 'tranches' in which to invest, then the Securitisation Framework should be applied along with the relevant risk weights. If only a single instrument with the same return is offered to investors then the Sukuk would be treated in the same manner as bonds and included under the asset class of the issuer.

In all cases apply the risk weight that reflects the external rating of the Sukuk. Where the Sukuk is unrated, treat as an unrated bond, except where the risks still remain with the originator (e.g. where the originator underwrites/guarantees the issue) in which case the rating of the originator will apply.

Off Balance sheet

Q Do cash margin for off balance sheet exposures also qualify as CRM?

A Yes. Cash collateral (margins) for Off balance sheet exposures need to be reported, at the counter-party level, in CRM returns (CR4 or CR4a) in the cash collateral column AFTER converting applying the same CCF % which has been applied to the corresponding off balance sheet exposure. The same treatment would apply to other collaterals eligible under CR4 etc.

Banks may find it beneficial to prepare a separate table (not for submission to CBUAE) for on balance sheet and off balance sheet collateral before entering the consolidated numbers onto CR4 etc.

Q Is reporting of off balance sheet exposure in CR2 and CR3 before application of CCF% would be net of cash margin.

A No, reporting of off balance sheet exposure is before application of CCF% and gross of any CRM (cash margins etc.) when entering the 'Exposure before CCF' in CR2 and CR3.

Market Risk

Q Investments designated as 'available for sale' that are accounted for applying fair value through the profit & loss account, are these considered under trading book?

A No. Only those investments that are mark-to-market under IFRS and designated as trading book under IAS39 are consistent with definition of trading book for market risk under Basel II.

APPENDIX 6: National Discretions

Basel II para. reference (June 2006 version)	Summary of Basel II Issues subject to National Discretion	Central Bank of UAE Decisions
Scope of Application and Other Issues		
24 & 27	Choice of rule between consolidation and deduction. All relevant financial activities will be consolidated, but if not consolidated, deducted from the capital.	The threshold level for consolidation in the UAE is ownership of above 50%. Deduction, if ownership is 50% or below
28	Threshold for minority investments in banking and financial entities to be deemed significant and be either deducted or consolidated on a pro-rata basis	The threshold level for pro-rata consolidation is ownership equal to or above 20% but less than 50% Deduction where this criteria is not met
30-34	Treatment of significant investments in insurance subsidiaries The committee believes that at this stage it is, in principle, appropriate to deduct banks' equity and other regulatory capital investments in insurance subsidiaries and also significant minority investments in insurance entities.	Ownership of 10% and above in insurance subsidiaries will lead to deduction.

Basel II para. reference (June 2006 version)	Summary of Basel II Issues subject to National Discretion	Central Bank of UAE Decisions
33	The capital invested in a majority-owned or controlled insurance entity may exceed the amount of regulatory capital required for such an entity (surplus capital). Supervisors may permit the recognition of such surplus capital in calculating a bank's capital adequacy, under limited circumstances. Banks recognising surplus capital in insurance subsidiaries will publicly disclose the amount of such surplus capital recognized in their capital.	Banks are permitted to recognise surplus capital in insurance subsidiaries - explained in Paragraph 33 of International Convergence of Capital measurement and Capital Standards- June 2006 issued by the Basel Committee on Banking Supervision (Basel II).
35	Significant minority and majority investments in commercial entities that exceed certain materiality levels will be deducted from banks' capital.	Yes, deduction when investments exceed materiality levels of 15% of the bank's capital for individual significant investments in commercial entities and 60% of the bank's capital for the aggregate of such investments. As a transitional arrangement, banks holding such investments (acquired prior to 1 January 2008) that exceed the above materiality levels, will be exempted from any such deduction until 1 January 2011 and instead will apply a risk weight of 100%
Claims on Sovereigns		
53	Claims on central banks and sovereigns will be risk weighted in accordance with external credit assessment	Yes, except that for all GCC sovereigns banks may apply a zero risk weight

Basel II para. reference (June 2006 version)	Summary of Basel II Issues subject to National Discretion	Central Bank of UAE Decisions
54 and 201	Recognise the lower risk-weights of other supervisory authorities for domestic currency sovereign exposures funded in that currency	Yes, for all GCC sovereigns
55	Allow the recognition of export credit agencies' country risk scores for risk-weighting claims on sovereigns	Not permitted
201	Apply a lower risk-weight to claims (and portions of claims) guaranteed by the sovereign (or central bank) when denominated and funded in domestic currency	Yes
Claims on Non-Central Government Public Sector Entities (PSEs)		
57 – 58	Claims on domestic PSEs	Domestic currency claims on a GCC PSE should be treated as claims on their sovereigns if their central bank or monetary authority treats them as such. Excludes commercial PSEs. Foreign currency claims on such a PSE should be risk weighted one grade less favourable than its sovereign i.e. 20% RW. Claims on other foreign PSEs should be risk weighted one grade less favourable than its sovereign. Claims on commercial companies owned by GCC sovereign or PSEs that operate as a commercial organization shall be treated as claims on a corporate and assigned a risk weight based on the external credit rating.
Claims on Banks		
60 – 64	Claims on banks may be risk-weighted one category less favourable than claims on the sovereign (option one) or based on	Option 2

Basel II para. reference (June 2006 version)	Summary of Basel II Issues subject to National Discretion	Central Bank of UAE Decisions
	the bank's rating issued by a recognised external credit rating agency (option two)	
64	Allow a preferential risk-weight for claims on banks with an original maturity of three months or less that are denominated and funded in the domestic currency	Yes
Claims on Corporates		
67	Increase the standard risk-weight for un-rated claims when a higher risk-weight is warranted by the default experience of the jurisdiction. As part of the supervisory review process, supervisors may also consider whether the credit quality of corporate claims held by individual banks should warrant a standard risk weight higher than 100%	Yes, on a case by case basis
68	Allow all corporate claims to be risk-weighted at 100% without regard to external ratings	Not permitted. Where banks have selected an approved ECAI as per Para 90-91 below, all ratings must be applied where available and cannot be disregarded
Claims in the Regulatory Retail Portfolio		
69	Claims that qualify under criteria as laid down under Basel II (subject to discretion re Para 70 below) may be considered as retail claims in a regulatory retail portfolio and may be risk weighted at 75% (except for past due loans)	A 75% risk weighting will be allowed for claims in the regulatory retail portfolio that meet the four Basel II criteria (orientation, product, granularity and low value) and where the maximum aggregated gross amount to one party does not exceed AED 2,000,000, subject to Para 70 below.

Basel II para. reference (June 2006 version)	Summary of Basel II Issues subject to National Discretion	Central Bank of UAE Decisions
		All other retail loans should be risk weighted at 100%
70	Set a numerical limit on the regulatory retail portfolio so that no aggregate exposure to one counterpart exceeds 0.2% of the overall regulatory retail portfolio	Yes – the limit is set at 0.2% of the overall retail portfolio
71	National supervisory bodies may Increase the suggested risk-weights for regulatory retail exposures	CBUAE retains the discretion to increase the risk weights when circumstances dictate
Claims Secured by Residential Property		
72 – 73	Apply a preferential risk-weight (i.e. 35%) for claims secured by mortgages on residential properties (occupied by the borrower or rented) subject to Loan to Value (LTV) criteria	Preferential risk weights may be applied where the security is perfected and: - ▪ Where claims (not exceeding AED 10 million), are secured by residential property with loan-to-value ratio (LTV) of up to 85% a risk weight of 35% will apply ▪ If a bank does not hold information regarding LTVs for individual exposures, or if the LTV is above 85%, a risk weighting of 75% will apply to exposures that meet the criteria for regulatory retail claims LTVs should be assessed on origination, making use of independent valuations and market information where appropriate, future similar valuations may also be permitted to determine LTVs. All other claims (including claims past due 90 days) secured on residential property should be risk weighted 100% including the excess of the claims that exceed the above ceiling
Claims Secured by Commercial Real Estate		

Basel II para. reference (June 2006 version)	Summary of Basel II Issues subject to National Discretion	Central Bank of UAE Decisions
Footnote 29 to paragraph 74	Allow certain commercial property loans to be risk-weighted at 50% (subject to conditions)	Not permitted – 100% risk weight is applicable
Past Due Loans		
75 and 78	Allow the risk weight for the unsecured portion of any loan (including a qualifying residential mortgage loan) that is past due for more than 90 days, net of specific provisions, to be reduced from 100% to 50%, when specific provisions are at least 50% of the outstanding amount of the loan.	No – 100% risk weight must be applied
Footnote 30 to paragraph 75	Treat non-past due loans extended to counter-parties subject to a 150% risk-weight the same way as past due loans (i.e. where specific provisions are more than 50% of the claim, risk weight the un-provided portion of the claim at 50%)	Yes
77	Allow a 100% risk-weight for past due loans that are fully secured by other forms of collateral where provisions are greater than 15% of the outstanding amount of the loan	Yes Other collateral may include ▪ Quoted Shares (in UAE, internationally recognised exchange) ▪ Motor vehicles ▪ Residential Real Estate ▪ Commercial Real Estate
Other Categories		
80	Apply a risk-weight of 150% or higher to other assets (e.g. venture capital and private equity investments)	Yes, a 150% risk weight will apply for:- 1. Venture capital and private equity investments 2. Real estate acquired in settlement of debt and not liquidated within the statutory period

Basel II para. reference (June 2006 version)	Summary of Basel II Issues subject to National Discretion	Central Bank of UAE Decisions
		CBUAE may choose to assign 150% or higher risk weights reflecting higher risks associated with certain assets
Footnote 32 to paragraph 81	Allow gold bullion held in banks' own vaults or on an allocated basis to the extent it is backed by bullion liabilities to be risk-weighted at 0%	Yes
90-91	Acceptable Credit Rating Agencies	Banks may choose from the following initially approved agencies:- - Moody's - S&P - Fitch IBCA - Capital Intelligence Others may be added to this list at the discretion of the Central Bank of The UAE Banks should follow the guidance in Para 94 and disclosures must be as per Para 95
92	National Supervisors will issue Mapping of ECAI assessments to Risk Weights	Yes – see Appendices 2 and 3 of Basel II Guidelines for banks- Standardised Approach issued by Central Bank of the UAE
Use of External Ratings		
Footnote 37 to paragraph 102	Allow the option to use a borrower's domestic currency rating for exposure in foreign exchange transactions when an exposure arises through a bank's participation in a loan that has been extended, or has been guaranteed against convertibility and transfer risk, by Multilateral Development Banks	Yes

Basel II para. reference (June 2006 version)	Summary of Basel II Issues subject to National Discretion	Central Bank of UAE Decisions
108	Allow a bank to use unsolicited ratings in the same way as solicited ratings	Not permitted
Operational Risk		
652 (FN104)	At national supervisory discretion, a supervisor can choose to allow a bank to use the alternative standardised approach (ASA) provided the bank is able to satisfy its supervisor that this alternative approach provides an improved basis by, for example, avoiding double counting of risks.	Yes – However, once a bank has been allowed to use the ASA it would not be allowed to revert to the Standardised Approach without the permission of CBUAE.
654 (FN105)	Supervisors may adopt a more conservative treatment of gross income.	Yes – negative numbers should be excluded from the calculations of gross income
663 (FN 108)	As some internationally active banks will wish to use the Standardised approach, it is important that such banks have adequate operational risk management systems. Consequently, an internationally active bank using the Standardised Approach must meet the criteria in paragraph 663. For other banks, these criteria are recommended, with national discretion to impose them as requirements.	All banks are expected to follow the requirements in Para 663 as this is likely to bring about an improvement in management and assessment of their Operational Risk. Furthermore, banks are expected to seek guidance from the BIS paper 'Sound Practices for The Management and Supervision of Operational Risk' February 2003

APPENDIX 8: Multi Lateral Development Banks

1. World Bank (IERD) and its affiliates
2. Asian Development Bank
3. European Investment Bank
4. European Bank for Reconstruction and Development
5. Inter-American Development Bank
6. Islamic Development Bank
7. Caribbean Development Bank
8. OPEC Fund for International Development
9. Arab Fund for Economic and Social Development
10. Arab Monetary Fund
11. Arab Bank for Economic Development in Africa (BADEA)
12. Council for Europe Development Bank