

**FINANCIAL SERVICES REGULATORY AUTHORITY**  
**سلطة تنظيم الخدمات المالية**

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## **Prudential – Investment, Insurance Intermediation and Banking Rules (PRU)**

\*In this Annex, underlining indicates new text and strikethrough indicates deleted text, unless otherwise indicated.



## 1. APPLICATION, INTERPRETATION AND CATEGORISATION

### 1.1 Application

1.1.1 (1) These Rules apply to every Authorised Person other than:

- (a) an Insurer; and
- ~~(b) a Representative Office;~~
- ~~(c) a Credit Rating Agency (CRA); and~~
- ~~(d)~~ (db) a Fund Manager of a Venture Capital Fund except for PRU 2.3 and PRU 6.12.

...

(3) Where a Chapter, ~~part~~ or Section of these Rules applies to a limited scope of Categories of Authorised Person, the term "Authorised Person" used in those provisions is to be read accordingly.

...

#### Branches

1.1.2 Unless otherwise directed by the Regulator, an Authorised Person that is a Branch is required to comply with the Rules in Chapters 2 to 11 as specifically provided in "Application Table ~~A~~B" which forms part of this Rule.

#### Guidance

1. The effect of Rule 1.1.1(1)(a) is that these Rules do not apply to ~~all Authorised Persons, except Insurers, that operate a Representative Office and those that are CRAs.~~ Those firms that are authorised to effect or carry out Contracts of Insurance should instead refer to the PIN module.

...

- d. a Chapter imposing processes for risk self-assessment by Authorised Persons and supervisory assessment, ~~by which an Authorised Person which is a Domestic Firm in Category 1, 2 or 5 has obligations to establish and conduct an IRAP and an ICAAP, and to provide documented assessments to~~ by the Regulator; and

...

#### Domestic Firms

4. To assist Authorised Persons that are Domestic Firms there is a table "Application Table ~~B~~A" which sets out in general the application of these

Rules to different Categories of Authorised Persons. This table is for guidance purposes only.

...

The order of Application Tables A and B has been reversed; Table A now refers to Domestic Firms and Table B to Branches. Only the amendments to Section and Rule references are marked up, with underlining indicating new text and strikethrough indicating deleted text.

**APPLICATION TABLE A:  
FOR AN AUTHORISED PERSONS THAT OPERATES AS A BRANCH IN ADGM DOMESTIC FIRM**

Chapters	Category 1	Category 2	Category 3A	Category 3B	Category 3C	Category 4	Category 5
Chapter 1: Application, Interpretation and Categorisation	Whole Chapter	Whole Chapter	Whole Chapter	Whole Chapter	Whole Chapter	Whole Chapter	Whole Chapter
Chapter 2: General Requirements	Whole Chapter	Whole Chapter	Whole Chapter	Whole Chapter	Whole Chapter	Whole Chapter	Whole Chapter
Chapter 3: Capital	Whole Chapter, except Rules 3.2.42 and 3.2.6, and Sections 3.46, 3.57 and 3.720	Whole Chapter, except Rules 3.2.42 and 3.2.6, and Sections 3.36, 3.7 and 3.520	Whole Chapter, except Rules 3.2.42, 3.2.6 and Sections 3.36, 3.7, 3.20 and 3.521.	Whole Chapter, except Rules 3.2.42 and 3.2.7 and Sections 3.34, 3.5 and 3.421	Whole Chapter, except Rules 3.2.42 and 3.2.7 and Sections 3.34, 3.5 and 3.421	Whole Chapter, except Rules 3.2.42 and 3.2.7 and Sections 3.34, 3.5 and 3.421	Whole Chapter, except Rules 3.2.42 and 3.2.6, and Sections 3.46, 3.57 and 3.720
Chapter 4: Credit Risk	Whole Chapter	Whole Chapter	Whole Chapter				Whole Chapter
Chapter 5: Market Risk	Whole Chapter	Whole Chapter	Only Sections 5.1, 5.2 and 5.6				Whole Chapter, except Section 5.4
Chapter 6: Operational Risk	Whole Chapter, except Section 6.12	Whole Chapter, except Section 6.12	Whole Chapter, except Section 6.12	Whole Chapter, except Sections 6.10 and 6.11	Whole Chapter, except Sections 6.10 and 6.11	Whole Chapter, except Sections 6.10 and 6.11	Whole Chapter, except Section 6.12
Chapter 7: Interest Rate Risk In the Non-Trading Book	Whole Chapter	Whole Chapter					
Chapter 8: Group Risk	Whole Chapter	Whole Chapter	Only Sections 8.1 and 8.5	Only Sections 8.1 and 8.5	Only Sections 8.1 and 8.5	Only Sections 8.1 and 8.5	Whole Chapter
Chapter 9: Liquidity Risk	Whole Chapter, except Rule 9.2.2(3)	Only Rule 9.2.2 (3)	Only <u>Rule 9.2.2 (3)</u>				Whole Chapter, except Rule 9.2.2(3)

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Chapters	Category 1	Category 2	Category 3A	Category 3B	Category 3C	Category 4	Category 5
Chapter 10: Supervisory Review and Evaluation Processes	Whole Chapter	Whole Chapter	Whole Chapter	Whole Chapter, except Sections 10.4 and 10.6	Whole Chapter, except Sections 10.4 and 10.6		Whole Chapter
Chapter 11: Disclosure Requirements	Whole Chapter	Whole Chapter					Whole Chapter

**APPLICATION TABLE B:  
FOR AN AUTHORISED PERSONS THAT OPERATES AS A DOMESTIC FIRMA BRANCH IN  
ADGM**

Chapters	Category 1	Category 2	Category 3A	Category 3B	Category 3C	Category 4	Category 5
Chapter 1: Application, Interpretation and Categorisation	Whole Chapter	Whole Chapter	Whole Chapter	Whole Chapter	Whole Chapter	Whole Chapter	Whole Chapter
Chapter 2: General Requirements	Whole Chapter	Whole Chapter	Whole Chapter	Whole Chapter	Whole Chapter	Whole Chapter	Whole Chapter
Chapter 3: Capital	Only Rule 3.2.42	Only Rule 3.2.42	Only Rule 3.2.42	Only Rule 3.2.42	Only Rule 3.2.42	Only Rule 3.2.42	Only Rule 3.2.42
Chapter 4: Credit Risk	Only Sections 4.1 to 4.4 and Rules 4.5.1 to 4.5.7 and 4.5.9	Only Sections 4.1 to 4.4 and Rules 4.5.1 to 4.5.7 and 4.5.9	Only Sections 4.1 to 4.4 and Rules 4.5.1 to 4.5.7 and 4.5.9				Only Sections 4.1 to 4.4 and Rules 4.5.1 to 4.5.7 and 4.5.9
Chapter 5: Market Risk	Only Sections 5.1 and 5.2	Only Sections 5.1 and 5.2	Only Sections 5.1 and 5.2				Only Sections 5.1 and 5.2
Chapter 6: Operational Risk	Whole Chapter, except Sections 6.11 and 6.12	Whole Chapter, except Sections 6.11 and 6.12	Whole Chapter, except Sections 6.11 and 6.12	Whole Chapter, except Sections 6.10 and 6.11	Whole Chapter, except Sections 6.10 and 6.11	Whole Chapter, except Sections 6.10 and 6.11	Whole Chapter, except Sections 6.11 and 6.12
Chapter 7: Interest Rate Risk In the Non-Trading Book	Whole Chapter	Whole Chapter					
Chapter 8: Group Risk	Only Sections 8.1, 8.2 and 8.5	Only Sections 8.1, 8.2 and 8.5	Only Sections 8.1 and 8.5	Only Sections 8.1 and 8.5	Only Sections 8.1 and 8.5	Only Sections 8.1 and 8.5	Only Sections 8.1, 8.2 and 8.5
Chapter 9: Liquidity Risk	Whole Chapter, except Rule 9.2.2(3)	Only Rule 9.2.2 (3)	Only Rule 9.2.2 (3).				Whole Chapter, except Rule 9.2.2(3)
Chapter 10: Supervisory Review and Evaluation Processes							

Chapters	Category 1	Category 2	Category 3A	Category 3B	Category 3C	Category 4	Category 5
Chapter 11: Disclosure Requirements							

## 1.2 Glossary

1.2.1 The following terms and abbreviations bear the following meanings for the purpose of these Rules:

...	...
Administering a Specified Benchmark	Means the Regulated Activity specified in paragraph 68(1)(b) of the FSMR Schedule 1.
...	...
Alternative Standardised Approach	The manner in which the Operational Risk Capital Requirement is calculated in accordance with Sections 6.11 and A6A7.3.
Annual Audited Expenditure	The expenditure calculated in accordance with Rule 3.7.32.
...	...
AT1	Additional <del>€</del> Tier 1.
AT1 Capital	Has the meaning given in Section 3.1411.
...	...
Base Capital Requirement	Has the meaning given in Section 3.63.
Basic Indicator Approach	The manner in which the Operational Risk Capital Requirement is calculated in accordance with Sections 6.11 and A6A7.1.
...	...
Capital Conservation Buffer	Means the capital buffer requirements as applied in Section 3.917.
Capital Requirement	The <u>minimum amount of capital</u> Capital Resources that an Authorised Person must hold, calculated in accordance with <del>Sections 3.3, Section</del> Section 3.4 or 3.56, as applicable.
Capital Resources	The total Capital Resources of an Authorised Person calculated in accordance with Section 3.1115.
...	...
CCP	Means a central counterparty.
...	...

Central Bank	The Central Bank of the UAE <del>or its equivalent in another country or territory.</del>
...	...
CET1	Common <del>equity tier</del> <u>Equity Tier 1</u> .
CET1 Capital	Has the meaning given in Section 3.13 <del>10</del> .
...	...
Collateral	Means a Client Investment which has been paid for in full by a Client and which is held or controlled by the Authorised Person <u>either outright by way of title transfer or under the terms of a deposit, pledge, charge or other security arrangement.</u>
...	...
Collective Investment Fund Risk Capital Requirement	A component of <u>the</u> Market Risk Capital Requirement calculated in accordance with Section 5.9.
<u>Combined Buffer</u>	<u>Has the meaning given in Rule 3.19.1.</u>
<u>Combined Buffer Requirement</u>	<u>The CET1 Capital required to satisfy the conditions for the Combined Buffer.</u>
...	...
Connected Counterparties <sub>y</sub>	...
...	...
<u>Countercyclical Capital Buffer</u>	<u>Means the capital buffer requirements as applied in Section 3.18.</u>
...	...
<del>CPW</del>	<del>Counterparty weighting.</del>
...	...
Credit Risk Capital Requirement <del>(CRCOM)</del>	The credit risk capital requirement calculated in accordance with Section 4.6.
...	...
<u>Credit Valuation Adjustment</u>	<u>Has the meaning given in App5.</u>

...	...
<u>CVA</u>	<u>Credit Valuation Adjustment.</u>
<u>CVA Risk Capital Requirement</u>	<u>Means the requirement calculated in accordance with App5.</u>
...	...
Duration Method	A measure of General Market Risk calculated in accordance with Rule <del>A5A6</del> 2.19.
...	...
<u>EAD</u>	<u>Exposure at default</u>
...	...
<u>EPRS</u>	<u>Electronic Prudential Reporting System</u>
...	...
Financial Services Permission	<del>is a</del> permission given, or having effect as if so given, by the Regulator in accordance with Part 4 of the Financial Services and Markets Regulations.
...	...
High Quality Liquid Assets (HQLA)	Liquid assets that meet the conditions in Rules <del>A9A10</del> 2.2 to <del>A9A10</del> 2.9 of App <del>9</del> 10.
...	...
Leverage Ratio	The amount expressed as a percentage value that is calculated in accordance with Rule 3. <del>18</del> 21.
Liquidity Coverage Ratio (LCR)	The amount expressed as a percentage value that is calculated in accordance with Rule 9.3.4 and section <del>A9A10</del> 2 of App <del>9</del> 10.
...	...
Maturity Method	This is an advanced approach that an Authorised Person may use to measure the risk of holding or taking positions in debt Securities and other interest rate-related instruments, calculated in accordance with Rule <del>A5A6</del> 2.17.
...	...
<u>Minority interests</u>	<u>Capital invested in a Subsidiary that is owned by other shareholders from outside the Financial Group.</u>

Modified Duration	The time period calculation for the purposes of the Duration Method in accordance with Rule <del>A5</del> <u>A6</u> .2.21.
...	...
<u>Non-QCCP</u>	<u>Means a CCP that is not a QCCP.</u>
...	...
<del>Operating a Credit Rating Agency</del>	<del>Means the Regulated Activity specified in paragraph 65 of Schedule 1 of the FSMR.</del>
...	...
<del>Operating a Representative Office</del>	<del>Means the Regulated Activity specified in paragraph 67 of Schedule 1 of the FSMR.</del>
...	...
<del>Providing Information in Relation to a Specified Benchmark</del>	<del>Means the Regulated Activity specified in paragraph 68(1)(a) of Schedule 1 of the FSMR.</del>
...	...
<u>QCCP</u>	<u>Means an entity, deemed a qualifying central counterparty, that is licensed to operate as a CCP (including a licence granted by way of confirming an exemption), and is permitted by the appropriate regulator/overseer to operate as such. This is subject to the CCP being based and prudentially supervised in a jurisdiction where the relevant regulator/overseer has established, and publicly indicated that it applies to the central counterparty on an ongoing basis, domestic rules and regulations that are consistent with the CPSS-IOSCO Principles for Financial Market Infrastructures.</u> <u>The Regulator may in its sole discretion determine that a CCP that is established in a jurisdiction that does not apply the CPSS-IOSCO Principles for Financial Market Infrastructures qualifies as a QCCP.</u>
...	...
<u>Risk Exposure Amount</u>	<u>Has the meaning given in Rule 3.5.8.</u>
...	...
T1 Capital	Has the meaning given in Rule 3. <del>12</del> <u>10</u> .1.
...	...

T2 Capital	Has the meaning given in Rule 3.15 <u>12</u> .1.
...	...
<u>Total Risk Exposure Amount</u>	<u>Has the meaning given in Rule 3.5.7.</u>
<u>Trade Exposure</u>	<u>Means a current exposure, including a variation margin due to the clearing member or to the Client, but not yet received, and any potential future exposure of a clearing member or a Client, to a CCP arising from Derivatives, SFTs or long settlement transactions, as well as initial margin.</u>
...	...

## Categories of Authorised Persons

...

### Category 4

**1.3.6** An Authorised Person is in Category 4 if:

- (a) its Financial Services Permission authorises it to carry on one or more of the Regulated Activities of Arranging Credit, Arranging Deals in Investments, Advising on Investments or Credit, Arranging Custody, Insurance Intermediation, Providing Trust Services (where it is not acting as trustee in respect of an express trust), Insurance Management, Acting as the Administrator of a Collective Investment Fund, ~~Administering a Specified Benchmark, Operating a Credit Rating Agency, or~~ Operating a Multilateral Trading Facility or Organised Trading Facility, ~~Operating a Representative Office or Providing Information in Relation to a Specified Benchmark;~~ and

...

### Category 5

**1.3.7** An Authorised Person is in Category 5 if it:

...

- (b) Manages a Profit Sharing Investment Account which is a PSIAu.

...

## 2 GENERAL REQUIREMENTS

...

**2.3.2** An Authorised Person must, subject to Rule 2.3.3:

- (a) ~~prepare its returns in accordance with the Rules in this Chapter, the instructional guidelines in PRU and elsewhere, and the requirements of the Regulator's electronic prudential reporting system~~Electronic Prudential Reporting System (EPRS) of the Regulator; and
- (b) submit the returns to the Regulator using ~~the electronic prudential reporting system~~EPRS.

### Guidance

The returns and instructional guidelines are provided in these Rules and ~~the Regulator's electronic prudential reporting system~~EPRS.

...

- 2.3.4** (1) In relation to an annual return the form must be ~~signed~~certified through EPRS by ~~two officers~~the CEO, a Director or a Partner of the Authorised Person ~~each of whom is a Director, Partner or individual previously approved by the Regulator for that purpose.~~
- (2) In relation to a quarterly or a monthly return the form must be ~~signed~~certified through EPRS by ~~one officer~~an Officer of the Authorised Person ~~who is a Director, Partner or individual which has previously approved~~been identified by the Regulator/Authorised Person as having the authority to provide the certification for that purpose.

...

- 2.3.6** (1) An Authorised Person must use the appropriate forms ~~which are set out in the FOR module~~EPRS for the preparation and submission of returns which are required under these Rules.
- (2) All returns must be completed in ~~thousands of~~ dollars (\$).

- 2.3.7** (1) An Authorised Person must submit to the Regulator annual returns, ~~in the applicable format prescribed in the FOR module,~~ within four months of the end of the ~~Authorised Person's financial year~~of the Authorised Person.
- (2) An Authorised Person must submit to the Regulator ~~any other return~~quarterly returns, in the applicable format prescribed ~~in~~by the ~~FOR module~~Regulator, within one month after the end of the reporting period to which the return relates.

(3) An Authorised Person must submit to the Regulator monthly returns, in the applicable format prescribed by the Regulator, within fifteen days of the end of the reporting period to which the return relates.

**2.3.8** (1) When a return which is required under these Rules is not submitted on or before the due date or within the prescribed period, such non-submission incurs ~~a late payment~~ an administration fee of \$1,000.

...

Chapter 3 has been reordered substantially, with the inclusion of additional, new material, and is included here in its entirety. Where there are material changes underlining indicates new text and strikethrough indicates deleted text, unless otherwise indicated. Text that has been moved and/or renumbered, but is otherwise unchanged, is not marked.

### **3 CAPITAL AND LEVERAGE**

#### **Introduction**

#### **Guidance**

1. This Chapter deals with all aspects of prudential requirements relating to the capital adequacy of Authorised Persons, in terms of both quantity and quality, and, where appropriate, the maintenance of liquid assets. (Chapter 9 covers more generally the related prudential topic of liquidity, the ability of an Authorised Person to meet its financial obligations as they fall due). The Chapter outlines the minimum capital requirements that an Authorised Person should hold, based on Pillar 1 of the Basel Accord, and aims to ensure that an Authorised Person maintains adequate capital resources to support the risks associated with its activities and that it can fully absorb unexpected losses at any time. A summary of the minimum capital requirements is given in App 3.2.
2. This Chapter also includes provisions forming part of the framework for the Regulator's assessment, under Pillar 2 of the Basel Accord, of the capital adequacy of an Authorised Person, with further detail given in Chapter 10. The disclosure requirements placed upon an Authorised Person under Pillar 3 of the Basel Accord are covered in Chapter 11.
3. Part 1 of this Chapter sets out the application provisions. Part 2 of this Chapter outlines the fundamental capital adequacy obligations and the systems and controls requirements to ensure compliance with this critical regulatory obligation. Part 3 of this Chapter ~~includes all~~ and the related App4 include the Rules and associated guidance for the calculation of the minimum Capital Requirement for different Categories of Authorised Persons. ~~This part~~ Additionally, this Part also ~~specifies the~~ includes requirements ~~in respect~~ for the maintenance of liquid assets by firms subject to the Expenditure Based Capital Minimum Conservation Buffer and associated obligations. Part 4 of this Chapter specifies detailed Rules on the calculation of Capital Resources of an Authorised Person, including detailed Rules on the eligibility criteria for different components of Capital Resources which correspond to varying levels of quality. This part also specifies the requirements in respect of the Capital Conservation Buffer and associated obligations.
4. App3 provides ~~detailed~~ guidance on various aspects of stress and scenario testing which are ~~required~~ to be considered by an Authorised Person to assist it in complying effectively ~~comply~~ with the Rules in this Chapter.

## **PART 1 – Application**

### **3.1 Application**

**3.1.1** The Parts, Sections and Rules in this Chapter apply to an Authorised Person as stated in those provisions.

#### **Guidance**

1. Part 2 of this Chapter imposes a number of basic requirements, including the following core requirements:
  - a. for an Authorised Person in Category 1, 2, 3A or 5, the components of its Capital Resources should at all times equal or exceed the thresholds specified in Section 3.16; and
  - b. for an Authorised Person in Category 3B, 3C or 4, its Capital Resources should at all times equal or exceed the amount of its Capital Requirement.
2. In particular, note that:
  - a. Part 3 applies to all firms, but with differentiated calculations for the Capital Requirement for the various Categories of Authorised Persons, as prescribed in Sections 3.4 and 3.6;
  - b. within Part 3, an exemption from the calculation of T2 Capital in relation to firms authorised to Manage a Profit Sharing Investment Account which is a PSIAu is prescribed in Rule 3.12.9; and
  - c. Part 4 applies to all firms.

## **PART 2 – Basic Requirements**

### **3.2 Application**

**3.2.1** In this Section the Rules apply to an Authorised Person in any Category as follows:

- (a) Rule 3.2.2 applies to an Authorised Person operating as a Branch; and
- (b) Rules 3.2.3 to 3.2.5 apply to an Authorised Person operating as a Domestic Firm.

#### **Branches – general requirements**

**3.2.2** An Authorised Person that is a Branch must:

- (a) ensure that it has and maintains, at all times, liquid assets and access to financial resources which are adequate in relation to the nature, size and

complexity of its business both as to amount and quality to ensure that there is no significant risk that liabilities cannot be met as they fall due;

- (b) ensure that it complies at all times with its Home State Regulator's prudential requirements;
- (c) submit to the Regulator a copy of every capital adequacy summary report and Leverage Ratio report submitted to its Home State Regulator within 10 business days of the due date for submission to that regulator; and
- (d) in the event of any anticipated or actual breach of any prudential requirements set by its Home State Regulator, notify the Regulator immediately with any relevant documents.

#### **Domestic Firms – adequate capital resources**

- 3.2.3** An Authorised Person that is a Domestic Firm must have, at all times, Capital Resources which exceed the amount of its Capital Requirement.

#### **Guidance**

The specific Capital Requirements for the various Categories of Authorised Persons that are Domestic Firms are dealt with in Sections 3.4 and 3.6.

#### **Domestic Firms – maintaining capital resources**

- 3.2.4** An Authorised Person that is a Domestic Firm must:

- (a) have and maintain, at all times, Capital Resources of the types and amounts specified in, and calculated in accordance with, these Rules;
- (b) ensure that it maintains capital and liquid assets in addition to the requirement in (a) which are adequate in relation to the nature, size and complexity of its business to ensure that there is no significant risk that liabilities cannot be met as they fall due; ~~and~~
- (c) ~~these Rules shall not prevent Authorised Persons from holding Capital Resources in excess of or applying stricter measures than required by these Rules.~~

#### **Guidance**

1. These Rules do not prevent Authorised Persons from holding Capital Resources in excess of or applying stricter measures than required by these Rules.
2. For the purposes of Rule 3.2.4, an Authorised Person's Governing Body should assess whether the Capital Resources which are required by the Regulator as set out in these Rules are adequate in relation to the Authorised

Person's specific business model and risk profile. Additional resources should be maintained by the Authorised Person where its Governing Body has considered that the required Capital Resources do not adequately reflect the nature and risks of the Authorised Person's business.

3. The liabilities referred to in Rule 3.2.4(b) include an Authorised Person's contingent and prospective liabilities, such as liabilities arising from a change in business strategy or claims made against the Authorised Person, but not liabilities that might arise from prospective transactions which the Authorised Person could avoid, for example by ceasing its operations. Liabilities from prospective transactions refers to the potential liabilities which can be avoided by adequate risk management, risk transfer or avoiding the transaction completely. This refers to any prospective transaction, for example, lending Money to a borrower or entering into a contract for the provision of services by a service provider.
4. An Authorised Person subject to the requirements in Chapter 10 may be required to meet an Individual Capital Requirement imposed under those Rules following the Pillar 2 review process, in addition to the Capital Requirement calculated under Pillar 1.

### **Domestic Firms – systems and controls**

#### **Guidance**

For the purposes of Part 2, an Authorised Person is required to have appropriate systems and controls in place to enable it to be certain that it has adequate Capital Resources to meet the requirements in Part 4 on capital adequacy at all times and to allow it to demonstrate that at any particular time if required to do so by the Regulator. Where through the operation of those systems and controls an Authorised Person forms the view that it does not currently or is not likely to be able to satisfy the requirements of Rule 3.2.3 in future, that Authorised Person is required to immediately inform the Regulator in accordance with Rule 3.2.5.

- 3.2.5**
- (1) An Authorised Person must have systems and controls to enable it to determine and monitor:
    - (a) its Capital Requirement; and
    - (b) whether the amount of its Capital Resources is, and is likely to remain, adequate at all times to ensure compliance with the applicable capital adequacy requirements.
  - (2) Such systems and controls must be capable of contributing to an analysis of:
    - (a) realistic scenarios which are relevant to the circumstances of the Authorised Person; and

- (b) the effects on the Capital Requirement of the Authorised Person and on its Capital Resources if those scenarios occurred.
- (3) An Authorised Person must notify the Regulator immediately and confirm in writing any breach, or expected breach, of any of the provisions of this Chapter by the Authorised Person.

**Guidance**

1. App3 provides guidance on the nature and type of stress and scenario testing that Authorised Persons should be undertaking frequently to support their view that they have adequate financial resources to meet their obligations.
2. The requirements in this Chapter apply to Authorised Persons on a solo basis. An Authorised Person may also be subject to Capital Resources requirements at a Group level. Group requirements are addressed in Chapter 8 of these Rules.

**PART 3– Calculating the Capital Requirement**

**3.3 Base Capital Requirement**

**3.3.1** This Section applies to an Authorised Person in any Category.

**Guidance**

The Base Capital Requirement is a component of the calculation of the Capital Requirement under Sections 3.4 and 3.6.

**3.3.2** The table below sets out the Base Capital Requirement for each Category of Authorised Persons.

Category	Base Capital Requirement (US \$)
1	10 million
2	2 million
3A	500,000
3B	4 million
3C	250,000, except where an Authorised Person has a Financial Services Permission only to carry out the Regulated Activity of Managing a Collective

Category	Base Capital Requirement (US \$)
	Investment Fund, in which case the Base Capital Requirement is the higher of: a) 150,000 if the Authorised Person manages a Public Fund or any other type of fund that is available to retail customers; or b) 50,000 otherwise.
4	10,000
5	10 million

**3.3.3** An Authorised Person must have Common Equity Tier 1 Capital (CET1 Capital), as defined in Section 3.10, of not less than its relevant Base Capital Requirement at the time that it obtains authorisation and at all times thereafter.

**3.4 Capital Requirements for Categories 1, 2, 3A and 5**

**3.4.1** This Section applies to an Authorised Person in Category 1, 2, 3A or 5.

**3.4.2** (1) The Capital Requirement for an Authorised Person is calculated, subject to (2), as the higher of:

(a) the applicable Base Capital Requirement as set out in Section 3.3; or

(b) its Risk Capital Requirement as set out in Section 3.5.

(2) Where 1(b) is the higher and the Authorised Person has an ICR imposed on it then the Capital Requirement is its ICR plus Risk Capital Requirement.

**3.5 Risk Capital Requirement**

**Guidance**

This Section applies to Authorised Persons in Categories 1, 2, 3A and 5 pursuant to Rule 3.4.2(1)(b).

**3.5.1** An Authorised Person must calculate its Risk Capital Requirement as the sum of the following:

(a) the CRCOM;

(b) the Market Risk Capital Requirement;

- (c) the Operational Risk Capital Requirement; ~~and~~
- (d) the CVA Risk Capital Requirement; and
- (e) the Displaced Commercial Risk Capital Requirement, where applicable.

#### **CRCOM**

- 3.5.2** An Authorised Person must calculate its Credit Risk Capital Requirement in accordance with the applicable Rules in Chapter 4.

#### **Guidance**

1. Detailed Rules and Guidance in respect of the CRCOM are specified in Chapter 4. The CRCOM ~~includes~~ is based on the risk weighted assets (RWA) for all Credit Risk Exposures, securitisation Exposures and Counterparty Risk Exposures.
2. Rules and Guidance in respect of calculating the CRCOM for Islamic Contracts are contained in the IFR Rules.

#### **Market Risk Capital Requirement**

- 3.5.3** An Authorised Person must calculate its Market Risk Capital Requirement in accordance with the applicable Rules in Chapter 5.

#### **Guidance**

1. Detailed Rules and Guidance in respect of the Market Risk Capital Requirement and each of its components are contained in Chapter 5.
2. Rules and Guidance in respect of calculating Market Risk for Islamic Contracts are contained in the IFR rules.

#### **Operational Risk Capital Requirement**

- 3.5.4** An Authorised Person must calculate its Operational Risk Capital Requirement in accordance with the applicable Rules in Chapter 6.

#### **CVA Risk Capital Requirement**

- 3.5.5** An Authorised Person must calculate its CVA Risk Capital Requirement in accordance with the applicable Rules in App5.

#### **Guidance**

1. An Authorised Person should refer to Chapters 4, 5 and 6 to determine whether it is required to calculate a Credit Risk Capital Requirement (also referred to in these Rules as CRCOM), a Market Risk Capital Requirement or an Operational Risk Capital Requirement, respectively.

2. The Displaced Commercial Risk Capital Requirement will only apply to an Authorised Person Managing a Profit Sharing Investment Account which is a PSIAu.
3. An Authorised Person will also need to consider the relevant provisions in the IFR rules relating to Credit Risk and Market Risk for Islamic Contracts when calculating its CRCOM and Market Risk Capital Requirement.
4. Where the Risk Capital Requirement is the binding Capital Requirement calculated using the provisions in Section 3.4 the Regulator may impose an Individual Capital Requirement (see Chapter 10) on an Authorised Person. Such a requirement is additional to the Risk Capital Requirement and is, therefore, a component of the Capital Requirement for the Authorised Person.

### **Displaced Commercial Risk Capital Requirement**

- 3.5.6** An Authorised Person Managing a Profit Sharing Investment Account which is a PSIAu must calculate its Displaced Commercial Risk Capital Requirement in accordance with the IFR rules.

### **Total Risk Exposure Amount**

- 3.5.7** An Authorised Person must calculate its Total Risk Exposure Amount, after taking into account the provisions of Rule 3.5.8, as the sum of:
- (a) the Credit RWA as calculated using Rule 4.8.1(2);
  - (b) the Risk Exposure Amount associated with the Market Risk Capital Requirement;
  - (c) the Risk Exposure Amount associated with the Operational Risk Capital Requirement;
  - (d) the Risk Exposure Amount associated with the CVA Risk Capital Requirement; and
  - (e) the Risk Exposure Amount associated with the Displaced Commercial Risk Capital Requirement, where applicable, as calculated in accordance with IFR Rule 5.4.5.
- 3.5.8** An Authorised Person must multiply the capital requirements referred to under points 3.5.7(b) to 3.5.7(e) by a factor of 12.5 in order to determine the Risk Exposure Amounts associated with those elements of the Total Risk Exposure Amount.

### **Guidance**

1. The Total Risk Exposure Amount must be calculated by Authorised Persons in Categories 1, 2, 3A and 5 for the determination of appropriate minimum capital resources and for reporting purposes.
2. The Displaced Commercial Risk Capital Requirement will only apply to an Authorised Person Managing a Profit Sharing Investment Account which is a PSIAu.
3. An Authorised Person will also need to consider the relevant provisions in the IFR rules relating to Credit Risk and Market Risk for Islamic Contracts when calculating its CRCOM and Market Risk Capital Requirement.
4. Where the Risk Capital Requirement is the binding Capital Requirement calculated using the provisions in Section 3.4 the Regulator may impose an Individual Capital Requirement (see Chapter 10) on an Authorised Person. Such a requirement is additional to the Risk Capital Requirement and is, therefore, a component of the Capital Requirement for the Authorised Person.

### **3.6 Capital Requirements for Categories 3B, 3C and 4**

**3.6.1** This Section applies to an Authorised Person in Category 3B, 3C or 4.

**3.6.2** The Capital Requirement for such an Authorised Person is calculated as the higher of:

- (a) the applicable Base Capital Requirement as set out in Section 3.3; or
- (b) the Expenditure Based Capital Minimum as set out in Section 3.7.

### **Guidance**

The Expenditure Based Capital Minimum is a component of the calculation of the Capital Requirement under Section 3.6 and is relevant in determining whether the Regulator has to be notified under Rule 3.20.2.

### **3.7 Expenditure Based Capital Minimum**

#### **Guidance**

This Section applies to Authorised Persons in Categories 3B, 3C and 4 pursuant to Rule 3.6.2(b).

**3.7.1** An Authorised Person must calculate its Expenditure Based Capital Minimum as:

- (a) in the case of an Authorised Person which holds Client Assets or Insurance Money, 18/52nds;

- (b) in the case of an Authorised Person in Category 3B or 3C which does not hold Client Assets or Insurance Money, 13/52nds; or
- (c) in the case of an Authorised Person in Category 4, which does not hold Insurance Money, 6/52nds;

of the Annual Audited Expenditure, calculated in accordance with Rule 3.7.2.

### **Annual Audited Expenditure**

- 3.7.2** (1) Subject to Rule 3.7.3, Annual Audited Expenditure constitutes all expenses and losses that arise in the Authorised Person's normal course of business in a twelve-month accounting period (excluding exceptional items) which are recorded in the Authorised Person's audited profit and loss account, less the following items (if they are included in the Authorised Person's audited profit and loss account):
- (a) staff bonuses, except to the extent that they are non-discretionary;
  - (b) the shares of Employees and Directors in profits, including Share Options, except to the extent that they are non-discretionary;
  - (c) other appropriations of profits, except to the extent that they are automatic;
  - (d) shared commissions and fees payable that are directly related to commissions and fees receivable, which are included with total revenue;
  - (e) fees, brokerage and other charges paid to clearing houses, exchanges and intermediate brokers for the purposes of executing, registering or clearing transactions;
  - (f) any expenses for which pre-payments or advances have already been made to the respective claimant (e.g. pre-paid rent, pre-paid communication charges etc.) and deducted from Capital Resources as illiquid assets;
  - (g) foreign exchange losses; and
  - (h) contributions to charities.
- (2) For the purposes of (1)(c), a management charge must not be treated as an appropriation of profits.
- 3.7.3** (1) For the purposes of Rule 3.7.2, an Authorised Person must calculate its relevant Annual Audited Expenditure with reference to the Authorised Person's most recent audited financial statements.

- (2) If the Authorised Person's most recent audited financial statements do not represent a twelve-month accounting period, it must calculate its Annual Audited Expenditure on a pro rata basis so as to produce an equivalent annual amount.
- (3) If an Authorised Person has not completed its first twelve months of business operations, it must calculate its Annual Audited Expenditure based on forecast expenditure as reflected in the budget for the first twelve months of business operations, as submitted with its application for authorisation.
- (4) (a) If an Authorised Person:
  - (i) has a material change in its expenditure (whether up or down); or
  - (ii) has varied its authorised activities,it must recalculate its Annual Audited Expenditure and Expenditure Based Capital Minimum accordingly.
- (b) Where an Authorised Person has recalculated its Annual Audited Expenditure and Expenditure Based Capital Minimum in accordance with (a), it must submit this recalculation to the Regulator within seven days of its completion and seek agreement/approval from the Regulator. The Regulator may within thirty days of receiving the recalculation object to the recalculation and require the Authorised Person to revise its Expenditure Based Capital Minimum.

#### **Liquid assets**

- 3.7.4**
- (1) An Authorised Person to which this Section applies must, at all times, maintain an amount of assets which exceeds its Expenditure Based Capital Minimum in the form of liquid assets.
  - (2) For the purpose of this Rule, and subject to (3), liquid assets comprise any of the following:
    - (a) cash in hand;
    - (b) Money deposited with a regulated bank or Deposit-taker which has a short-term credit rating of A1 or P1 (or equivalent) and above from an ECAI;
    - (c) demand Deposits with a tenor of one year or less with a bank or Deposit-taker in (b);

- (d) time Deposits with a tenor of one year or less which have an option to redeem the Deposit at any time. In such cases, the Deposit amount eligible to be included as liquid assets must be calculated as net of any costs associated with such early redemption;
  - (e) cash receivable from a regulated clearing house and cash Deposits with such clearing houses, other than any fees or contributions to guarantee or reserve funds of such clearing houses; or
  - (f) any other asset which may be approved by the Regulator as comprising a liquid asset for the purpose of this Rule.
- (3) For the purpose of this Rule, liquid assets do not include:
- (a) any Investment, asset or Deposit which has been pledged as security or Collateral for any obligations or liabilities assumed by it or by any other third party; or
  - (b) cash held in Client Money or Insurance Money accounts.

## **PART 4 – Calculating Capital Resources**

### **3.8 Application**

**3.8.1** This Part applies to an Authorised Person in any Category.

#### **Guidance**

The earlier Section 3.2 imposes a number of basic requirements on an Authorised Person, including requirements to have and maintain a quantity and quality of Capital Resources which would enable it to meet its capital adequacy requirements specified in Chapter 3 of these Rules.

### **3.9 Tier 1 capital**

**3.9.1** ~~The Tier 1 capital (referred to in these Rules as T1 Capital) of an Authorised Person refers to "going concern" capital which allows an Authorised Person to continue its activities and prevent insolvency of the Authorised Person. Tier 1 capital must be calculated as the total of its Common Equity Tier 1 capital (referred to in these Rules as CET1 Capital) and its Additional Tier 1 capital (referred to in these Rules as AT1 Capital).~~

#### **Guidance**

The Tier 1 capital (referred to in these Rules as T1 Capital) of an Authorised Person refers to "going concern" capital which allows an Authorised Person to continue its activities and prevent insolvency of the Authorised Person.

### **3.10 Common Equity Tier 1 capital (CET1 Capital)**

- 3.10.1** CET1 Capital constitutes the sum of CET1 capital elements in Rule 3.10.2, subject to the adjustments, deductions and exemptions stipulated later in this Part.
- 3.10.2** CET1 Capital consists of the sum of the following capital elements:
- (a) capital instruments, provided the conditions laid down in Rule 3.10.3 are fully met;
  - (b) Share premium accounts related to the instruments referred to in (a);
  - (c) retained earnings;
  - (d) accumulated other comprehensive income, as defined in the International Financial Reporting Standards; and
  - (e) other reserves which are required to be disclosed under International Financial Reporting Standards, excluding any amounts already included in accumulated other comprehensive income or retained earnings.
- 3.10.3** (1) For the purposes of Rule 3.10.2(a), a capital instrument is eligible for inclusion in CET1 Capital where all the following conditions are met:
- (a) the instruments are issued directly by the Authorised Person with the prior written approval of the shareholders of the Authorised Person;
  - (b) the instruments are fully paid up and their purchase is not funded directly or indirectly by the Authorised Person;
  - (c) the instruments meet all the following conditions as regards their classification:
    - (i) they qualify as equity capital within the meaning of the Companies Regulations;
    - (ii) they are classified as equity within the meaning of the International Financial Reporting Standards; and
    - (iii) they are classified as equity capital for the purposes of determining balance sheet insolvency, under the Insolvency Regulations;
  - (d) the instruments are clearly and separately disclosed on the balance sheet in the financial statements of the Authorised Person;
  - (e) the instruments are perpetual;
  - (f) the principal amount of the instruments may not be reduced or repaid, except in either of the following cases:

- (i) the liquidation of the Authorised Person; or
  - (ii) discretionary repurchases of the instruments or other discretionary means of reducing capital, where the Authorised Person has notified the Regulator of its intention to do so, in writing, at least thirty days prior to taking such steps;
- (g) the provisions governing the instruments do not indicate expressly or implicitly that the principal amount of the instruments would or might be reduced or repaid other than in the liquidation of the Authorised Person, and the Authorised Person does not otherwise provide such an indication prior to or at issuance of the instruments;
- (h) the instruments meet the following conditions as regards distributions:
- (i) there are no preferential distributions, including in relation to other CET1 Capital instruments, and the terms governing the instruments do not provide preferential rights to payment of distributions;
  - (ii) distributions to holders of the instruments may be paid only out of distributable items;
  - (iii) the conditions governing the instruments do not include a cap or other restriction on the maximum level of distributions;
  - (iv) the level of distributions is not determined on the basis of the amount for which the instruments were purchased at issuance;
  - (v) the conditions governing the instruments do not include any obligation for the Authorised Person to make distributions to its holders and the Authorised Person is not otherwise subject to such an obligation;
  - (vi) non-payment of distributions does not constitute an event of default of the Authorised Person; and
  - (vii) the cancellation of distributions imposes no restrictions on the institution;
- (i) compared to all the capital instruments issued by the Authorised Person, the instruments absorb the first and proportionately

greatest share of losses as they occur, and each instrument absorbs losses to the same degree as all other CET1 Capital instruments;

- (j) the instruments rank below all other claims in the event of insolvency or liquidation of the Authorised Person;
  - (k) the instruments entitle their owners to a claim on the residual assets of the Authorised Person, which, in the event of its liquidation and after the payment of all senior claims, is proportionate to the amount of such instruments issued and is not fixed or subject to a cap;
  - (l) the instruments are not secured, or guaranteed by any of the following:
    - (i) the Authorised Person or its Subsidiaries;
    - (ii) any Parent of the Authorised Person or its Subsidiaries; or
    - (iii) any member of its Financial Group; and
  - (m) the instruments are not subject to any arrangement, contractual or otherwise, that enhances the seniority of claims under the instruments in insolvency or liquidation.
- (2) The conditions in (1)(i) must be complied with notwithstanding a write-down on a permanent basis of the principal amount of AT1 Capital instruments.
- (3) Where any of the conditions in (1) cease to be met:
- (a) the instrument must cease to qualify as a CET1 Capital instrument; and
  - (b) the Share premium accounts that relate to that instrument must cease to qualify as a CET1 element.

**3.10.4** For the purposes of Rule 3.10.2(c), an Authorised Person may include interim or year-end net profits in CET1 Capital before the Authorised Person has approved its annual audited accounts confirming its final profit or loss for the year, but only where:

- (a) those profits have been reviewed by the external Auditor of the Authorised Person, which is responsible for auditing its accounts; and
- (b) the Authorised Person is fully satisfied that any foreseeable charge or dividend has been deducted from the amount of those net profits.

### **Guidance**

The review of the interim or year-end profits of the Authorised Person referred to in Rule 3.10.4 should provide an adequate level of assurance that those profits have been evaluated in accordance with the principles set out in the International Financial Reporting Standards. The Regulator may request an Authorised Person to provide it with a copy of its external Auditor's opinion on whether the interim profits are reasonably stated.

### **CET1 Adjustments**

**3.10.5** An Authorised Person must, in the calculation of CET1 Capital, exclude the following:

- (a) any increase in its equity under the International Financial Reporting Standards, including:
  - (i) where such an increase is associated with future margin income that results in a gain on sale for the Authorised Person; and
  - (ii) where the Authorised Person is the Originator of a securitisation, net gains that arise from the capitalisation of future income from the securitised assets that provide Credit Enhancement to positions in the securitisation;
- (b) the amount of cash flow hedge reserve related to gains or losses on cash flow hedges of Financial Instruments that are not valued at fair value, including projected cash flows; and
- (c) all unrealised gains or losses on liabilities of the Authorised Person that are valued at fair value, and which result from changes in the Authorised Person's own credit quality, except when such gains or losses are offset by a change in the fair value of another Financial Instrument which is measured at fair value and resulting from changes in the Authorised Person's own credit quality.

**3.10.6** Except for the items referred to in Rule 3.10.5, an Authorised Person must not make any adjustments to remove from its Capital Resources unrealised gains or losses on its assets or liabilities measured at fair value.

### **Guidance**

An Authorised Person is expected to follow the guidance provided in respect of prudent valuation in Section 2.4 and in App2, in valuing all its assets measured at fair value while calculating its Capital Resources.

### **CET1 Deductions**

**3.10.7** Subject to the following Rules in this Section, an Authorised Person must deduct the following from the calculation of its CET1 Capital:

- (a) losses for the current financial year;
- (b) goodwill and other intangible assets as defined in the International Financial Reporting Standards;
- (c) deferred tax assets that rely on future profitability;
- (d) defined benefit pension fund assets of the Authorised Person;
- (e) the applicable amount, by reference to Rule 3.10.12, of direct and indirect holdings by an Authorised Person of its own CET1 Capital instruments including instruments under which an Authorised Person is under an actual or contingent obligation to effect a purchase by virtue of an existing contractual obligation;
- (f) holdings of the CET1 Capital instruments of Relevant Entities where those entities have a reciprocal cross holding with the Authorised Person which have the effect of artificially inflating the Capital Resources of the Authorised Person;
- (g) the applicable amount, by reference to Rule 3.10.13, of direct and indirect holdings by the Authorised Person of CET1 Capital instruments of Relevant Entities where the Authorised Person does not have a significant investment in those entities;
- (h) the applicable amount, by reference to Rules 3.10.13 and 3.10.18, of direct and indirect holdings by the Authorised Person of the CET1 Capital instruments of Relevant Entities where the Authorised Person has a significant investment in those entities;
- (i) the amount of items required to be deducted from the calculation of AT1 Capital in accordance with the relevant Rules under Section 3.11, that exceeds the AT1 Capital of the Authorised Person;
- (j) the Exposure amount of the following items which qualify for a risk weight of 1000%, where the Authorised Person deducts that Exposure amount from CET1 Capital as an alternative to applying a risk weight of 1000%:
  - (i) Qualifying Holdings;
  - (ii) securitisation positions, in accordance with relevant Rules in Chapter 4; and
  - (iii) free deliveries, in accordance with the Rules in Section A4.6; and
- (k) for an Authorised Person which is a Partnership, the amount by which the aggregate of the amounts withdrawn by its Partners or members exceeds the profits of that firm.

### **CET1 Deductions - intangible assets**

**3.10.8** For the purposes of Rule 3.10.7(b), an Authorised Person must determine the intangible assets to be deducted in accordance with the following:

- (a) the amount to be deducted must be reduced by the amount of associated deferred tax liabilities that would be extinguished if the intangible assets became impaired or were derecognised under the International Financial Reporting Standards; and
- (b) the amount to be deducted must include goodwill included in the valuation of significant Investments of the Authorised Person.

### **CET1 Deductions - deferred tax assets**

**3.10.9** (1) For the purposes of Rule 3.10.7(c), and subject to (2), the amount of deferred tax assets that rely on future profitability must be calculated without reducing it by the amount of the associated deferred tax liabilities of the Authorised Person.

(2) The amount of deferred tax assets that rely on future profitability may be reduced by the amount of the associated deferred tax liabilities of the Authorised Person, provided the following conditions are met:

- (a) those deferred tax assets and associated deferred tax liabilities both arise from the tax law of the same tax jurisdiction; and
- (b) the taxation authority of that tax jurisdiction permits the offsetting of deferred tax assets and the associated deferred tax liabilities.

### **Guidance**

1. Deferred tax assets are assets that may be used to reduce the amount of an Authorised Person's future tax obligations. Associated deferred tax liabilities of the Authorised Person used for the purposes of Rule 3.10.9 may not include deferred tax liabilities that reduce the amount of intangible assets or defined benefit pension fund assets required to be deducted. The amount of associated deferred tax liabilities referred to in this guidance should be allocated between the following:

- a. deferred tax assets that rely on future profitability and arise from temporary differences that are not deducted as part of a threshold exemption for deductions from CET 1 Capital; and
- b. all other deferred tax assets that rely on future profitability.

2. An Authorised Person should allocate the associated deferred tax liabilities according to the proportion of deferred tax assets that rely on future

profitability that the items referred to in Guidance note 1.a. and b. represent.

- 3.10.10** (1) An Authorised Person must apply a risk weight in accordance with Chapter 4, as applicable, to deferred tax assets that do not rely on future profitability.
- (2) For the purpose of (1), deferred tax assets that do not rely on future profitability comprise the following:
- (a) overpayments of tax by the Authorised Person for the current year;
  - (b) current year tax losses of the Authorised Person carried back to previous years that give rise to a claim on, or a receivable from, a central government, regional government or local tax authority; and
  - (c) deferred tax assets arising from temporary differences which, in the event the Authorised Person incurs a loss, becomes insolvent or enters liquidation, are replaced, on a mandatory and automatic basis in accordance with the applicable national law, with a claim on the central government of the jurisdiction in which the Authorised Person is incorporated which must absorb losses to the same degree as CET1 Capital instruments on a going concern basis and in the event of insolvency or liquidation of the Authorised Person.

#### **CET1 Deductions - defined benefit pension fund assets**

- 3.10.11** For the purposes of Rule 3.10.7(d), the amount of defined benefit pension fund assets to be deducted from CET1 Capital must be reduced by the following:
- (a) the amount of any associated deferred tax liability which could be extinguished if the assets became impaired or were derecognised under the International Financial Reporting Standards; and
  - (b) the amount of assets in the defined benefit pension fund which the Authorised Person has an unrestricted ability to use where the Authorised Person has provided adequate advance notification of its intention to use those assets to the Regulator. Those assets used to reduce the amount to be deducted must receive a risk weight in accordance with Chapter 4 of these Rules.

#### **CET1 Deductions - holdings of own CET1 Capital instruments**

- 3.10.12** For the purposes of Rule 3.10.7(e), an Authorised Person must calculate holdings of its own CET1 Capital instruments on the basis of gross long positions subject to the following exceptions:

- (a) an Authorised Person must calculate the amount of holdings of own CET1 Capital instruments in the Trading Book on the basis of the net long position, provided the long and short positions are in the same underlying Exposure and the short positions involve no Counterparty Credit Risk;
- (b) an Authorised Person must determine the amount to be deducted for indirect holdings in the Trading Book that take the form of holdings of index Securities by calculating the underlying Exposure to own CET1 Capital instruments included in the indices; and
- (c) an Authorised Person must net gross long positions in own CET1 Capital instruments in its Trading Book resulting from holdings of index Securities against short positions in own CET1 Capital instruments resulting from short positions in the underlying indices, including where those short positions involve Counterparty Credit Risk.

#### **CET1 Deductions - significant investment in a Relevant Entity**

**3.10.13** For the purposes of Rules 3.10.7(g) and (h), an investment by an Authorised Person in a Relevant Entity must be considered as a significant investment if it meets any of the following conditions:

- (a) the Authorised Person owns more than 10% of the CET1 Capital instruments issued by that entity;
- (b) the Authorised Person has Close Links with that entity and owns CET1 Capital instruments issued by that entity; and
- (c) the Authorised Person owns CET1 Capital instruments issued by that entity and the entity is not included in consolidation pursuant to Chapter 8 of these Rules but is included in the same accounting consolidation as the Authorised Person for the purposes of financial reporting under the International Financial Reporting Standards.

#### **CET1 Deductions - investments in CET1 Capital instruments of Relevant Entities**

**3.10.14** For the purposes of Rules 3.10.7(f), (g) and (h), the amount of holdings of CET1 Capital instruments and other capital instruments of Relevant Entities to be deducted, must be calculated, subject to Rule 3.10.15, on the basis of the gross long positions.

**3.10.15** For the purposes of Rules 3.10.7(g) and (h), an Authorised Person must make the deductions in accordance with the following:

- (a) the holdings in the Trading Book of the capital instruments of Relevant Entities must be calculated on the basis of the net long position in the same underlying Exposure provided the maturity of the short position matches the

maturity of the long position or has a residual maturity of at least one year; and

- (b) the amount to be deducted for indirect holdings in the Trading Book of the capital instruments of Relevant Entities that take the form of holdings of index Securities must be determined by calculating the underlying Exposure to the capital instruments of the Relevant Entities in the indices.

**3.10.16** (1) For the purposes of Rule 3.10.7(g), the amount to be deducted is calculated by multiplying the amount referred to in (a) by the factor derived from the calculation referred to in (b):

- (a) the aggregate amount by which the direct, indirect and synthetic holdings by the Authorised Person of the CET1, AT1 and T2 Capital instruments of Relevant Entities, in which the Authorised Person does not have a significant investment, exceeds 10% of the CET1 items of the Authorised Person calculated after applying the following to CET1 items:

- (i) all of the adjustments referred to in Rule 3.10.5;
- (ii) the deductions referred to in Rules 3.10.7(a) to (f) and (h) to (j), excluding the amount to be deducted for deferred tax assets that rely on future profitability and arise from temporary differences; and
- (iii) the deductions referred to in Rules 3.10.14 and 3.10.15;

- (b) the amount of direct and indirect holdings by the Authorised Person of the CET1 Capital instruments of Relevant Entities divided by the aggregate amount of direct and indirect holdings by the Authorised Person of the CET1, AT1 and T2 Capital instruments issued by those Relevant Entities.

(2) An Authorised Person must exclude Underwriting positions held for five working days or fewer from the amount referred to in (1)(a) and from the calculation of the factor referred to in (1)(b).

(3) The amount to be deducted pursuant to (1) must be apportioned across each CET1 Capital instrument held. An Authorised Person must determine the portion of holdings of CET1 Capital instruments that is to be deducted pursuant to (1) by dividing the amount specified in (a) by the amount specified in (b):

- (a) the amount of holdings required to be deducted pursuant to (1)(a);
- (b) the aggregate amount of direct and indirect holdings by the Authorised Person of all the capital instruments of Relevant Entities

in which the Authorised Person does not have a significant investment.

- 3.10.17** (1) The amount of holdings referred to in Rule 3.10.7(g) that is equal to or less than 10% of the CET1 items of the Authorised Person after applying the provisions laid down in Rule 3.10.6(1)(a)(i) to (iii) must not be deducted and must be subject to the applicable risk weights in accordance with Chapter 4.
- (2) An Authorised Person must determine the portion of holdings of all the capital instruments that is risk weighted by dividing the amount specified in (a) by the amount specified in (b):
- (a) the amount of holdings required to be risk weighted pursuant to Rule 3.10.17(1);
  - (b) the aggregate amount of direct and indirect holdings by the Authorised Person of all the capital instruments of Relevant Entities in which the Authorised Person does not have a significant investment.
- 3.10.18** For the purposes of Rule 3.10.7(h), the amount to be deducted from CET1 elements must exclude Underwriting positions held for five working days or fewer and must be determined in accordance with Rule 3.10.14 and 3.10.15.

#### **CET1 Deductions - exemptions**

- 3.10.19** (1) In making the deductions required pursuant to Rules 3.10.7(c) and (h), an Authorised Person must not deduct the items listed in (a) and (b), where in aggregate they are equal to or less than 15% of CET1 Capital:
- (a) deferred tax assets that are dependent on future profitability and arise from temporary differences, and in aggregate are equal to or less than 10% of the CET1 items of the Authorised Person calculated after applying the following:
    - (i) adjustments referred in Rule 3.10.5; and
    - (ii) deductions referred to in (a) to (g) and (i) to (j) of Rule 3.10.7, excluding deferred tax assets that rely on future profitability and arise from temporary differences.
  - (b) where an Authorised Person has a significant investment in a Relevant Entity, the direct and indirect holdings of that Authorised Person of the CET1 Capital instruments of those entities that in aggregate are equal to or less than 10% of the CET1 items of the Authorised Person calculated after applying the following:
    - (i) adjustments referred in Rule 3.10.5; and

- (ii) deductions referred to in (a) to (h) and (i) to (j) of Rule 3.10.7 excluding deferred tax assets that rely on future profitability and arise from temporary differences.
- (2) Items that are not deducted pursuant to (1) must be risk weighted at 200% and subject to the requirements of Chapter 4, as applicable.

### **3.11 Additional Tier 1 capital**

**3.11.1** Additional Tier 1 Capital (referred to in these Rules as AT1 Capital) constitutes the sum of AT1 Capital elements in Rule 3.11.2, subject to the deductions stipulated later in this Section.

**3.11.2** AT1 Capital consists of the sum of the following capital elements:

- (a) capital instruments which meet the eligibility criteria laid down in Rule 3.11.3; and
- (b) the Share premium accounts related to the instruments referred to in (a).

**3.11.3** (1) For the purposes of Rule 3.11.2(a), a capital instrument is eligible for inclusion in AT1 Capital where all of the following conditions are met:

- (a) the instruments are issued and paid up;
- (b) the instruments are not purchased by any of the following:
  - (i) the Authorised Person or its Subsidiaries; or
  - (ii) an Undertaking in which the Authorised Person has participation in the form of ownership, direct or by way of control, of 20% or more of the voting rights or capital of that Undertaking;
- (c) the purchase of the instruments is not funded directly or indirectly by the Authorised Person;
- (d) the instruments rank below T2 Capital instruments in the event of the insolvency of the Authorised Person;
- (e) the instruments are not secured, or guaranteed by any of the following:
  - (i) the Authorised Person or its Subsidiaries;
  - (ii) any Parent of the Authorised Person or their Subsidiaries;
  - (iii) any member of its Financial Group in accordance with Chapter 8; or

- (iv) any Undertaking that has Close Links with entities referred to in (i) to (iii);
- (f) the instruments are not subject to any arrangement, contractual or otherwise that enhances the seniority of the claim under the instruments in insolvency or liquidation;
- (g) the instruments are perpetual and the provisions governing them include no incentive for the Authorised Person to redeem them;
- (h) where the provisions governing the instruments include one or more call Options, the option to call may be exercised at the sole discretion of the Issuer;
- (i) the instruments may be called, redeemed or repurchased only where the Authorised Person has notified the Regulator of its intention to call, redeem or repurchase the instruments in writing and well in advance, and not before five years after the date of issuance of the respective instruments;
- (j) the provisions governing the instruments do not indicate explicitly or implicitly that the instruments would or might be called, redeemed or repurchased and the Authorised Person does not otherwise provide such an indication;
- (k) the Authorised Person does not indicate explicitly or implicitly that the Regulator would not object to a plan to call, redeem or repurchase the instruments;
- (l) distributions under the instruments meet the following conditions:
  - (i) they are paid out of distributable items;
  - (ii) the level of distributions made on the instruments will not be modified based on the credit standing of the Authorised Person or any of its Parents or any entities in its Financial Group;
  - (iii) the provisions governing the instruments give the Authorised Person full discretion at all times to cancel the distributions on the instruments for an unlimited period and on a non-cumulative basis, and the Authorised Person may use such cancelled payments without restriction to meet its obligations as they fall due;
  - (iv) cancellation of distributions does not constitute an event of default of the Authorised Person; and

- (v) the cancellation of distributions imposes no restrictions on the Authorised Person;
  - (m) the instruments do not contribute to a determination that the liabilities of an Authorised Person exceed its assets, where such a determination constitutes a test of insolvency under the Insolvency Regulations;
  - (n) the provisions governing the instruments require the principal amount of the instruments to be written down, or the instruments to be converted to CET1 Capital instruments, upon the occurrence of a trigger event;
  - (o) the contractual provisions governing the instruments meet the requirements set out in Rule 3.11.3(4);
  - (p) the provisions governing the instruments include no feature that could hinder the recapitalisation of the Authorised Person; and
  - (q) where the instruments are not issued directly by the Authorised Person or by an operating entity within the Financial Group to which the Authorised Person belongs, or by the Parent of the Authorised Person, the proceeds are immediately available without limitation in a form that satisfies the conditions laid down in this Rule to any of the following:
    - (i) the Authorised Person;
    - (ii) an operating entity within the Financial Group to which the Authorised Person belongs; or
    - (iii) any Parent of the Authorised Person.
- (2) For the purposes of (1)(l)(v) and (1)(p), the provisions governing AT1 Capital instruments must not include the following:
- (a) a requirement for distributions on the instruments to be made in the event of a distribution being made on an instrument issued by the Authorised Person that ranks to the same degree as, or more junior than, an AT1 Capital instrument;
  - (b) a requirement for the payment of distributions on CET1, AT1 or T2 Capital instruments to be cancelled in the event that distributions are not made on those AT1 Capital instruments; or
  - (c) an obligation to substitute the payment of interest or dividend by a payment in any other form.

- (3) For the purposes of (1)(n), the following provisions apply to AT1 Capital instruments:
- (a) a trigger event occurs when the CET1 Capital of the Authorised Person falls below either of the following:
    - (i) 6.625% of its Total Risk Exposure Amount; or
    - (ii) a level higher than 6.625%, where determined by the Authorised Person and specified in the provisions governing the instrument;
  - (b) where the provisions governing the instruments require them to be converted into CET1 Capital ~~instruments~~ upon the occurrence of a trigger event, those provisions must specify either of the following:
    - (i) the rate of such conversion and a limit on the permitted amount of conversion; or
    - (ii) a range within which the instruments will convert into CET1 Capital instruments;
  - (c) where the provisions governing the instruments require their principal amount to be written down upon the occurrence of a trigger event, the write down must reduce all the following:
    - (i) the claim of the holder of the instrument in the liquidation of the Authorised Person;
    - (ii) the amount required to be paid in the event of the call of the instrument; and
    - (iii) the distributions made on the instrument.
- (4) For the purposes of (1)(o):
- (a) The provisions governing AT1 Capital instruments must require such instruments to, at the option of the Regulator, either be partially or fully written down or converted into ordinary shares upon the occurrence of a trigger event.
  - (b) For the purpose of this provision, a "trigger event" shall refer to a notification by the Regulator notifying the Authorised Person in writing, in accordance with any regulations of ADGM relating to recovery and resolution, that the Regulator has determined that unless a write down or conversion is conducted, the Authorised Person will no longer be viable.

- (c) Any compensation paid to the instrument holders as a result of a write down shall be paid immediately and in the form of ordinary shares of the Authorised Person, or the holding company of the Authorised Person if approved by the Regulator.
- (d) The Authorised Person shall maintain at all times all prior authorisation necessary to issue immediately the relevant number of ordinary shares should the trigger event occur and the AT1 Capital instruments be converted into ordinary shares.
- (e) Where an Authorised Person intends to include the AT1 Capital instruments issued by a Subsidiary in a non-ADGM jurisdiction in the consolidated AT1 Capital, the Authorised Person may do so, to the extent permitted under these Rules, if the provisions governing the instrument specify a trigger event equivalent to the trigger specified in paragraph (b) above, or where the trigger event relates to the supervisor of the Subsidiary deciding to make a public sector injection of capital or equivalent support, without which the Authorised Person would no longer be viable. The Regulator will only activate such triggers in respect of such Subsidiary, after consultation with the supervisor of the Subsidiary, where:

  - (i) if applicable, the Subsidiary is non-viable as determined by the supervisor of the Subsidiary in accordance with applicable laws of that jurisdiction on insolvency, resolution or recovery of financial institutions; and
  - (ii) the Authorised Person is, or would be, non-viable, as determined by the Regulator, as a result of providing, or committing to provide, a capital injection or similar support to the Subsidiary;
- (f) For the purposes of paragraph (e) above, any ordinary shares paid as compensation to the holders of the capital instrument shall be ordinary shares of either the Subsidiary or of the Authorised Person.

### **Guidance**

Where the Regulator determines that certain conditions in relation to the viability of the institution are met, capital instruments eligible for inclusion in AT1 Capital will be either partially or fully written down or converted into ordinary shares.

- (5) The following must apply where, in the case of an AT1 Capital instrument, the conditions laid down in this Rule cease to be met:

  - (a) that instrument must cease to qualify as an AT1 Capital instrument; and

- (b) the part of the Share premium accounts that relates to that instrument must cease to qualify as an AT1 Capital element.

#### **AT1 Deductions**

**3.11.4** Subject to the following Rules in this Section, an Authorised Person must deduct the following from the calculation of its AT1 Capital:

- (a) direct and indirect holdings by an Authorised Person of own AT1 Capital instruments including instruments under which an Authorised Person is under an actual or contingent obligation to effect a purchase by virtue of an existing contractual obligation;
- (b) holdings of the AT1 Capital instruments of Relevant Entities where those entities have a reciprocal cross-holding with the Authorised Person which have the effect of artificially inflating the Capital Resources of the Authorised Person;
- (c) the amount determined in accordance with Rule 3.11.8 of direct and indirect holdings by the Authorised Person of the AT1 Capital instruments of Relevant Entities where the Authorised Person does not have a significant investment in those entities;
- (d) direct and indirect holdings by the Authorised Person of the AT1 Capital instruments of Relevant Entities where the Authorised Person has a significant investment in those entities, excluding Underwriting positions held for five working days or fewer; and
- (e) the amounts required to be deducted from T2 Capital pursuant to Rule 3.12.4 that exceed the T2 Capital of the Authorised Person.

#### **AT1 Deductions - holdings of own AT1 Capital instruments**

**3.11.5** For the purposes of Rule 3.11.4(a), an Authorised Person must calculate holdings of its own AT1 Capital instruments on the basis of gross long positions subject to the following exceptions:

- (a) an Authorised Person must calculate the amount of holdings of own AT1 Capital instruments in the Trading Book on the basis of the net long position provided the long and short positions are in the same underlying Exposure and the short positions involve no Counterparty Credit Risk;
- (b) an Authorised Person must determine the amount to be deducted for indirect holdings in the Trading Book of own AT1 Capital instruments that take the form of holdings of index Securities by calculating the underlying Exposure to own AT1 Capital instruments in the indices; and
- (c) an Authorised Person must net gross long positions in own AT1 Capital instruments in the Trading Book resulting from holdings of index Securities

may be netted by the Authorised Person against short positions in own AT1 instruments resulting from short positions in the underlying indices, including where those short positions involve Counterparty Credit Risk.

#### **AT1 Deductions - investments in AT1 Capital instruments of Relevant Entities**

- 3.11.6** For the purposes of Rule 3.11.4(b), (c) and (d), the amount of holdings of AT1 Capital instruments of Relevant Entities to be deducted must be calculated on the basis of the gross long positions.
- 3.11.7** For the purposes of Rule 3.11.4(c) and (d), an Authorised Person must make the deductions in accordance with the following:
- (a) the holdings in the Trading Book of the capital instruments of Relevant Entities must be calculated on the basis of the net long position in the same underlying Exposure provided the maturity of the short position matches the maturity of the long position or has a residual maturity of at least one year; and
  - (b) the amount to be deducted for indirect holdings in the Trading Book of the capital instruments of Relevant Entities that take the form of holdings of index Securities must be determined by calculating the underlying Exposure to the capital instruments of the Relevant Entities in the indices.

#### **AT1 Deductions - significant investment in a Relevant Entity**

- 3.11.8** (1) For the purposes of Rule 3.11.4(c), an Authorised Person must calculate the applicable amount to be deducted by multiplying the amount referred to in (a) by the factor derived from the calculation referred to in (b):
- (a) the amount referred to in Rule 3.10.16(1)(a);
  - (b) the amount of direct and indirect holdings by the Authorised Person of the AT1 Capital instruments of Relevant Entities divided by the aggregate amount of all direct and indirect holdings by the Authorised Person of the CET1, AT1 and T2 Capital instruments of those Relevant Entities.
- (2) An Authorised Person must exclude Underwriting positions held for five working days or fewer from the amount referred to in Rule 3.10.16(1)(a) and from the calculation of the factor referred to in (1)(b).
- (3) An Authorised Person must determine the portion of holdings of AT1 Capital instruments that is to be deducted pursuant to (1) by dividing the amount specified in (a) by the amount specified in (b):
- (a) the amount of holdings required to be deducted pursuant to (1)(a);

- (b) the aggregate amount of direct and indirect holdings by the Authorised Person of all the capital instruments of Relevant Entities in which the Authorised Person does not have a significant investment.

### **3.12 Tier 2 capital**

**3.12.1** ~~Tier 2 capital refers to "gone concern" capital which helps to ensure that depositors and senior creditors can be repaid if an Authorised Person fails. Tier 2 capital allows an Authorised Person to continue its activities and prevent insolvency of the Authorised Person.~~ Tier 2 Capital (referred to in these Rules as T2 Capital) constitutes the sum of the elements in Rule 3.12.2 subject to the deductions stipulated later in this Section.

#### **Guidance**

Tier 2 capital refers to "gone concern" capital which helps to ensure that depositors and senior creditors can be repaid if an Authorised Person fails. Tier 2 capital allows an Authorised Person to continue its activities and prevent insolvency of the Authorised Person.

**3.12.2** T2 Capital consists of the sum of the following elements:

- (a) capital instruments which meet the eligibility criteria laid down in Rule 3.12.3; and
- (b) the Share premium accounts related to the instruments referred to in (a).

**3.12.3** (1) For the purpose of Rule 3.12.2(a), a capital instrument is eligible for inclusion in T2 Capital where all the following conditions are met:

- (a) the instruments are issued and fully paid-up;
- (b) the instruments are not purchased by any of the following:
  - (i) the Authorised Person or its Subsidiaries;
  - (ii) an Undertaking in which the Authorised Person has participation in the form of ownership, direct or by way of control, of 20% or more of the voting rights or capital of that Undertaking;
- (c) the purchase of the instruments is not funded directly or indirectly by the Authorised Person;
- (d) the claim on the principal amount of the instruments under the provisions governing the instruments is wholly subordinated to claims of all non-subordinated creditors;

- (e) the instruments are not secured, or guaranteed by any of the following:
  - (i) the Authorised Person or its Subsidiaries;
  - (ii) any Parent of the Authorised Person or their Subsidiaries;
  - (iii) any member of the Financial Group to which the Authorised Person belongs; or
  - (iv) any Undertaking that has Close Links with entities referred to in (i) to (iii);
- (f) the instruments are not subject to any arrangement that otherwise enhances the seniority of the claim under the instruments;
- (g) the instruments have an Original Maturity of at least five years;
- (h) the provisions governing the instruments do not include any incentive for them to be redeemed by the Authorised Person;
- (i) where the instruments include one or more call Options, the Options are exercisable at the sole discretion of the Issuer;
- (j) the instruments may be called, redeemed or repurchased only where the Authorised Person has notified the Regulator of its intention to call, redeem or repurchase the instruments in writing and well in advance, and not before five years after the date of issuance of the respective instruments;
- (k) the provisions governing the instruments do not indicate or suggest that the instruments would or might be redeemed or repurchased other than at maturity and the Authorised Person does not otherwise provide such an indication or suggestion;
- (l) the provisions governing the instruments do not give the holder the right to accelerate the future scheduled payment of interest or principal, other than in the insolvency or liquidation of the Authorised Person;
- (m) the level of interest or dividend payments due on the instruments will not be modified based on the credit standing of the Authorised Person, its Parent or any member of its Financial Group;
- (n) the contractual provisions governing the instruments meet the requirements set out in Rule 3.12.3(3):
- (o) where the instruments are not issued directly by the Authorised Person or by an operating entity within its Financial Group, or by its

Parent, the proceeds are immediately available without limitation in a form that satisfies the conditions laid down in this Rule to any of the following:

- (i) the Authorised Person;
- (ii) an operating entity within its Financial Group; or
- (iii) any Parent of the Authorised Person.

(2) The extent to which T2 Capital instruments can be considered as eligible for inclusion in T2 Capital during the final five years of maturity of those instruments is calculated by multiplying the result derived from the calculation in (a) by the amount referred to in (b):

- (a) the nominal amount of the instruments on the first day of the final five year period of their contractual maturity divided by the number of calendar days in that period;
- (b) the number of remaining calendar days of contractual maturity of the instruments.

(3) For the purposes of (1)(n):

(a) The provisions governing T2 Capital instruments must require such instruments to, at the option of the Regulator, either be partially or fully written down or converted into ordinary shares upon the occurrence of a trigger event.

(b) For the purpose of this provision, a "trigger event" shall refer to a notification by the Regulator notifying the Authorised Person in writing, in accordance with any regulations of ADGM relating to recovery and resolution, that the Regulator has determined that unless a write down or conversion is conducted, the Authorised Person will no longer be viable.

(c) Any compensation paid to the instrument holders as a result of a write down shall be paid immediately and in the form of ordinary shares of the Authorised Person, or the holding company of the Authorised Person if approved by the Regulator.

(d) The Authorised Person shall maintain at all times all prior authorisation necessary to issue immediately the relevant number of ordinary shares should the trigger event occur and the T2 Capital instruments be converted into ordinary shares.

(e) Where an Authorised Person intends to include the T2 Capital instruments issued by a Subsidiary in a non-ADGM jurisdiction in the consolidated T2 Capital, the Authorised Person may do so, to

the extent permitted under these Rules, if the provisions governing the instrument specify a trigger event equivalent to the trigger specified in paragraph (b) above, or where the trigger event relates to the supervisor of the Subsidiary deciding to make a public sector injection of capital or equivalent support, without which the Authorised Person would no longer be viable. The Regulator will only activate such triggers in respect of such Subsidiary, after consultation with the supervisor of the Subsidiary where:

- (i) if applicable, the Subsidiary is non-viable as determined by the supervisor of the Subsidiary in accordance with applicable laws of that jurisdiction on insolvency, resolution or recovery of financial institutions; and
  - (ii) the Authorised Person is, or would be, non-viable, as determined by the Regulator, as a result of providing, or committing to provide, a capital injection or similar support to the Subsidiary;
- (f) For the purposes of paragraph (e) above, any ordinary shares paid as compensation to the holders of the capital instrument shall be ordinary shares of either the Subsidiary or of the Authorised Person.

### **Guidance**

Where the Regulator determines that certain conditions in relation to the viability of the institution are met, capital instruments eligible for inclusion in T2 Capital will be either partially or fully written down or converted into ordinary shares.

- (4) The following must apply where, in the case of a T2 Capital instrument, the conditions laid down in this Rule cease to be met:
  - (a) that instrument must cease to qualify as a T2 Capital instrument; and
  - (b) the part of the Share premium accounts that relates to that instrument must cease to qualify as a T2 Capital element.

### **T2 regulatory deductions and exclusions**

**3.12.4** Subject to the following Rules in this Section, an Authorised Person must deduct the following from the calculation of its T2 Capital:

- (a) direct and indirect holdings by an Authorised Person of own T2 Capital instruments, including own T2 instruments that an Authorised Person could be obliged to purchase as a result of existing contractual obligations;

- (b) holdings of the T2 Capital instruments of Relevant Entities where those entities have a reciprocal cross holding with the Authorised Person which have the effect of artificially inflating the Capital Resources of the Authorised Person;
- (c) the amount of direct and indirect holdings by the Authorised Person of the T2 Capital instruments of Relevant Entities where the Authorised Person does not have a significant investment in those entities; and
- (d) direct and indirect holdings by the Authorised Person of the T2 Capital instruments of Relevant Entities where the Authorised Person has a significant investment in those entities, excluding Underwriting positions held for fewer than five working days.

#### **T2 Deductions - holdings of own T2 Capital instruments**

**3.12.5** For the purposes of Rule 3.12.4(a), an Authorised Person must calculate holdings of its own T2 Capital instruments on the basis of the gross long positions subject to the following exceptions:

- (a) an Authorised Person must calculate the amount of holdings in the Trading Book on the basis of the net long position provided the long and short positions are in the same underlying Exposure and the short positions involve no Counterparty Credit Risk;
- (b) an Authorised Person must determine the amount to be deducted for indirect holdings in the Trading Book of own T2 Capital instruments that take the form of holdings of index Securities by calculating the underlying Exposure to own T2 Capital instruments in the indices; and
- (c) an Authorised Person must net gross long positions in own T2 Capital instruments in the Trading Book resulting from holdings of index Securities against short positions in own T2 instruments resulting from short positions in the underlying indices, including where those short positions involve Counterparty Credit Risk.

#### **T2 Deductions - investments in T2 Capital instruments of Relevant Entities**

**3.12.6** For the purposes of Rules 3.12.4(b), (c) and (d), the amount of holdings of T2 Capital instruments and other capital instruments of Relevant Entities to be deducted must be calculated on the basis of the gross long positions.

**3.12.7** For the purposes of Rules 3.12.4(c) and (d), an Authorised Person must make the deductions in accordance with the following:

- (a) the holdings in the Trading Book of the capital instruments of Relevant Entities must be calculated on the basis of the net long position in the same underlying Exposure provided the maturity of the short position matches the

maturity of the long position or has a residual maturity of at least one year; and

- (b) the amount to be deducted for indirect holdings in the Trading Book of the capital instruments of Relevant Entities that take the form of holdings of index Securities must be determined by calculating the underlying Exposure to the capital instruments of the Relevant Entities in the indices.

### **T2 deductions - insignificant investment in a Relevant Entity**

- 3.12.8** (1) For the purposes of Rule 3.12.4(c), an Authorised Person must calculate the applicable amount to be deducted by multiplying the amount referred to in (a) by the factor derived from the calculation referred to in (b):
- (a) the amount referred to in Rule 3.10.16(1)(a);
  - (b) the amount of direct and indirect holdings by the Authorised Person of the T2 Capital instruments of Relevant Entities divided by the aggregate amount of all direct and indirect holdings by the Authorised Person of the CET1, AT1 and T2 Capital instruments of those Relevant Entities.
- (2) An Authorised Person must exclude Underwriting positions held for five working days or fewer from the amount referred to in Rule 3.10.16(1)(a) and from the calculation of the factor referred to in (1)(b).
- (3) An Authorised Person must determine the portion of holdings of T2 Capital instruments that is to be deducted by dividing the amount specified in (a) by the amount specified in (b):
- (a) the amount of holdings required to be deducted pursuant to (1)(a);
  - (b) the aggregate amount of direct and indirect holdings by the Authorised Person of the capital instruments of Relevant Entities in which the Authorised Person does not have a significant investment.

### **T2 Exclusion - Managing a Profit Sharing Investment Account**

- 3.12.9** An Authorised Person must exclude from T2 Capital any amount by which the total of the Profit Equalisation Reserve and the Investment Risk Reserve exceeds the Displaced Commercial Risk Capital Requirement calculated in accordance with the IFR rules.

### **3.13 Minority interests and instruments issued by Subsidiaries**

**Minority interests that qualify for inclusion in consolidated CET1 Capital**

**3.13.1** Minority interests must include the CET1 Capital instruments, plus the related retained earnings and Share premium accounts of a Subsidiary, only where all of the following conditions are met:

- (a) the Subsidiary is one of the following:
  - (i) an Authorised Person; or
  - (ii) a regulated entity;
- (b) the Subsidiary is a member of the Financial Group and included in the scope of consolidated supervision in accordance with Chapter 8; and
- (c) those CET1 Capital instruments are owned by Persons other than the Undertakings included in the Financial Group.

**3.13.2** Minority interests that are funded, directly or indirectly, through a Special Purpose Entity (SPE) or otherwise, by the Parent of the Authorised Person or any member of its Financial Group must not qualify for inclusion in the consolidated CET1 Capital of the Financial Group.

**3.13.3** An Authorised Person must determine the amount of minority interests of a Subsidiary that is eligible for inclusion in its consolidated CET1 Capital by subtracting from the minority interests of that Subsidiary the result of multiplying the amount referred to in (a) by the percentage referred to in (b):

- (a) the CET1 Capital of the Subsidiary minus the lesser of the following:
  - (i) the amount of CET1 Capital of that Subsidiary required to meet the sum of the Subsidiary's CET1 Capital requirement (on a solo basis) of 6.0% of its Total Risk Exposure Amount, calculated in accordance with Rule 3.5.7, and its Combined Buffer Requirement; or
  - (ii) the amount of consolidated CET1 Capital that relates to that Subsidiary that is required on a consolidated basis to meet the sum of its Financial Group's CET1 Capital requirement of 6.0% of its Total Risk Exposure Amount, calculated in accordance with Rule 3.5.7, and its Combined Buffer Requirement;
- (b) the minority interests of the Subsidiary expressed as a percentage of all CET1 Capital instruments of that Undertaking plus the related retained earnings and Share premium accounts.

**Qualifying AT1, T1, T2 Capital and qualifying Capital Resources**

**3.13.4** Qualifying AT1, T1, T2 Capital and qualifying Capital Resources must include the minority interest, AT1, T1 or T2 Capital instruments, as applicable, plus the related

retained earnings and Share premium accounts of a Subsidiary only where the following conditions are met:

- (a) the Subsidiary is one of the following:
  - (i) an Authorised Person; or
  - (ii) a regulated entity;
- (b) the Subsidiary is a member of the Financial Group and included in the scope of consolidated supervision in accordance with Chapter 8; and
- (c) those instruments are owned by Persons other than the Undertakings included in the Financial Group.

#### **Qualifying AT1 and T2 Capital issued by a Special Purpose Entity**

**3.13.5** AT1 and T2 Capital instruments issued by an SPE, and the related retained earnings and Share premium accounts, may be included in qualifying AT1 or T2 Capital or qualifying Capital Resources, as applicable, only where the following conditions are met:

- (a) the SPE issuing those instruments is included fully in the Financial Group to which the Authorised Person belongs;
- (b) the instruments, and the related retained earnings and Share premium accounts, are included in qualifying AT1 Capital only where the conditions laid down in Rule 3.11.3(1) are satisfied;
- (c) the instruments, and the related retained earnings and Share premium accounts, are included in qualifying T2 Capital only where the conditions laid down in Rule 3.12.3(1) are satisfied; and
- (d) the only asset of the SPE is its investment in the Capital Resources of any of its Parents or their Subsidiaries, which are included fully in the Financial Group to which the Authorised Person belongs, the form of which satisfies the relevant conditions laid down in Rule 3.11.3(1) or Rule 3.12.3(1), as applicable.

#### **Guidance**

If the Regulator considers the assets of an SPE to be minimal and insignificant for such an entity, the Regulator may consider waiving the condition specified in Rule 3.13.5(d).

#### **Qualifying T1 Capital instruments included in consolidated T1 Capital**

**3.13.6** An Authorised Person must determine the amount of qualifying T1 Capital of a Subsidiary that is included in consolidated T1 Capital of the Authorised Person's

Financial Group by subtracting from the qualifying T1 Capital of that Subsidiary the result of multiplying the amount referred to in (a) by the percentage referred to in (b):

- (a) the lesser of the following:
  - (i) the amount of T1 Capital of that Subsidiary required to meet the sum of the Subsidiary's T1 Capital requirement (on a solo basis) of 8.0% of its Total Risk Exposure Amount, calculated in accordance with Rule 3.5.7, and its Combined Buffer Requirement; or
  - (ii) the amount of consolidated T1 Capital that relates to the Subsidiary that is required on a consolidated basis to meet the sum of its Financial Group's T1 Capital requirement of 8.0% of the Total Risk Exposure Amount, calculated in accordance with Rule 3.5.7, and its Combined Buffer Requirement;
- (b) the qualifying T1 Capital of the Subsidiary expressed as a percentage of all T1 Capital instruments of that Subsidiary plus the related retained earnings and Share premium accounts.

**Qualifying T1 Capital included in consolidated AT1 Capital**

**3.13.7** An Authorised Person must determine the amount of qualifying T1 Capital of a Subsidiary that is included in consolidated AT1 Capital by subtracting from the qualifying T1 Capital of that Subsidiary included in consolidated T1 Capital, the minority interests of that Subsidiary that are included in consolidated CET1 Capital.

**Qualifying Capital Resources included in consolidated Capital Resources**

**3.13.8** An Authorised Person must determine the amount of qualifying Capital Resources of a Subsidiary that is included in consolidated Capital Resources of its Financial Group by subtracting from the qualifying Capital Resources of that Subsidiary, the result of multiplying the amount referred to in (a) by the percentage referred to in (b):

- (a) the lesser of the following:
  - (i) the amount of Capital Resources of the Subsidiary required to meet the sum of the Subsidiary's total Capital Requirement (on a solo basis) of 10.0% of its Total Risk Exposure Amount, calculated in accordance with Rule 3.5.7 and its Combined Buffer Requirement; or
  - (ii) the amount of Capital Resources that relates to the Subsidiary that is required on a consolidated basis to meet the sum of its Financial Group's total Capital Requirement of 10.0% of its Total Risk Exposure Amount, calculated in accordance with Rule 3.5.7, and its Combined Buffer Requirement;

- (b) the qualifying Capital Resources of the Subsidiary, expressed as a percentage of all Capital Resources instruments of the Subsidiary that are included in its CET1, AT1 and T2 Capital items and the related retained earnings and Share premium accounts.

### **Qualifying Capital Resources instruments included in consolidated T2 Capital**

**3.13.9** An Authorised Person must determine the amount of qualifying Capital Resources of a Subsidiary that is included in consolidated T2 Capital by subtracting from the qualifying Capital Resources of that Subsidiary that are included in consolidated Capital Resources, the qualifying T1 Capital of that Subsidiary that is included in consolidated T1 Capital of the Financial Group of the Authorised Person.

### **3.14 Qualifying Holdings outside the financial sector**

**3.14.1** (1) Where an Authorised Person has a Qualifying Holding in an Undertaking which is not one of the following:

- (a) an Undertaking that is a Relevant Entity; or
- (b) an Undertaking that carries on activities that are:
  - (i) a direct extension of banking;
  - (ii) ancillary to banking; or
  - (iii) leasing, factoring, the management of unit trusts, the management of data processing services or any other similar activity,

and the amount of the holding exceeds 15% of the eligible total Capital Resources of the Authorised Person, the Authorised Person must comply with the requirements in (3).

(2) The total amount of the Qualifying Holdings of an Authorised Person in Undertakings other than those referred to in (1) that exceeds 60% of its Capital Resources are subject to the requirements in (3).

(3) An Authorised Person must apply the following requirements to Qualifying Holdings referred to in (1) and (2):

- (a) a risk weight of 1000% to the following:
  - (i) the amount of Qualifying Holdings referred to in (1) in excess of 15% of Capital Resources; and
  - (ii) the total amount of Qualifying Holdings referred to in (2) in excess of 60% of the Capital Resources of the Authorised Person; and

- (b) must not count Qualifying Holdings referred to in (1) and (2) where the amount of those holdings exceeds the percentages of Capital Resources laid down in (1) and (2).
- (4) As an alternative to applying a 1000% risk weight to the amounts in excess of the limits specified in (1) or (2), an Authorised Person may deduct those amounts from CET1 Capital.
- (5) Shares of Undertakings to which (1) or (2) do not apply must not be included in calculating the eligible capital limits specified in (1) where any of the following conditions are met:
  - (a) those Shares are held temporarily during a financial reconstruction or rescue operation;
  - (b) the holding of the Shares is an Underwriting position held for five working days or less; or
  - (c) those Shares are held in the name of the Authorised Person on behalf of others.

### **3.15 Calculation of Capital Resources**

**3.15.1** This Section applies to an Authorised Person in any Category.

**3.15.2** The total of Capital Resources is derived according to the following formula:

$$T1 \text{ Capital} + T2 \text{ Capital} = \text{Capital Resources}$$

where:

- (a) "T1 Capital" represents Tier 1 capital, that being the sum of CET1 Capital and AT1 Capital;
- (b) "CET1 Capital" represents Common Equity Tier 1 capital assessed in accordance with Section 3.10;
- (c) "AT1 Capital" represents Additional Tier 1 capital assessed in accordance with Section 3.11; and
- (d) "T2 Capital" represents Tier 2 capital assessed in accordance with Section 3.12.

**3.15.3** An Authorised Person must calculate its Capital Resources in accordance with the table below and the provisions in Sections 3.9 to 3.12.

(A1) Elements of Common Equity Tier 1 (CET1) Capital
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(A2) Adjustments to/deductions from CET1 Capital
<b>(A3) CET1 Capital = A1 – A2</b>
(A4) Elements of Additional Tier 1 (AT1) Capital
(A5) Deductions from AT1 Capital
<b>(A6) AT1 Capital = A4 – A5</b>
<b>(A7) Tier 1 (T1) Capital = A3 + A6</b>
(A8) Elements of Tier 2 (T2) Capital
(A9) Deductions from T2 Capital
<b>(A10) Tier 2 (T2) Capital = A8 – A9</b>
<b>(A11) Capital Resources = A7 + A10</b>

**3.15.4** The Capital Resources for an Authorised Person to which this section applies is defined as the sum of its CET1 Capital, AT1 Capital and T2 Capital.

**3.16 Adequate Capital Resources for Categories 1, 2, 3A and 5**

**Application**

**3.16.1** This Section applies to an Authorised Person in Category 1, 2, 3A or 5.

**Capital ratios**

**3.16.2** Subject to 3.2.3, an Authorised Person must ensure that it complies with the following requirements at all times:

- (a) The ratio of CET1 Capital to Total Risk Exposure Amount must not be less than 6.0%.
- (b) The ratio of T1 Capital to Total Risk Exposure Amount must not be less than 8.0%.
- (c) The ratio of Capital Resources to Total Risk Exposure Amount must not be less than 10.0%.

**Guidance**

In Rule 3.16.2 CET1 Capital is that calculated at step A3, T1 Capital is that calculated at step A7 and Capital Resources are those calculated at step A11 of Rule 3.15.3.

**3.16.3** The Regulator may impose a further requirement, termed an Individual Capital Requirement (ICR), on an Authorised Person to hold additional Capital Resources arising from Pillar 2 adjustments (see Chapter 10). Where the Authorised Person has an ICR imposed on it, then the Authorised Person must, at all times, maintain adequate Capital Resources of the type and amount as specified in Rule 10.6.1 in addition to those kept to meet the capital adequacy requirements outlined in Rule 3.2.2.

**3.17 Capital Conservation Buffer**

**3.17.1** This Section applies to an Authorised Person in Category 1, 2, ~~3A~~ or 5.

**3.17.2** Where, pursuant to Section 3.4, the Risk Capital Requirement forms the Capital Requirement of an Authorised Person, then that Authorised Person is subject to a Capital Conservation Buffer requirement.

**3.17.3** The Capital Conservation Buffer requirement is equivalent to 2.5% of the Total Risk Exposure Amount of an Authorised Person and must comprise only CET1 Capital.

- 3.17.4** (1) An Authorised Person must maintain the required buffer amount, calculated in accordance with Rule 3.17.3, at all times.
- (2) The Capital Conservation Buffer requirement applies on both a solo and a consolidated basis, for Authorised Persons forming part of Financial Groups.

**3.17.5** An Authorised Person must not use CET1 Capital that is kept to meet the Capital Conservation Buffer requirement towards meeting:

- (a) ~~the firm's Risk Capital Requirement~~ the capital ratios specified in Rule 3.16.2;  
or
- (b) any Individual Capital Requirement as may be imposed pursuant to Chapter 10.

**3.18 Countercyclical Capital Buffer**

**3.18.1** This Section applies to an Authorised Person in Category 1, 2 or 5.

**3.18.2** Where, pursuant to Section 3.4, the Risk Capital Requirement forms the Capital Requirement of an Authorised Person, then it is subject to a Countercyclical Capital Buffer requirement.

**3.18.3** (1) An Authorised Person must maintain the required buffer amount as CET1 Capital at all times, as calculated in accordance with Rule 3.18.4.

(2) The Countercyclical Capital Buffer requirement applies on both a solo and a consolidated basis, for Authorised Persons forming part of Financial Groups.

**3.18.4** An Authorised Person must maintain a Countercyclical Capital Buffer of CET1 Capital calculated by multiplying its Total Risk Exposure Amount, calculated in accordance with Rule 3.5.7, by the weighted average of the Countercyclical Capital Buffer rates, calculated in accordance with Rules 3.18.5 to 3.18.8.

**Relevant credit risk exposures**

**3.18.5** Relevant credit risk exposures are those for which Credit RWAs have to be calculated in accordance with Chapter 4, other than those that fall into the following asset classes:

- (a) Central government and central bank.
- (b) Public sector enterprises.
- (c) Multilateral development bank (MDB).
- (d) International organisation.
- (e) Bank.

**Guidance**

Exposures to banks with short-term credit assessments are not relevant credit risk exposures as they fall within the exempt asset class set out in Rule 3.18.5(e). However, exposures to non-bank entities with similar short-term credit assessments are relevant credit risk exposures for the purposes of Rule 3.18.5.

**Weighted average of the Countercyclical Capital Buffer rates**

**3.18.6** The weighted average of the Countercyclical Capital Buffer rates shall be calculated by:

- (a) for each jurisdiction in which the Authorised Person has relevant credit risk exposures, dividing the Total Risk Exposure Amount that relates to the relevant credit risk exposures in that jurisdiction by the Total Risk Exposure

Amount that relates to the Authorised Person's relevant credit risk exposures across all jurisdictions and multiplying it by the applicable Countercyclical Capital Buffer rate in that jurisdiction; and

- (b) summing those contributions across all jurisdictions.

**Geographical location**

- 3.18.7** For the purposes of the calculation of the institution-specific Countercyclical Capital Buffer rate an Authorised Person must identify, to the best of its ability, the geographical location of its relevant credit risk exposures as the jurisdiction where the underlying credit risk ultimately originates.

**Countercyclical Capital Buffer rates**

- 3.18.8** (1) For a relevant credit risk exposure located in ADGM or the UAE:

(a) the Countercyclical Capital Buffer rate is the rate set by the Central Bank from time to time, subject to a maximum rate of 2.5%; and

(b) any increase in the Countercyclical Capital Buffer rate specified by the Central Bank takes effect from the date specified by the Central Bank.

- (2) For a relevant credit risk exposure located in a third country:

(a) the Countercyclical Capital Buffer rate is:

(i) the rate set by the authority responsible for setting the Countercyclical Capital Buffer rate in that third country from time to time; or

(ii) 2.5% where the rate set by the third country rate setting authority exceeds 2.5%; or

(i) the rate set by the Central Bank where it sets a rate for a relevant credit exposure in the third country that exceeds that set by the third-country rate-setting authority, up to a maximum of 2.5%; or

(iv) zero where the third country rate setting authority has not set a Countercyclical Capital Buffer rate for that jurisdiction and the Central Bank does not specify such a rate; and

(b) any increase in the applicable Countercyclical Capital Buffer rate shall take effect from the date specified by the third country rate setting authority or the Central Bank, as appropriate;

- (3) Subject to (2)(a)(ii) and (iii) above for a relevant credit exposure in a third country, where a Countercyclical Capital Buffer rate for a jurisdiction is reduced that reduction shall take effect immediately.

**Guidance**

An example of the calculation of the Countercyclical Capital Buffer follows, for an Authorised Person with Total Risk Exposure Amount for relevant credit risk exposures in countries A, B and C of 60, 25 and 15 respectively, where the applicable Countercyclical Capital Buffer rates are 2.0%, 1.0% and 1.5% respectively, and Total Risk Exposure Amount across all three countries of 200.

	Rule(s)	A	B	C	Total
Countercyclical Capital Buffer rate - applicable	3.18.8	2.0%	1.0%	1.5%	
Total Risk Exposure Amount - relevant credit risk exposures	3.18.5 and 3.18.7	60	25	15	100
Countercyclical Capital Buffer rate - weighted	3.18.6	1.20%	0.25%	0.225%	1.675%
Total Risk Exposure Amount	3.5.7(i)	100	60	40	200
<b>Countercyclical Capital Buffer</b>	<b>3.18.4</b>				<b>3.35</b>

**3.18.9** Countercyclical Capital Buffer rates shall apply from the later of:

- (a) the date set by the Central Bank or the third country rate-setting authority;  
or
- (b) 1 July 2018.

**3.19** **Combined Buffer**

**3.19.1** The Combined Buffer is the sum of the Capital Conservation Buffer and the Countercyclical Capital Buffer.

**3.19.2** An Authorised Person must not use CET1 Capital that is held to meet the Combined Buffer Requirement towards meeting:

- (a) the capital ratios specified in Rule 3.16.2;
- (b) any Individual Capital Requirement that may be imposed pursuant to Chapter 10; or
- (c) any other buffer, where applicable.

**Guidance**

Where an Authorised Person does not hold sufficient dedicated CET1 Capital to meet the Combined Buffer Requirement it will be required to undertake remedial action in order to restore the level of CET1 Capital to the required level.

**Restrictions on distributions**

**3.19.3** Where an Authorised Person fails to meet the Combined Buffer Requirement, it must:

- (a) calculate the maximum distributable amount in accordance with Rule 3.19.6; and
- (b) ensure that it does not undertake any of the following actions until such time as it has calculated the maximum distributable amount and notified the Regulator under Rule 3.19.7:
  - (i) make a distribution in connection with CET1 Capital, or create an obligation to pay variable remuneration or discretionary pension benefits, or pay variable remuneration if the obligation to pay was created at a time when the institution failed to meet its Combined Buffer Requirement; or
  - (ii) make payments on AT1 and T2 Capital instruments.

**3.19.4** An Authorised Person must:

- (a) in subsequently taking any of the actions described in Rule 3.19.3(b)(i) and (ii), after having calculated the maximum distributable amount and notified the Regulator, ensure that it distributes no more than its calculated maximum distributable amount; and
- (b) prepare and submit a capital conservation plan pursuant to Rule 3.19.9.

**3.19.5** For the purposes of Rule 3.19.3(b)(i), a distribution in connection with CET1 Capital includes any of the following:

- (a) payment of cash dividends;
- (b) distribution of fully or partly paid bonus Shares or other capital instruments;
- (c) a redemption or purchase by an institution of its own Shares or other capital instruments;
- (d) a repayment of amounts paid up in connection with capital; or
- (e) a distribution of other items referred to in Section 3.10 as eligible for inclusion as CET1 Capital.

**3.19.6** (1) In this Section, a reference to a "maximum distributable amount" means the maximum amount that an Authorised Person may distribute in connection with CET1 Capital as specified in Rules 3.19.3 and 3.19.4.

(2) Subject to sub-paragraph (4), an Authorised Person must determine the maximum distributable amount by multiplying the sum specified in (a) by the factor determined under (b):

- (a) the total of interim or year-end profits that were not included in CET1 Capital pursuant to Rule 3.10.2 and which have accrued after

the most recent distribution of profits and after any of the actions referred to in Rule 3.19.3(b);

(b) where the CET1 Capital of the Authorised Person, which is not used to meet the capital ratios specified in Rule 3.16.2 plus any Individual Capital Requirement as may be imposed pursuant to Chapter 10, falls:

(i) within the first quartile of the Combined Buffer Requirement, the factor shall be 0;

(ii) within the second quartile of the Combined Buffer Requirement, the factor shall be 0.2;

(iii) within the third quartile of the Combined Buffer Requirement, the factor shall be 0.4;

(iv) within the fourth quartile of the Combined Buffer Requirement, the factor shall be 0.6.

(3) An Authorised Person must calculate the lower and upper bounds of each quartile of the Combined Buffer requirement as follows:

Lower bound of quartile = (Combined Buffer Requirement / 4) x (Q<sub>n</sub> - 1);  
and

Upper bound of quartile = (Combined Buffer Requirement / 4) x Q<sub>n</sub>,

where Q<sub>n</sub> indicates the ordinal number of the quartile concerned.

(4) If an Authorised Person undertakes any action under Rule 3.19.3(b), it must take that into account and reduce the maximum distributable amount accordingly.

### **Guidance**

The expression of both CET1 Capital and the Combined Buffer Requirement above is in absolute terms rather than as a percentage of the Total Risk Exposure Amount.

**3.19.7** For the purpose of Rule 3.19.3(b), where an Authorised Person intends to distribute any of its distributable profits or intends to undertake an action referred to in Rule 3.19.3(b)(i) or (ii), the Authorised Person must notify the Regulator and provide the following information:

(a) the amount of capital maintained by the Authorised Person, subdivided as follows:

(i) CET1 Capital;

- (ii) AT1 Capital; and
  - (iii) T2 Capital;
- (b) the amount of its interim and year-end profits;
- (c) the maximum distributable amount calculated in accordance with Rule 3.19.6; and
- (d) the amount of distributable profits it intends to allocate between the following:
  - (i) dividend payments;
  - (ii) Share buybacks;
  - (iii) payments on AT1 Capital instruments; and
  - (iv) the payment of variable remuneration or discretionary pension benefits, whether by creation of a new obligation to pay, or by payment pursuant to an obligation to pay created at a time when the institution failed to meet its Combined Buffer Requirement.

### **Guidance**

Upon receiving a notification under this Rule, the Regulator will make an assessment of the firm's ability to meet and maintain its Capital Requirement on a sustainable basis going forward.

- 3.19.8** An Authorised Person must maintain systems and processes to ensure that the amount of distributable profits and the maximum distributable amount are calculated accurately, and must be able to demonstrate the accuracy of the calculations to the Regulator on request.

### **Capital conservation plan**

- 3.19.9** Where an Authorised Person fails to meet the Combined Buffer Requirement, it must prepare a capital conservation plan and submit it to the Regulator no later than five business days after it identified its failure to meet the Combined Buffer Requirement. The capital conservation plan must include the following:
- (a) estimates of income and expenditure and a forecast balance sheet;
  - (b) measures to increase the CET1 Capital of the Authorised Person;
  - (c) a plan and timeframe for the increase of CET1 Capital with the objective of restoring the Combined Buffer; and

- (d) any other information the Regulator might need in order to carry out its considerations referred to in Rule 3.19.10 effectively.

**3.19.10** (1) Following assessment, the Regulator will approve the capital conservation plan only if it considers that the plan, if implemented, would be reasonably likely to conserve or raise sufficient CET1 Capital to enable the Authorised Person to meet its Combined Buffer Requirement, within a period that the Regulator considers appropriate.

- (2) If the Regulator does not approve the capital conservation plan, the Regulator may require the Authorised Person to increase its CET1 Capital to meet the Combined Buffer Requirement, within a specified period of time. The Regulator may also impose more stringent restrictions on distributions than those imposed under Rule 3.19.3 where the capital conservation plan is not approved.

### **Guidance**

Where the Risk Capital Requirement forms the Capital Requirement of an Authorised Person in Category 1, 2, or 5 it should therefore hold sufficient total Capital Resources of the quality required to meet the following requirements:

- a. the capital ratios specified in Rule 3.16.2;
- b. any Individual Capital Requirement as may be imposed pursuant to Chapter 10;
- c. the Combined Buffer; and
- c. any other buffer, where applicable.

## **3.20 Adequate Capital Resources For Categories 3B, 3C and 4**

**3.20.1** This Section applies to an Authorised Person in Category 3B, 3C or 4.

### **Guidance**

1. Pursuant to Section 3.6 an Authorised Person in Category 3B, 3C or 4 should hold sufficient total Capital Resources of the quality required to meet its Capital Requirement, whether that is the Base Capital Requirement or the Expenditure Based Capital Minimum.
2. The Capital Resources should comprise a minimum of CET1 Capital equal to the relevant Base Capital Requirement for the Category to which the Authorised Person belongs.

## Notifications to the Regulator

- 3.20.2** An Authorised Person in Category 3B, 3C or 4 must notify the Regulator immediately and confirm in writing if its Capital Resources fall below 120% of its Capital Requirement.

## PART 5 - Leverage

### 3.21 The Leverage Ratio

- 3.21.1** This Part applies to an Authorised Person in Category 1, 2 or 5.

#### Guidance

1. This Section is relevant to an Authorised Person that is required to report its Leverage Ratio to the Regulator under Chapter 2, or to disclose its Leverage Ratio under ~~App 11~~ Chapter 11.
2. The purpose of the Leverage Ratio is to provide a simple, transparent, non-risk-based methodology to act as a supplementary measure of risk, alongside the risk-based capital requirements applicable in ADGM.
3. "Leverage", in this context, means the relative size of (a) an institution's assets, off-balance sheet obligations and contingent obligations to pay or to deliver or to provide collateral, including obligations from received funding, made commitments, derivatives or repurchase agreements, but excluding obligations which can only be enforced during the liquidation of an institution; compared to (b) that institution's own funds.

- 3.21.2** An Authorised Person must calculate its Leverage Ratio in accordance with the following methodology:

$$\text{Leverage Ratio} = \text{Capital Measure} \div \text{Exposure Measure}$$

where:

- (a) "Capital Measure" represents the Tier 1 Capital of the Authorised Person calculated in accordance with Rule 3.9.1; and
- (b) "Exposure Measure" represents the value of Exposures of the Authorised Person calculated in accordance with Rules 3.21.5 and 3.21.6.

- 3.21.3** An Authorised Person must hold sufficient Tier 1 Capital to maintain, at all times, a minimum Leverage Ratio of 3% or as otherwise set by the Regulator.

- 3.21.4** An Authorised Person must notify the Regulator immediately in writing if, at any time, it does not hold, or is likely not to hold, an amount and quality of capital that is necessary to comply with Rule 3.21.3.

**Guidance**

Institutions shall calculate the Leverage Ratio as the simple arithmetic mean of the monthly leverage ratios over a quarter, or using a more frequent basis for the calculation if that is in line with their internal practices.

**3.21.5** For the purpose of determining the Exposure Measure, the value of Exposures of an Authorised Person must be calculated in accordance with the International Financial Reporting Standards (IFRS) subject to the following adjustments:

- (a) on-balance sheet, non-Derivative Exposures must be net of specific allowances and valuation adjustments (e.g. credit valuation adjustments);
- (b) physical or financial Collateral, guarantees or other credit risk mitigation techniques must not be used to reduce exposure values of assets; and
- (c) loans must not be netted with Deposits.

**Guidance**

~~1. The following Guidance is intended to illustrate how an Authorised Person should calculate its Leverage Ratio in accordance with this section.~~

~~2. The Exposure Measure under Rule 3.18.3 should be calculated as the sum of:~~

- ~~a. on-balance sheet items; and~~
- ~~b. off-balance sheet items.~~

~~3. In relation to on-balance sheet items:~~

- ~~a. for SFTs, the Exposure value should be calculated in accordance with IFRS and the Netting requirements referred to in Rule 4.9.14;~~
- ~~b. for Derivatives, including credit protection sold, the Exposure value should be calculated as the sum of the on-balance sheet value in accordance with IFRS and an add-on for potential future Exposure calculated in accordance with Rules A4.6.14 to A4.6.21 of App 4; and~~
- ~~c. for other on-balance sheet items, the Exposure value should be calculated based on their balance sheet values in accordance with Rule 4.9.3.~~

~~4. In relation to off-balance sheet items:~~

- ~~a. for commitments that are unconditionally cancellable at any time by the Authorised Person without prior notice, the Exposure value~~

~~should be the notional amount for the item multiplied by a CCF of 10%; and~~

~~b. for other off-balance sheet items, including:~~

~~i. direct credit substitutes;~~

~~ii. certain transaction-related contingent items;~~

~~iii. short-term self-liquidating trade-related contingent items and commitments to underwrite debt and equity Securities;~~

~~iv. note issuance facilities and revolving Underwriting facilities;~~

~~v. transactions, other than SFTs, involving the posting of Securities held by the Authorised Person as Collateral;~~

~~vi. asset sales with recourse, where the Credit Risk remains with the Authorised Person;~~

~~vii. other commitments with certain drawdown;~~

~~viii. any other commitments; and~~

~~ix. Unsettled Transactions,~~

~~the Exposure value should be the notional amount for each of the items multiplied by a CCF of 100%.~~

~~5. For an Islamic Financial Institution, assets corresponding to Unrestricted PSiAs will fall within the Exposure Measure and, therefore, are relevant to the Leverage Ratio calculation.~~

**3.21.6** The Exposure Measure under Rule 3.21.2(b) must be calculated as the sum of:

(a) on-balance sheet items; and

(b) off-balance sheet items.

(i) In relation to on-balance sheet items:

a. for SFTs, the Exposure value should be calculated in accordance with IFRS and the Netting requirements referred to in Rule 4.9.14;

b. for Derivatives, including written credit protection, the Exposure value should be calculated as the sum of the on-balance sheet value in accordance with IFRS and an add-on for potential future Exposure calculated in accordance with Rules A4.6.14 to A4.6.21 of App 4; and

- c. for other on-balance sheet items, the Exposure value should be calculated based on their balance sheet values in accordance with Rule 4.9.3.
- (ii) In relation to off-balance sheet items:
- a. for commitments that are unconditionally cancellable at any time by the Authorised Person without prior notice, the Exposure value should be the notional amount for the item multiplied by a CCF of 10%;
- b. for short-term self-liquidating trade letters of credit arising from the movement of goods (e.g. documentary credits collateralised by the underlying shipment), the Exposure value should be the notional amount for the item multiplied by a CCF of 20% in relation to both issuing and confirming banks;
- c. for certain transaction-related contingent items (e.g. performance bonds, bid bonds, warranties, and standby letters of credit related to particular transactions) the Exposure value should be the notional amount for the item multiplied by a CCF of 50%;
- d. for note issuance facilities and revolving underwriting facilities, the Exposure value should be the notional amount for the item multiplied by a CCF of 50%;
- e. for other off-balance sheet items, including:
- i. direct credit substitutes;
- ii. forward asset purchases, forward deposits and partly paid shares and securities which represent commitments with certain drawdown; and
- iii. transactions, other than SFTs, involving the posting of Securities held by the Authorised Person as Collateral;
- iv. the Exposure value should be the notional amount for each of the items multiplied by a CCF of 100%; and
- f. where an Authorised Person has an undertaking to provide a commitment on an off-balance sheet item, an Authorised Person should apply the lower of the two applicable CCFs.
- (iii) For an Islamic Financial Institution, assets corresponding to Unrestricted PSIA's will fall within the Exposure Measure and are therefore relevant to the Leverage Ratio calculation.

## 4 CREDIT RISK

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### 4.11 Credit Quality Grades and External Credit Assessments

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**4.11.1** ~~As~~ Where possible, an Authorised Person must assign a CR Exposure to a Credit Quality Grade based on the external credit assessment that is applicable to the CR Exposure in accordance with tables mapping the ratings from an ECAI recognised by the Regulator to Credit Quality Grades, ~~which will be~~ published by the Regulator.

**4.11.2** CR Exposures with external credit assessments from external credit rating agencies that are not recognised by the Regulator in the tables mapping the ratings to the Credit Quality Grades must be assigned to the Credit Quality Grade associated with "unrated" Exposures.

**4.11.3** An Authorised Person must only use an external credit assessment which is accessible to the public. An Authorised Person may not use a credit assessment that is made available only to the parties to a transaction.

**4.11.4** An Authorised Person must only use external credit assessments by a recognised ECAI ~~for the purposes of mapping the ratings from that ECAI to Credit Quality Grades.~~ The Regulator may impose conditions on the use of such external credit assessments.

...

**4.11.8** Where a CR Exposure is risk-weighted in accordance with Rules 4.11.67(a) or (b), an Authorised Person may use a domestic currency external credit assessment only if the CR Exposure is denominated in that domestic currency.

...

### 4.12 Risk weights

**4.12.1** An Authorised Person with a CR Exposure must:

...

- (c) for a CR Exposure arising from an Unsettled Transaction, determine the ~~applicable risk weight~~ Credit RWA in accordance with Rules A4.6.5 to A4.6.8.

...

**Exposures associated with particularly high risks**

**4.12.19** An Authorised Person must apply a risk weight of 150% to Exposures, including Exposures in the form of Shares or Units in a Collective Investment Fund, that are associated with particularly high risks.

...

**Collateral**

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**4.13.5** (1) For an Authorised Person using the FCSA, eligible financial Collateral comprises:

...

## 6 OPERATIONAL RISK

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### 6.1 Application

#### 6.1.1 This Chapter applies to an Authorised Person as follows:

...

- (c) Section 6.12 applies only to an Authorised Person in Category 3B, 3C or 4 which undertakes one or more of the following Regulated Activities:

...

~~(xiii) — Administering a Specified Benchmark;~~

~~(xiv) — Operating a Credit Rating Agency;~~

...

~~(xvi) — Operating a Representative Office;~~

~~(xvii) — Providing Information in Relation to a Specified Benchmark; or~~

...

## 7 INTEREST RATE RISK IN THE NON-TRADING BOOK

...

### 7.4 Systems and controls for Non-Trading Book interest rate risk

#### Non-Trading Book interest rate risk policy

...

##### Guidance

...

4. Authorised Persons should measure their vulnerability to loss in stressed market conditions, including the breakdown of key assumptions, and consider those results when establishing and reviewing their policies and limits for interest rate risk. Possible stress scenarios for this exercise should include:

...

- c. changes in the relationships between key market rates (i.e. basis risk), e.g.
  - i. a surge in term and savings Deposit rates and benchmark rates ~~like LIBOR~~ but no change in the prime rate, and
  - ii. a drop in the prime rate but no change in term and savings Deposit rates and benchmark rates ~~like LIBOR~~;

...

##### Guidance

...

3. An Authorised Person should establish and enforce operating limits and other practices that maintain Exposures within levels consistent with their internal policies and that accord with their approach to measuring the risk. In particular, Authorised Persons should set a limit on the extent to which floating rate Exposures are funded by fixed rate sources and vice versa to limit the risk. In floating rate lending, Authorised Persons should limit the extent to which they run any basis risk that may arise if lending and funding are not based on precisely the same market interest rate ~~(e.g. LIBOR).~~

## **8 GROUP RISK**

...

### **Restrictions on Category 3A, 3B, 3C and 4 Authorised Persons**

- 8.5.2 (1) An Authorised Person in Category 3A, 3B, 3C or 4 must not, subject to (2), be a Parent of an entity that:

## 9 LIQUIDITY RISK

...

### 9.1 Application

9.1.1 (1) This Chapter applies to an Authorised Person in Category 1, 2, 3A or 5.

(2) Only Rule 9.2.2(3) applies to an Authorised Person in Category 2 or 3A.

...

### 9.2.2

...

#### Requirements imposed on a firm in Category 2 ~~firm~~ or 3A

(3) An Authorised Person in Category 2 or 3A must:

...

Part of the guidance under Rule 9.3.4 is to be converted to a Rule and the subsequent Rules in Section 9.3 renumbered.

#### Liquidity Coverage Ratio

9.3.4 An Authorised Person must, except as provided in Rule 9.3.8~~7~~ maintain an LCR of at least the level specified in the table below from the date specified in the table.

##### Minimum LCR levels:

Date	1 October 2015	1 January 2016	1 January 2017	1 January 2018	1 January 2019
Minimum LCR	60%	70%	80%	90%	100%

#### Guidance

~~Under Rule 9.3.4 an Authorised Person must maintain a minimum LCR level of 60% starting on 1 October 2015.~~ The minimum requirement increases subsequently in LCR level will increase each following year to full phase until it is fully phased-in of the LCR Requirement on 1 January 2019. Rule 9.3.4 sets

minimum levels and is not intended to limit the generality of the requirement in Rule 9.3.3.

~~An Authorised Person must calculate its LCR using the following formula and in accordance with the Rules in section A9.2 of App9.~~

~~$LCR = \text{Value of stock of HQLA} / \text{Total Net Cash Outflows over the next 30 calendar days}$~~

**9.3.5** An Authorised Person must calculate its LCR using the following formula and in accordance with the Rules in section A9A10.2 of App910.

$LCR = \text{Value of stock of HQLA} / \text{Total Net Cash Outflows over the next 30 calendar days.}$

...

**9.3.6** (1)The Regulator may by written notice to an Authorised Person in relation to the LCR Requirement applying to it:

...

~~(3) If the Regulator decides to exercise its power under (1)(a),(b),(c) or (e), the Authorised Person may refer the matter to the FMT for review.~~

...

## 11 DISCLOSURE REQUIREMENTS

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### 11.3 Disclosure frequency, locations and process

#### Frequency

- 11.3.1 (1) The disclosures set out in this Chapter must be made by the Authorised Person at least once a year, other than disclosures of CET1 Capital, T1 Capital and T2 Capital ~~and~~ deductions from Capital Resources, the Leverage Ratio and its components (the capital measure and the exposure measure), and the Liquidity Coverage Ratio and its components which must be made on a quarterly basis.

...

**APP1 CATEGORIES OF AUTHORISED PERSONS**

**A1.1 Categorisation of Authorised Persons**

...

Some Regulated Activities currently falling under Category 4 will be removed.

Category 1	Category 2	Category 3A	Category 3B	Category 3C	Category 4	Category 5
Accepting Deposits	Providing Credit	Dealing in Investments as Principal (only as a Matched Principal)	Providing Custody (only if for a Fund)	Managing a Collective Investment Fund	Arranging Credit	An Islamic Financial Institution Managing a Profit Sharing Investment Account which is a PSIAu
Managing a Profit Sharing Investment Account which is a PSIAu	Dealing in Investments as Principal (not as Matched Principal)	Dealing in Investments as Agent	Acting as the Trustee of an Investment Trust	Managing Assets	Arranging Deals in Investments	
				Managing a Profit Sharing Investment Account which is a PSIAr	Advising on Investments or Credit	
				Providing Custody other than for a Fund	Arranging Custody	
				Providing Trust Services as a trustee of an express trust	Insurance Intermediation	
				Providing Money Services	Insurance Management	
					Acting as the Administrator of a Collective Investment Fund	
					Operating a Multilateral Trading Facility or Organised Trading Facility	
					Providing Trust Services other than as a trustee of an express trust	

## APP2 GENERAL REQUIREMENTS

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### A2.4 Reporting to the Regulator

**A2.4.1** ~~Forms~~ The forms to be used by Authorised Persons for the purpose of reporting under these Rules are set out in ~~the FOR module~~ EPRS.

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**APP3 CAPITAL AND LEVERAGE**

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**A3.2 Capital Requirements**

**Guidance**

1. This table summarises the capital requirement that Authorised Persons are subject to. An Authorised Person must hold sufficient minimum capital resources to meet the Capital Requirement.

<b>Capital Requirements</b>				
<b>Category</b>	<-----maximum of----->			
	<b>Base Capital Requirement (USD)</b>	<b>Expenditure based capital minimum</b>		<b>Risk Capital Requirement</b>
		<b>Holding Client Assets or Insurance Money?</b>		
		<b>No</b>	<b>Yes</b>	
<b><u>1</u></b>	<u>10mn</u>			<u>Credit, Market, Operational (plus, where appropriate, Displaced Commercial)</u>
<b><u>2</u></b>	<u>2mn</u>	<u>13/52nds of Annual Expenditure</u>	<u>18/52nds of Annual Expenditure</u>	<u>Credit, Market, Operational</u>
<b><u>3A</u></b>	<u>500k</u>			<u>Credit, Market, Operational</u>
<b><u>3B</u></b>	<u>4mn</u>			
<b><u>3C</u></b>	<u>250k</u> <u>(i) 150k for a Public Fund or one available to retail customers or</u> <u>(ii) 50k otherwise</u>			
<b><u>4</u></b>	<u>10k</u>	<u>6/52nds of Annual Expenditure</u>		
<b><u>5</u></b>	<u>10mn</u>			<u>Credit, Market, Operational and Displaced Commercial</u>

2. All Authorised Persons, whichever Category they are a member of, must hold a minimum amount of CET1 Capital at the time that they obtain authorisation and at all times thereafter, in accordance with Rule 3.3.3.

3. Where the Risk Capital Requirement is the binding capital requirement for an Authorised Persons in Categories 1, 2 and 5 it must also hold a Capital Conservation Buffer of CET1 Capital of 2.5% of the Total Risk Exposure Amount and, where applicable, a Countercyclical Capital Buffer of CET1 Capital to be determined in accordance with Section 3.18.
  
4. Authorised Persons in Category 4 are only permitted to hold Insurance Monies.

**APP4 CREDIT RISK**

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**Calculation of E\* for collateralised transactions other than OTC Derivative transactions and long settlement transactions**

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**A4.3.6** An Authorised Person using standard supervisory haircuts or own-estimate haircuts under the FCCA must calculate E\* for any collateralised transaction not covered by a qualifying bilateral Netting agreement or a qualifying cross-product Netting agreement other than OTC Derivative transactions or long settlement transactions, using the following formula:

$$E^* = \max \{0, [E \text{ (or EAD)}](1 + HE) - C(1 - HC - HFX)]\}$$

...

**A4.6 Credit RWA - Unsettled Transactions, Free Deliveries and OTC Derivatives**

**Guidance**

...

4. In cases of a system-wide failure of a settlement or clearing system, an Authorised Person need not calculate CRCOM on transactions remaining unsettled till the settlement or clearing system is brought back to normal operations.

...

**A4.6.4** CRW is applied in accordance with Section A4.3 except that the maximum CPW counterparty weighting for an OTC Derivative is 50%.

**Unsettled Transactions**

**A4.6.5** An Authorised Person must calculate the Credit RWA for transactions in which debt instruments, equities, foreign currencies and commodities (excluding repos, reverse repos and Securities or commodities lending/borrowing) remain unsettled after their due delivery dates, using the following formula:

Credit RWA on Unsettled Transactions = E x the appropriate percentage from the second column in the table below:

...

~~**A4.6.8** An Authorised Person must determine E for an unsettled non-DvP transaction as equal to the outstanding receivables after the end of the first contractual payment or delivery date.~~

## Guidance

- 1.—E is the price difference to which the Authorised Person is exposed, being the difference between the agreed settlement price for the debt instrument, equity, foreign currency or commodity in question and its current market value, where the difference could involve a loss for the firm.
- ~~2.— In cases of a system wide failure of a settlement or clearing system, an Authorised Person need not calculate CRCOM on transactions remaining unsettled till the settlement or clearing system is brought back to normal operations.~~
- ~~3.— In respect of unsettled non-DvP transactions referred to in Rule A4.6.8, if the dates when two payment legs are made are the same according to the time zones where each payment is made, they are deemed to have been settled on the same day.~~

## Free delivery transactions

~~A4.6.9~~ The CRW for transactions in which an Authorised Person has:

- ~~(a) delivered Securities or commodities before receiving payment;~~
- ~~(b) paid for Securities or commodities before receiving the items purchased;~~  
~~or~~
- ~~(c) entered into a foreign exchange contract undertaken in the spot market or contracted for forward settlement and has released funds to its Counterparty but has not yet received the funds in the other currency;~~

~~is calculated by the formula:~~

~~Credit RWA on free deliveries = E x CRW x the multiplier from the table below:~~

<del>Number of business days since delivery</del>	<del>Multiplier used for calculation of Credit RWA on free deliveries</del>
<del>0-15</del>	<del>1</del>
<del>16-30</del>	<del>5</del>
<del>31-45</del>	<del>7.5</del>
<del>46 or more</del>	<del>10</del>

~~A4.6.10~~ If an Authorised Person has delivered commodities or Securities to a Counterparty and has not received payment:  $E = CV$  due to the Authorised Person.

~~A4.6.11~~ If an Authorised Person has made payment to a Counterparty for commodities or Securities and has not received them:  $E = MV$  of the commodities or Securities.

~~A4.6.12~~ If the settlement of the transaction is to be effected across a national border, Credit RWA needs to be calculated only when more than one business day has elapsed since the firm has made the relevant payment or delivery.

~~A4.6.13~~ In the case of a Non-Trading Book item, an Authorised Person must treat an Exposure in accordance with the relevant provisions of Chapter 4.

A4.6.8 An Authorised Person must calculate the Credit RWA in accordance with the table in Rule A4.6.11 for free delivery transactions in both the Trading and Non-Trading Book where it has:

- (a) delivered Securities or commodities before receiving payment;
- (b) paid for Securities or commodities before receiving the items purchased; or
- (c) entered into a foreign exchange contract undertaken in the spot market or contracted for forward settlement and has released funds to its Counterparty but has not yet received the funds in the other currency.

A4.6.9 If the settlement of the transaction is to be effected across a national border, Credit RWA needs to be calculated only when more than one business day has elapsed since the firm has made the relevant payment or delivery.

### Guidance

In respect of free delivery transactions referred to in Rule A4.6.9, if the dates when two payment legs are made are the same according to the time zones where each payment is made, they are deemed to have been settled on the same day.

A4.6.10 For a free delivery transaction an Authorised Person must determine its exposure  $E$  after the end of the first contractual payment or delivery date as follows:

- (a) if an Authorised Person has delivered Securities or Commodities or foreign exchange funds to a Counterparty and has not received payment:

$$E = CV \text{ due to the Authorised Person}$$

- (b) if an Authorised Person has made payment of CV to a Counterparty for commodities or Securities and has not received them:

$$E = CV - MV \text{ of the Securities, commodities or foreign exchange funds due to it}$$

**A4.6.11** The Credit RWA in respect of free delivery transactions are to be calculated in accordance with the following table:

<u>Transaction stage</u>	<u>Treatment</u>
<u>Up to first contractual payment or delivery leg</u>	<u>No calculation required</u>
<u>From first contractual payment or delivery leg up to four business days after second contractual payment or delivery leg</u>	<u>Treat as an exposure</u>
<u>From five business days post contractual payment or delivery leg until extinction of the transaction</u>	<u>Treat as an exposure with a risk-weight of 1000%</u>

**A4.6.12** An Authorised Person must treat an Exposure in accordance with the relevant provisions of Chapter 4.

**A4.6.13** If the Authorised Person considers the total amount of the exposures resulting from free delivery transactions to be immaterial it may apply a risk weight of 100% to these exposures, except where a risk weight of 1000% is applied in accordance with Rule A4.6.11.

Existing Rules A4.6.14 to A4.6.23 (struck through) are to be replaced in their entirety by new Rules A4.6.14 to A4.6.58 (underlined).

### **Financial Derivatives**

~~**A4.6.14** For the purposes of calculating Credit RWA, a financial Derivative includes, but is not limited to OTC Derivatives and Credit Derivatives. Exposures dealt with under this Section do not include Exposures to central counterparties which qualify for a zero Exposure value.~~

~~**A4.6.15** For OTC Derivative transactions: Credit RWA = CEA x CRW.~~

~~Where:~~

~~(a) contracts traded on exchanges, where they are subject to daily margining requirements, are excluded; and~~

~~(b) CEA is calculated using the formula:~~

~~CEA = the replacement cost of the OTC Derivative contract (obtained by marking to market) (in the case of a transaction with negative replacement cost, a value of zero) + PFCE.~~

### **Guidance**

Details of how to net the PFCE are given in Rule A4.6.22.

~~A4.6.16 (1) — In case of Credit Derivatives including but not limited to Total Return Swaps and credit default swaps, an Authorised Person must determine its PFCE by multiplying the nominal amount of the instrument by the following percentages:~~

~~(a) — 5% where the reference obligation of the Credit Derivative is one that if it gave rise to a direct Exposure of the Authorised Person would be a qualifying reference obligation; or~~

~~(b) — 10% where the reference obligation is one that if it gave rise to a direct Exposure of the Authorised Person would not be a qualifying reference obligation.~~

~~(2) — For the purposes of this Rule, a "qualifying reference obligation" means any Security that is issued by any MDB, any Security (including one issued by a PSE) that has a Credit Quality Grade of 3 or better as set out in Section 4.12 based on the external credit assessment of at least one recognised external credit rating agency, and any unrated Security issued by a PSE which belongs to a country with a Credit Quality Grade of 1 as set out in Section 4.12.~~

~~A4.6.17 — In the case of credit default swaps, an Authorised Person which is a seller of credit protection may assign a PFCE of 0%, unless the protection is subject to close-out on the insolvency of the buyer.~~

~~A4.6.18 — In cases where a Credit Derivative provides protection in relation to "nth to default" amongst a number of underlying obligations, an Authorised Person must apply a percentage in accordance with Rule A4.6.16 applicable to the obligation with the nth lowest credit quality determined by whether it is one that if incurred by the Authorised Person would be a qualifying reference obligation for the purposes of Rule A4.6.16(1)(a).~~

#### **Guidance**

~~Where the Credit Derivative is a first to default transaction, the appropriate percentage for the PFCE will be determined by the lowest credit quality of the underlying obligations in the basket. If there are non-qualifying items in the basket, the percentage applicable to the non-qualifying reference obligations should be used. For second and any subsequent default transactions, underlying assets should continue to be allocated according to credit quality: i.e. for a second to default transaction, the applicable percentage figure is the percentage applicable to the second lowest credit quality.~~

~~A4.6.19 — For OTC Derivative transactions other than Credit Derivatives, PFCE is calculated by multiplying the NP of the contract by the appropriate percentage from the table below.~~

Type of contract		Residual maturity of contract		
		<1 Year	1-5 Years	>5 Years
Single currency interest rate basis swaps		0.0%	0.0%	0.0%
Interest rate	Single currency interest rate swaps other than basis swaps Multiple currency basis swaps Forward rate agreements Interest rate Futures Interest rate Options purchased Derivatives referenced on an Investment Grade debt Item Other contracts of a similar nature to those in this box.	0.0%	0.5%	1.5%
Foreign exchange (including gold) except as referred to in A4.6.20	Cross-currency interest rate swaps. Forward foreign exchange contracts. Currency Futures. Currency Options purchased. Other contracts of a similar nature to those in this box, including gold.	1.0%	5.0%	7.5%
Equities	Cash settled forward contracts Contracts of a nature similar to those in the interest rate and foreign exchange boxes. Derivatives referenced on a bond which is not an Investment Grade debt Item.	6.0%	8.0%	10.0%

Type of contract		Residual maturity of contract		
		<1 Year	1-5 Years	>5 Years
Precious metals (except gold)	Contracts of a nature similar to those in the interest rate and foreign exchange boxes concerning precious metals, except gold.	7.0%	7.0%	8.0%
Commodities (except precious metals) and any other contracts	Contracts of a nature similar to those in the interest rate or foreign exchange boxes concerning commodities other than precious metals.	10.0%	12.0%	15.0%

~~A4.6.20~~ If the contract is an OTC foreign exchange contract (not including gold) with an Original Maturity of 14 days or less: CEA = 0.

~~A4.6.21~~ Where a contract price is based upon more than one underlying instrument, the higher of the relevant PFCE multipliers must be used.

#### Netting of PFCE

##### Guidance

An Authorised Person may calculate the PFCE arising under OTC Derivative contracts on a net basis.

~~A4.6.22~~ Where the conditions in in Sections 4.13 are met, an Authorised Person may calculate its net PFCE on OTC Derivative contracts using the following formula:

~~PFCE reduced = 0.4 x PFCE gross + 0.6 x NGR x PFCE gross where:~~

- ~~(a) "PFCE reduced" is the reduced figure for PFCE for all contracts with a given Counterparty included in the Netting agreement;~~
- ~~(b) "PFCE gross" is the sum of the figures for PFCE for all contracts with a given Counterparty which are included in the Netting agreement; and~~
- ~~(c) "NGR" is the net to gross ratio, being the quotient of the net replacement cost for all contracts included in the Netting agreement with a given Counterparty (numerator) and the gross replacement cost for all contracts included in the Netting agreement with that Counterparty (denominator).~~

~~A4.6.23~~ For the purposes of Rule A4.6.19, the applicable maturity date must be the maturity of the longest date.

**Derivatives – Standardised Approach to Counterparty Credit Risk (SA-CCR)**

A4.6.14 The exposure at default (EAD) of derivative transactions (OTC and exchange-traded) and long settlement transactions must be calculated in accordance with this Section unless the Authorised Person has been granted permission by the Regulator to use an internal model.

A4.6.15 EAD is to be calculated separately for each netting set. It is determined as follows:

$$EAD = \alpha * (RC + PFE)$$

where:

$$\alpha = 1.4$$

RC = the replacement cost according to Rules A4.6.19 to A4.6.24

PFE = the amount for potential future exposure calculated according to Rule A4.6.26

A4.6.16 The replacement cost (RC) and the potential future exposure (PFE) components must be calculated differently for margined and unmargined netting sets. The EAD for a margined netting set is to be capped at the EAD of the same netting set calculated on an unmargined basis.

**Netting Sets**

A4.6.17 An Authorised Person may net transactions subject to any legally valid form of bilateral netting which results in legal substitution of one single payable/receivable amount for previous gross obligations.

A4.6.18 In every case in which netting is applied, the Authorised Person must demonstrate to the Regulator that it has the following in place:

(a) A netting contract with the counterparty or other agreement which creates a single legal obligation, covering all included transactions, such that the Authorised Person would have either a claim to receive or obligation to pay only the net sum of the positive and negative mark-to-market values of included individual transactions in the event a counterparty fails to perform due to any of the following:

(i) default,

(ii) bankruptcy,

(iii) liquidation, or

- (iv) similar circumstances.
- (b) Written and reasoned legal reviews that, in the event of a legal challenge, the relevant courts and administrative authorities would find the exposure of the Authorised Person to be such a net amount under:
  - (i) The law of the jurisdiction in which the counterparty is chartered and, if the foreign branch of a counterparty is involved, then also under the law of the jurisdiction in which the branch is located;
  - (ii) The law that governs the individual transactions; and
  - (iii) The law that governs any contract or agreement necessary to effect the netting.
- (c) Procedures to ensure that the legal characteristics of netting arrangements are kept under review in light of the possible changes in relevant law.

#### **Calculation of RC for unmargined transactions**

**A4.6.19** An unmargined transaction is a transaction in which variation margin is not exchanged. Collateral other than variation margin may be present.

**A4.6.20** RC for unmargined transactions is calculated in accordance with the following formula:

$$RC = \max\{V - C; 0\}$$

where:

V = the value of the derivative transactions in the netting set (constituted in accordance with Rule A4.6.18); and

C = the haircut value of the net collateral held, calculated in accordance with Section A4.3.

**A4.6.21** Derivative contracts with a one-way margining agreement in favour of the Authorised Person's counterparty must be treated as unmargined transactions.

#### **Net Independent Collateral Amount**

**A4.6.22** The independent collateral amount (ICA) is (i) collateral (other than variation margin) posted by the counterparty that is available to the Authorised Person on default of the counterparty; and/or (ii) the Independent Amount parameter as defined in standard industry documentation.

**A4.6.23** The net independent collateral amount (NICA) is any ICA posted by the counterparty less unsegregated collateral posted by the Authorised Person.

**Calculation of RC for margined transactions**

**A4.6.24** RC for margined transactions is calculated in accordance with the following formula:

$$RC = \max\{V - C; TH + MTA - NICA; 0\}$$

where:

V = the value of the derivative transactions in the netting set (constituted in accordance with Rule A4.6.18);

C = the haircut value of the net collateral held, calculated in accordance with Section A4.3;

TH = the positive threshold before the counterparty is required to send the Authorised Person collateral;

MTA = the minimum transfer amount applicable to the counterparty;

NICA = the net independent collateral amount.

**Guidance**

TH + MTA – NICA represents the largest exposure that would not trigger a variation margin call. For example, without initial margin, the greatest exposure that would not trigger a variation call is the threshold plus any minimum transfer amount.

**Potential Future Exposure**

**A4.6.25** The PFE consists of (i) an aggregate add-on component, which consists of add-ons calculated for each asset class and (ii) a multiplier that allows for the recognition of excess collateral or negative mark-to-market value for the transactions.

**A4.6.26** PFE is calculated as follows:

$$PFE = multiplier * AddOn^{aggregate}$$

where:

AddOn<sup>aggregate</sup> = the aggregate add-on component; and

multiplier = a function of three inputs (V, C and AddOn<sup>aggregate</sup>), calculated in accordance with Rule A4.6.27.

**A4.6.27** The multiplier input is calculated in accordance with the following formula:

$$multiplier = \min \left\{ 1; Floor + (1 - Floor) * \exp \left( \frac{V - C}{2^{*(1 - Floor)} * AddOn^{aggregate}} \right) \right\}$$

where:

exp(...) = the exponential function;

Floor = 5%;

V = the value of the derivative transactions in the netting set; and

C = the haircut value of the net collateral held, calculated in accordance with Section A4.3.

**General steps for calculating the add-on**

**A4.6.28** For each transaction, the Authorised Person must identify the primary risk factor or factors and attribute the transaction to one or more of the five asset classes: interest rate, foreign exchange, credit, equity or commodity.

**A4.6.29** The Authorised Person must determine the add-on for each asset class in accordance with the asset-class-specific formulae set out in A4.6.35 – A4.6.58.

**Guidance**

Most derivative transactions have one primary risk driver, defined by the reference underlying instrument (e.g. an interest rate curve for an interest rate swap, a reference entity for a credit default swap, a foreign exchange rate for an FX call option etc.).

**Formulae and parameters common to all asset classes**

**A4.6.30** The following formulae and adjustments are used in the determination of the add-ons for all asset classes.

**Supervisory delta adjustment:  $\delta_i$**

**A4.6.31** The Authorised Person must include the following supervisory delta adjustments in the calculation of the relevant add-on where relevant.

$\delta_i$	<u>Long in the primary risk factor</u>	<u>Short in the primary risk factor</u>
<u>Instruments that are not options or CDO tranches</u>	<u>+1</u>	<u>-1</u>

$\delta_i$	<u>Bought</u>	<u>Sold</u>
<u>Call options</u>	$+\Phi\left(\frac{\ln(P_i/K_i) + 0.5*\sigma_i^2 * T_i}{\sigma_i * \sqrt{T_i}}\right)$	$-\Phi\left(\frac{\ln(P_i/K_i) + 0.5*\sigma_i^2 * T_i}{\sigma_i * \sqrt{T_i}}\right)$

Put options	$-\Phi\left(-\frac{\ln(P_i/K_i) + 0.5\sigma_i^2 * T_i}{\sigma_i * \sqrt{T_i}}\right)$	$+\Phi\left(-\frac{\ln(P_i/K_i) + 0.5\sigma_i^2 * T_i}{\sigma_i * \sqrt{T_i}}\right)$
<p><u>With the following parameters:</u></p> <p><u>P<sub>i</sub> = underlying price (spot, forward, average etc.)</u></p> <p><u>K<sub>i</sub> = strike price</u></p> <p><u>T<sub>i</sub> = latest contractual exercise date of the option</u></p> <p><u>The supervisory volatility σ<sub>i</sub> of an option is specified on the basis of the supervisory factor applicable to the trade in accordance with the table set out in A4.6.34</u></p>		

<u>δ<sub>i</sub></u>	<u>Purchased (long protection)</u>	<u>Sold (short protection)</u>
<u>CDO tranches</u>	$+\frac{15}{(1 + 14*A_i) * (1 + 14*D_i)}$	$-\frac{15}{(1 + 14*A_i) * (1 + 14*D_i)}$
<p><u>With the following parameters:</u></p> <p><u>A<sub>i</sub> = attachment point of the CDO tranche</u></p> <p><u>D<sub>i</sub> = detachment point of the CDO tranche</u></p>		

### **Guidance**

"Long in the primary risk factor" means that the market value of the instrument increases, whereas "short in the primary risk factor" means that the market value of the instrument decreases when the value of the primary risk factor increases. The symbol Φ in these equations represents the standard normal cumulative distribution function.

### **Time risk horizons – unmargined transactions**

**A4.6.32** The Authorised Person must calculate the maturity factor (MF<sub>i</sub>) of unmargined transactions in accordance with the following formula:

$$MF_i^{(unmargined)} = \sqrt{\frac{\min(M_i; 1 \text{ year})}{1 \text{ year}}}$$

where M<sub>i</sub> is the remaining maturity of transaction i, floored at 10 business days.

**Guidance**

The formula requires that the minimum time risk horizon for unmargined transactions is the lesser of one year and the remaining maturity of the derivative contract, floored at 10 business days.

**Time risk horizons – margined transactions**

**A4.6.33** The Authorised Person must calculate the  $MF_i$  of margined transactions in accordance with the following formula:

$$MF_i^{(margined)} = \frac{3}{2} \sqrt{\frac{MPOR_i}{1 \text{ year}}}$$

The appropriate margin period of risk ( $MPOR_i$ ) is determined in accordance with the following table:

<u>Transaction Type</u>	<u>Minimum Margin Period of Risk (MPOR<sub>i</sub>)</u>
<u>Non-centrally-cleared derivative transactions subject to daily margin agreements</u>	<u>10 business days</u>
<u>Centrally cleared derivative transactions subject to daily margin agreements</u>	<u>5 business days</u>
<u>Netting sets consisting of 5,000 or more transactions that are not with a central counterparty</u>	<u>20 business days</u>
<u>Netting sets with outstanding disputes</u>	<u>Double the MPOR<sub>i</sub> for the relevant category of transaction</u>

**Supervisory factors, correlation and supervisory option volatilities**

**A4.6.34** Supervisory factors are specific to each asset class. The Authorised Person must refer to the table below to determine the supervisory factor relevant to their determination of the add-on for their particular asset class in accordance with the asset-class-specific formulae set out in Rules A4.6.35 to A4.6.58.

<u>Asset Class</u>	<u>Subclass</u>	<u>Supervisory factor (SF)</u>	<u>Correlation (<math>\rho</math>)</u>	<u>Supervisory option volatility (<math>\sigma</math>)</u>
<u>Interest rate</u>		<b><u>0.50%</u></b>	<u>N/A</u>	<u>50%</u>
<u>Foreign exchange</u>		<b><u>4.0%</u></b>	<u>N/A</u>	<u>15%</u>
<u>Credit, single name</u>	<u>AAA</u>	<b><u>0.38%</u></b>	<u>50%</u>	<u>100%</u>
	<u>AA</u>	<b><u>0.38%</u></b>	<u>50%</u>	<u>100%</u>
	<u>A</u>	<b><u>0.42%</u></b>	<u>50%</u>	<u>100%</u>
	<u>BBB</u>	<b><u>0.54%</u></b>	<u>50%</u>	<u>100%</u>
	<u>BB</u>	<b><u>1.06%</u></b>	<u>50%</u>	<u>100%</u>
	<u>B</u>	<b><u>1.6%</u></b>	<u>50%</u>	<u>100%</u>
	<u>CCC</u>	<b><u>6.0%</u></b>	<u>50%</u>	<u>100%</u>
<u>Credit, index</u>	<u>Investment Grade</u>	<b><u>0.38%</u></b>	<u>80%</u>	<u>80%</u>
<u>Equities</u>	<u>Speculative Grade</u>	<b><u>1.06%</u></b>	<u>80%</u>	<u>80%</u>
<u>Equity, single name</u>		<b><u>32%</u></b>	<u>50%</u>	<u>120%</u>
<u>Equity, index</u>		<b><u>20%</u></b>	<u>80%</u>	<u>75%</u>
<u>Commodity</u>	<u>Electricity</u>	<b><u>40%</u></b>	<u>40%</u>	<u>150%</u>
	<u>Oil/Gas</u>	<b><u>18%</u></b>	<u>40%</u>	<u>70%</u>
	<u>Metals</u>	<b><u>18%</u></b>	<u>40%</u>	<u>70%</u>
	<u>Agricultural</u>	<b><u>18%</u></b>	<u>40%</u>	<u>70%</u>
	<u>Other</u>	<b><u>18%</u></b>	<u>40%</u>	<u>70%</u>

**Trade level adjusted notional – interest rate and credit derivatives**

**A4.6.35** For interest rate and credit derivatives, the trade-level adjusted notional is the product of the trade notional amount, converted to the domestic currency, and the supervisory duration (SD<sub>i</sub>):

$$\text{Trade-level adjusted notional} = \text{Trade notional amount} * SD_i$$

**A4.6.36** SD<sub>i</sub> is determined in accordance with the following formula:

$$SD_i = \frac{\exp(-0.05 * S_i) - \exp(-0.05 * E_i)}{0.05}$$

where S<sub>i</sub> and E<sub>i</sub> are the start and end dates, respectively, of the time period referenced by the interest rate or credit derivative, floored by ten business days.

**Add-on for interest rate derivatives**

**A4.6.37** The add-on for interest rate derivatives is the sum of the add-ons for each hedging set of interest rate derivatives transacted with a counterparty in a netting set.

**A4.6.38** Interest rate derivatives consist of a separate hedging set for each currency. Interest rate derivatives are divided into three time 'buckets' as follows: less than one year, between one and five years and more than five years.

**A4.6.39** The add-on for a hedging set of interest rate derivatives is calculated in two steps:

**Step 1**

**A4.6.40** The effective notional is calculated in accordance with the following formula:

$$D_{jk}^{(IR)} = \sum_{i \in (Ccy_j, MB_k)} \delta_i * d_i^{(IR)} * MF_i^{(type)}$$

where:

i ∈ (Ccy<sub>j</sub>, MB<sub>k</sub>) refers to trades of currency *j* that belong to maturity bucket *k*.

**Guidance**

The effect of this formula is that the effective notional for each time bucket and currency is the sum of the trade-level adjusted notional amounts multiplied by the supervisory delta adjustments and the maturity factor.

**Step 2**

**A4.6.41** The Authorised Person must aggregate across maturity buckets for each hedging set in accordance with the following formula:

$$EffectiveNotional_j^{(IR)} = \left[ (D_{j1}^{(IR)})^2 + (D_{j2}^{(IR)})^2 + (D_{j3}^{(IR)})^2 + 1.4 * D_{j1}^{(IR)} * D_{j2}^{(IR)} + 1.4 * D_{j2}^{(IR)} * D_{j3}^{(IR)} + 0.6 * D_{j1}^{(IR)} * D_{j3}^{(IR)} \right]^{\frac{1}{2}}$$

**A4.6.42** The Authorised Person must then determine the hedging set level add-on in accordance with the following formula:

$$AddOn_j^{(IR)} = SF_j^{(IR)\wedge} * EffectiveNotional_j^{(IR)}$$

**A4.6.43** The Authorised Person must then aggregate the interest rate derivative add-on across hedging sets by simple summation, as follows:

$$AddOn^{(IR)} = \sum_j AddOn_j^{(IR)}$$

**Add-on for credit derivatives**

**A4.6.44** All credit derivatives referencing the same entity may be offset fully to form an entity-level effective notional amount:

$$EffectiveNotional_k^{(Credit)} = \sum_{i \in Entity_k} \delta_i * d_i^{(Credit)} * MF_i^{(type)}$$

where  $i \in Entity_k$  refers to trades of entity k.

**Guidance**

The effect of this formula is that the effective notional for each entity is the sum of the trade-level adjusted notional amounts multiplied by the supervisory delta adjustments and the maturity factor.

**A4.6.45** The add-on for all positions referencing the entity is determined in accordance with the following formula:

$$AddOn(Entity_k) = SF_k^{(Credit)} * EffectiveNotional_k^{(Credit)}$$

where  $SF_k$  is the supervisory factor for the credit asset class, determined in accordance with the table set out in A4.6.36.

**A4.6.46** The cumulative add-on for the credit derivatives hedging set is determined in accordance with the following formula:

$$AddOn^{(Credit)} = \left[ \left( \sum_k \rho_k^{(Credit)} * AddOn(Entity_k) \right)^2 + \sum_k (1 - (\rho_k^{(Credit)})^2) * (AddOn(Entity_k))^2 \right]^{\frac{1}{2}}$$

where  $\rho_k^{(\text{credit})}$  is the appropriate correlation factor corresponding to the entity  $k$ , determined in accordance with the table set out in A4.6.36.

**Trade level adjusted notional – foreign exchange derivatives**

**A4.6.47** The adjusted notional of foreign exchange derivatives is defined as the notional of the foreign currency leg of the contract, converted to the domestic currency.

**Guidance**

If both legs of the foreign exchange derivative are denominated in currencies other than the domestic currency, the notional amount of each leg is converted to the domestic currency and the leg with the larger domestic currency value is the adjusted notional amount.

**Add-on for foreign exchange derivatives**

**A4.6.48** The effective notional for foreign exchange derivatives is calculated in accordance with the following formula:

$$EffectiveNotional_j^{(FX)} = \sum_{i \in HS_j} \delta_i * d_i^{(FX)} * MF_i^{(type)}$$

where  $i \in HS_j$  refers to trades of hedging set  $HS_j$

**Guidance**

The effective notional for each currency pair, given by the above formula, is the sum of the trade-level adjusted notional amounts multiplied by the supervisory delta adjustments and the maturity factor.

**A4.6.49** The Authorised Person must calculate the hedging set level add-on in accordance with the following formula:

$$AddOn_{HS_j}^{(FX)} = SF_j^{(FX)} * |EffectiveNotional_j^{(FX)}|$$

**A4.6.50** The Authorised Person must then aggregate the foreign exchange derivative add-on across hedging sets by simple summation, as follows:

$$AddOn^{(FX)} = \sum_j AddOn_{HS_j}^{(FX)}$$

**Trade level adjusted notional – equity and commodity derivatives**

**A4.6.51** For equity and commodity derivatives, the adjusted notional is defined as the product of the current price of one unit of the stock or commodity and the number of units referenced by the trade.

**Add-on for equity derivatives**

**A4.6.52** The Authorised Person must determine the effective notional value of an equity derivative transaction referenced to an entity in accordance with the following formula:

$$EffectiveNotional_k^{(Equity)} = \sum_{i \in Entity_k} \delta_i * d_i^{(Equity)} * MF_i^{(type)}$$

where  $i \in Entity_k$  refers to trades of entity k.

**Guidance**

The effective notional for each entity, calculated in accordance with the above formula, is the sum of the trade-level adjusted notional amounts multiplied by the supervisory delta adjustments and the maturity factor.

**A4.6.53** The Authorised Person must calculate the add-on for all positions referencing entity k and its effective notional in accordance with the following formula:

$$AddOn(Entity_k) = SF_k^{(Equity)} * EffectiveNotional_k^{(Equity)}$$

**A4.6.54** The Authorised Person must calculate the add-on for the hedging set in accordance with the following formula:

$$AddOn^{(Equity)} = \left[ \left( \sum_k \rho_k^{(Equity)} \wedge * AddOn(Entity_k) \right)^2 + \sum_k (1 - (\rho_k^{(Equity)})^2) * (AddOn(Entity_k))^2 \right]^{\frac{1}{2}}$$

where  $\rho_k^{(equity)}$  is the appropriate correlation factor corresponding to the entity k, determined in accordance with the table set out in A4.6.34.

**Add-on for commodity derivatives**

**A4.6.55** The Authorised Person must determine the effective notional value of a commodity derivative transaction in a commodity of a particular type listed in A4.6.34 in accordance with the following formula:

$$EffectiveNotional_k^{(Com)} = \sum_{i \in Type_k^j} \delta_i * d_i^{(Com)} * MF_i^{(type)}$$

where  $i \in Type_k^j$  refers to trades of commodity type k in hedging set j.

**Guidance**

The effective notional for each commodity derivative, calculated in accordance with the above formula, is the sum of the trade-level adjusted notional amounts multiplied by the supervisory delta adjustments and the maturity factor.

**A4.6.56** The Authorised Person must determine the add-on for all commodity derivatives of commodity type k in accordance with the following formula:

$$AddOn(Type_k^j) = SF_{Type_k^j}^{(Com)} * EffectiveNotional_k^{(Com)}$$

**A4.6.57** The Authorised Person must determine the add-on for its commodity hedging set in accordance with the following formula:

$$AddOn_{HS_j}^{(Com)} = \left[ \left( \rho_j^{(Com)} * \sum_k AddOn(Type_k^j) \right)^2 + (1 - (\rho_j^{(Com)})^2) * \sum_k (AddOn(Type_k^j))^2 \right]^{\frac{1}{2}}$$

where  $\rho_j^{(Com)}$  is the appropriate correlation factor, determined in accordance with the table in A4.6.34, for the hedging set j.

**A4.6.58** The Authorised Person must determine the add-on for its commodity asset class in accordance with the following formula:

$$AddOn^{(Com)} = \sum_j AddOn_{HS_j}^{(Com)}$$

**A4.7 Credit RWA - repurchase agreements, reverse repurchase agreements, similar transactions and other deferred settlements**

...

**A4.7.10** For deferred settlement purchases and sales transactions with a contractual settlement date after the spot period as set out above but less than T + five business days:

~~**A4.7.11** — Credit RWA for deferred settlement transactions = E x CRW.~~

**A4.7.11** Not currently in use.

**A4.7.12** For deferred settlement purchases and sales transactions with a contractual settlement date exceeding T + five business days: ~~Credit RWA for deferred settlement transactions = E x CRW x the appropriate multiplier from the table below:~~

Credit RWA = E x CRW x the appropriate percentage from the table below:

Number of business days calculated from T	Percentages used for calculation of <del>CRCOM</del> Credit RWA on deferred settlement transactions
6 - 30	5 500%

Number of business days calculated from T	Percentages used for calculation of <del>CRCOM</del> Credit RWA on deferred settlement transactions
31 - 45	7.5 750%
46 or more	10 1000%

...

The following text in Section A4.9 is all revised and replaces the existing text.

#### **A4.9 Exposures to central counterparties**

**A4.9.1** This Section applies to exposures arising from Derivatives, SFTs and/or long settlement transactions that are cleared by a central counterparty (CCP). Exposures arising from the settlement of cash transactions (equities, fixed income, spot FX and spot commodities) are not subject to this Section.

**A4.9.2** Authorised Persons must:

- (a) monitor all their exposures to CCPs; and must have adequate procedures for the regular reporting of information on those exposures to senior management and appropriate committee or committees of the management body; and
- (b) must assess, through appropriate scenario analysis and stress testing, whether the level of capital held by the Authorised Person against exposures to a CCP is adequate.

#### **Guidance**

The assessment under Rule A4.9.2(b) must cover the inherent risks of exposures to the CCP, including potential future credit exposures, exposures from default fund contributions and, where the Authorised Person is acting as a clearing member of the CCP, exposures resulting from contractual arrangements providing for commitments to take over or replace offsetting transactions from clients of another clearing member, in case such other clearing member defaults or becomes insolvent.

#### **Trade Exposure of a clearing member to a qualifying central counterparty**

**A4.9.3** Where an Authorised Person acts as a clearing member, either for its own purposes or as an intermediary between a client and a qualifying central counterparty (QCCP), it must calculate Credit RWA in respect of its Trade Exposure to the QCCP in accordance with A4.6.14, except that it must apply a CRW of 2%, unless Rule A4.9.4 applies.

**A4.9.4** Where an Authorised Person is acting as an intermediary between a client and a QCCP and the terms of the QCCP-related transaction stipulate that the Authorised Person is not obligated to reimburse the client for any losses suffered due to changes in the value of that transaction in the event that the QCCP defaults, it may apply a CRW of 0% when calculating Credit RWA in respect of its Trade Exposure to the QCCP.

**Trade Exposure of a clearing member to a Non-QCCP**

**A4.9.5** Where an Authorised Person acts as a clearing member, either for its own purposes or as an intermediary between a client and a Non-QCCP, it must calculate Credit RWA in respect of its Trade Exposure to the Non-QCCP in accordance with A4.6.14 and apply an appropriate CRW for the corporate asset class of the Non-QCCP as set out in Rule 4.12.13.

**Trade Exposure of a clearing member to a client**

**A4.9.6** Where an Authorised Person acts as a clearing member, and in that capacity, acts as an intermediary between a client and a CCP, it must calculate Credit RWA in respect of its Trade Exposure to the client in accordance with Section A4.1.6 together with Section A5 and relevant provisions of Rule 4.13 in respect of any Collateral posted by the client, if applicable.

**Trade Exposure of a client to a clearing member**

**A4.9.7** Where an Authorised Person is a client of a clearing member, and enters into a transaction with the clearing member acting as an intermediary between the Authorised Person and a CCP, it must calculate Credit RWA in respect of its Trade Exposure to the clearing member as if it were a Trade Exposure to a QCCP provided all the conditions in Rule A4.9.8 are satisfied.

**A4.9.8** For the purposes of Rule A4.9.7 above, the following conditions must be met:

- (a)** the clearing member's offsetting transaction with a QCCP is identified by the QCCP as a client transaction and collateral to support it is held by the QCCP and/or the clearing member, as applicable, under arrangements that would prevent any losses to the Authorised Person due to: (i) the default or insolvency of the clearing member, (ii) the default or insolvency of the clearing member's other clients; and (iii) the joint default or insolvency of the clearing member and any of its other clients;
- (b)** the Authorised Person has conducted sufficient legal review (and undertaken such further review as necessary to ensure continuing enforceability) that concludes that, in the event of legal challenge, the relevant courts and administrative authorities would find that the Authorised Person would bear no losses on account of the insolvency of its clearing member or of any of its clearing member's clients under the relevant laws of the relevant jurisdiction(s); and

(c) laws, regulations, rules, contractual or administrative arrangements applicable to or binding the Authorised Person or the QCCP facilitate the transfer of the Authorised Person's position relating to that contract and transaction and of the corresponding collateral to another clearing member within the applicable margin period of risk in the event of default or insolvency of the original clearing member. In such a circumstance, the Authorised Person's position and the collateral must be transferred at market value unless the client requests to close out the position at market value.

**A4.9.9** Where an Authorised Person is a client of the clearing member and the conditions set out in Rule A4.9.8 are not satisfied, the Authorised Person must capitalise its exposure to the clearing member as a bilateral OTC transaction in accordance with A4.6.14.

**A4.9.10** Without prejudice to Rule A4.9.9, where an Authorised Person that is a client is not protected from losses where the clearing member and another client of the clearing member jointly default, but all the other conditions set out in Rule A4.9.8 are met, it must calculate Credit RWA in respect of its exposure to the clearing member in accordance with A4.6.14, except that it must apply a CRW of 4%.

#### **Trade Exposures in an indirect clearing arrangement**

**A4.9.11** Where an Authorised Person that is a client accesses the services of a CCP through indirect clearing arrangements (where, for example it is a client of a clearing member's client), it may calculate Credit RWA in respect of its exposure to its intermediary in accordance with Rules A4.9.7 to A4.9.8, provided that the conditions set out in Rule A4.9.8 are satisfied at every level of the chain of intermediaries.

#### **Treatment of posted collateral**

**A4.9.12** Any collateral posted pursuant to transactions covered by Rules A4.9.3 to A4.9.11 must, from the perspective of the Authorised Person posting such collateral, receive the CRWs that otherwise apply to such assets or collateral, regardless of the fact that such collateral has been posted as collateral as part of a clearing arrangement.

**A4.9.13** Where collateral of a clearing member or client is posted with a QCCP or a clearing member, the Authorised Person posting such collateral must also recognise credit risk arising as a result of the collateral being exposed to risk of loss based on the creditworthiness of the entity holding such collateral according to the following Rules:

(a) Where the entity holding such collateral is the QCCP, a CRW of 2% applies to collateral posted in relation to Trade Exposures. The relevant CRW of the QCCP will apply to collateral posted for other purposes. Where the Authorised Person uses the SA-CCR to calculate exposures, collateral

posted which is not held in a bankruptcy remote manner must be accounted for in the NICA term in accordance with A4.6.14. Where the Authorised Person uses an IMM Model in accordance with A4.6.14, the alpha multiplier must be applied to the exposure on posted collateral.

- (b) All collateral posted by the clearing member (including cash, securities, other pledged assets and excess initial or variation margin) that is held by a custodian and is bankruptcy remote from the QCCP, is not subject to a capital requirement for Counterparty Credit Risk exposure to such bankruptcy remote custodian (i.e. the related CRW is 0%).
- (c) Collateral posted by a client, that is held by a custodian, and is bankruptcy remote from the QCCP, the clearing member and other clients, is not subject to a capital requirement for Counterparty Credit Risk. If the collateral is held at the QCCP on a client's behalf and is not held on a bankruptcy remote basis, a 2% risk-weight must apply to the collateral if the conditions in Rule A4.9.9 are met; or 4% if the conditions in Rule A4.9.10 are met.

The treatments set out in Rule A4.9.13 are summarised in the table below.

<u>Collateral</u>		<u>Bankruptcy remote</u>	<u>Conditions</u>	<u>Risk weight</u>
<u>posted by</u>	<u>held by</u>			
<u>Clearing member</u>	<u>QCCP</u>	<u>No</u>		<u>2%</u>
<u>Client</u>	<u>Clearing member</u>	<u>No</u>		<u>CRW of QCCP</u>
<u>Clearing member</u>	<u>Custodian</u>	<u>Yes</u>		<u>0%</u>
<u>Client</u>	<u>Custodian</u>	<u>Yes</u>		<u>0%</u>
	<u>QCCP</u>	<u>Yes</u>	<u>PRU A4.9.8</u>	<u>2%</u>
	<u>QCCP</u>	<u>No</u>	<u>PRU A4.9.10</u>	<u>4%</u>

**Calculation of Credit RWA in relation to prefunded contributions to the default fund of a QCCP**

**A4.9.14** An Authorised Person acting as a clearing member must apply the following treatment to its exposures arising from its contributions to a default fund maintained by a QCCP:

- (a) it must calculate the Credit RWA for its prefunded contributions to the default fund of a QCCP in accordance with the approach set out in Rules A4.9.15 to A4.9.17; or
- (b) it must calculate the Credit RWA for its contributions to the default fund of a Non-QCCP in accordance with the approach set out in Rule A4.9.18.

**Prefunded contributions to the default fund of a QCCP**

**A4.9.15** An Authorised Person as a clearing member must calculate its Credit RWA for its prefunded contributions to the default fund of a QCCP in accordance with the steps set out in Rules A4.9.16 and A4.9.17 below.

**A4.9.16** An Authorised Person must first calculate the hypothetical capital requirement of the QCCP (KCCP) due to its counterparty credit risk exposures to all of its clearing members and their clients in accordance with the following formula:

$$K_{CCP} = \sum_{CM_i} EAD_i - RW - capital\ ratio$$

where:

RW = a risk weight of 20%;

Capital ratio = 10%;

EAD<sub>i</sub> = the exposure amount of the QCCP to clearing member i, including both the clearing member's own transactions and client transactions guaranteed by the clearing member, and all values of collateral held by the QCCP held over all clearing member accounts (including the clearing member's prefunded default fund contribution) against these transactions, relating to the valuation at the end of the regulatory reporting date before the margin called on the final margin call of that day is exchanged.

**Guidance**

- Where clearing members provide client clearing services, and client transactions and collateral are held in separate sub-accounts to the clearing member's proprietary business, each such client sub-account should enter the sum separately, i.e. the member EAD in the formula above is then the sum of the client sub-account EADs and any house sub-account EAD. This will ensure that client collateral cannot be used to offset the QCCP's exposures to clearing members' proprietary activity in the calculation of KCCP. If any of these sub-accounts contains both derivatives and SFTs, the EAD of that sub-account is the sum of the derivative EAD and the SFT EAD.

If the default fund contributions of the member (DF<sub>i</sub>) are not split with regard to client and house sub-accounts, they must be allocated per sub-account according to the respective fraction the initial margin of that sub-account has in relation to the total initial margin posted by or for the account of the clearing member.

(2) For derivatives, EAD<sub>i</sub> is calculated as the bilateral trade exposure the QCCP has against clearing member *i* using the approach in Rule A4.6.14. All collateral held by a QCCP to which that QCCP has a legal claim in the event of default of a member or client, including default fund contributions of that member (DF<sub>i</sub>), is used to offset the QCCP's exposure to that member or client, through inclusion in the potential future exposure multiplier in accordance with Rule A4.6.14.

(3) For SFTs, EAD is equal to max(EBRM<sub>i</sub> – IM<sub>i</sub> – DF<sub>i</sub>; 0), where:

a. EBRM<sub>i</sub> denotes the exposure value to clearing member *i* before risk mitigation. For the purposes of this calculation, variation margin that has been exchanged (before the margin called on the final margin call of that day) enters into the mark-to-market value of the transactions;

b. IM<sub>i</sub> is the initial margin collateral posted by clearing member *i* with the QCCP;

c. DF<sub>i</sub> is the prefunded default fund contribution by clearing member *i* that will be applied upon such clearing member's default, either along with or immediately following such member's initial margin, to reduce the QCCP loss.

**A4.9.17** An Authorised Person must next calculate the capital requirement for each clearing member in accordance with the following formula:

$$K_{CM_i} = \max \left( K_{CCP} \cdot \left( \frac{DF_i^{pref}}{DF_{CCP} + DF_{CM}^{pref}} \right); 10\% * 2\% * DF_i^{pref} \right)$$

where:

K<sub>CM<sub>i</sub></sub> = the capital requirement on the default fund contribution of clearing member "*i*";

DF<sub>CM</sub><sup>pref</sup> = the total prefunded default fund contributions from clearing members;

DF<sub>CCP</sub> = the CCP's prefunded own resources (e.g. contributed capital, retained earnings, etc.), which are contributed to the default waterfall, where these are junior or pari passu to prefunded member contributions; and

DF<sub>i</sub><sup>pref</sup> = the prefunded default fund contributions provided by clearing member *i*.

**Guidance**

1. If the Regulator is not provided with a calculation of  $K_{CCP}$ ,  $DFCM^{pref}$  and  $DF_{CCP}$  or if the Regulator is not able to confirm those calculations, the treatment set out in Rule A4.9.18 shall apply to the calculation made by the relevant Authorised Person to the default fund of a QCCP.
2.  $K_{CCP}$  should be calculated on a quarterly basis at a minimum, although the Regulator may require more frequent calculations in case of material changes (such as the QCCP clearing a new product). If the Authorised Person or Regulator performed the calculations, it should make available to any other Authorised Person which acts as a clearing member sufficient aggregate information about the composition of the QCCP's exposures to clearing members and information provided to the Authorised Person for the purposes of the calculation of  $K_{CCP}$ ,  $DFCM^{pref}$  and  $DF_{CCP}$ .
3. Such information should be provided at least on a quarterly basis.  $K_{CCP}$  and  $K_{CMI}$  should be recalculated at least quarterly, and should also be recalculated when there are material changes to the number or exposure of cleared transactions or material changes to the financial resources of the QCCP.

**Prefunded and unfunded contributions to the default fund of a Non-QCCP**

**A4.9.18** An Authorised Person must calculate Credit RWA for the exposures arising from its contributions to the default fund of a Non-QCCP in accordance with the following formula:

$$\text{Credit RWA} = (DF + UC) \times 10$$

where:

DF = the total prefunded default fund contributions provided by the Authorised Person; and

UC = the total unfunded default fund contributions which the Non-QCCP may require the Authorised Person to provide.

The Regulator may determine whether an Authorised Person's unfunded contribution to the default fund should be factored into the imposition of an Individual Capital Requirement under Rule 10.6.

**Cap on total Credit RWA with regard to QCCPs**

**A4.9.19** An Authorised Person's total Credit RWA for Trade Exposures to a QCCP and default fund exposures to a QCCP must be limited to the total Credit RWA that would apply if the exposures were to a Non-QCCP.

**A4.10 Securitisation**

...

**Guidance**

In relation to Rules A4.10.1 and A4.10.2, significant Credit Risk will be considered to have been transferred by the Originator of a securitisation if:

- a. the RWA amounts of the mezzanine securitisation positions held by the Originator in the securitisation do not exceed 50% of the RWA amounts of all mezzanine securitisation positions existing in this securitisation; and
- b. where there are no mezzanine securitisation positions in a given securitisation and the Originator can demonstrate that the Exposure value of the securitisation positions that would be subject to deduction from Capital Resources or a ~~1250%~~ 1000% risk weight exceeds a reasonable estimate of the expected loss on the securitised Exposures by a substantial margin, the Originator does not hold more than 20% of the Exposures values of the securitisation positions that would be subject to deduction from Capital Resources or a ~~1250%~~ 1000% risk weight.

...

**A4.12 The Simplified Approach for Category 2 and 3A firms**

...

**Risk Weights**

**Central government and central bank asset class**

...

**A4.12.4** Subject to Rules A4.12.5 and A4.12.6, an Authorised Person must risk-weight any CR Exposure in the central government and central bank asset class on the basis of the consensus country risk ~~scores~~ classifications of export credit agencies (referred to in this Section as "ECA") participating in the OECD's "Arrangement on Officially Supported Export Credits" and in accordance with the table below.

Risk weights for the central government and central bank asset class

ECA Risk Scores Country risk classification	0- <u>or</u> 1	2	3	4 to 6	7
Risk Weights	0%	20%	50%	100%	150%

**Guidance**

The consensus country risk classification for the purpose of the "Arrangement on Officially Supported Export Credits" is published by the OECD. At the time of the making of these Rules, the classification was available on the ~~OECD's website~~ (<http://www.oecd.org>) ~~in of OECD on the Export Credit Arrangement web-page of the Trade and Agriculture Directorate-~~ (<http://www.oecd.org/trade/xcred/cre-crc-current-english.pdf>).

...

**Bank asset class**

...

**A4.12.8** An Authorised Person must risk-weight any CR Exposure in the bank asset class on the basis of the consensus ECA country risk ~~score~~classifications as referred to in A4.12.4 for the jurisdictions in which they are incorporated, in accordance with the following table:

CRWs for the bank asset class

<del>ECA Risk Scores</del> <u>Country risk classification</u>	0- <u>or</u> 1	2	3	4 to 6	7
Risk Weights	20%	50%	100%	100%	150%

...

**A4.12.13 (1)** For an Authorised Person using the FCSA, eligible financial Collateral comprises:

...

- (c) any debt Securities issued by sovereigns (including a central government or central bank) of a jurisdiction that that has an ECA country risk ~~score~~classification of 4 or better; and
- (d) any debt Securities issued by a PSE that is treated as a sovereign and is of a jurisdiction that has an ECA country risk ~~score~~classification of 4 or better.

...

The text in APP5 is all new. The existing appendices APP5 to APP11 inclusive are to be renumbered as APP6 to APP12 and cross-references to them revised appropriately (and where these revisions are only indicated in the amendments that follow if they appear as part of a wider amendment).

## **APP5 CREDIT VALUATION ADJUSTMENT (CVA) RISK**

### **A5.1 Meaning of Credit Valuation Adjustment**

For the purposes of this Appendix, "Credit Valuation Adjustment" or "CVA" means an adjustment to the fair value of the portfolio of transactions with a counterparty. The adjustment reflects the current market value of the Credit Risk of the counterparty to the Authorised Person, but does not reflect the current market value of the credit risk of the Authorised Person to the counterparty.

### **A5.2 Scope**

**A5.2.1** An Authorised Person must calculate its capital requirement for CVA risk in accordance with this Appendix for all OTC Derivative Contracts in respect of all of its business activities, other than Credit Derivatives recognised to reduce risk-weighted exposure amounts for Credit Risk.

**A5.2.2** An Authorised Person must include Securities Financing Transactions in the calculation of the capital requirement required by Rule A5.2.1 if the Authorised Person considers the CVA risk exposures arising from those transactions are material. The Authorised Person should assess the materiality of CVA risk exposures arising from SFTs in the course of its Internal Risk Assessment Process, as set out in A11.1.

**A5.2.3** Transactions with a QCCP and a client's transactions with a clearing member, when the clearing member is acting as an intermediary between the client and a QCCP and the transactions give rise to a trade exposure of the clearing member to the QCCP, are excluded from the capital requirements for CVA risk.

### **A5.3 Calculation of CVA capital requirement**

**A5.3.1** An Authorised Person must calculate a portfolio capital requirement for CVA risk for each counterparty in accordance with the following formula, taking into account CVA hedges that are eligible in accordance with Section A5.4:

$$K = 2.33 \cdot \sqrt{h} \cdot \sqrt{\left( \sum_i 0.5 \cdot w_i \cdot \left( M_i \cdot EAD_i^{total} - M_i^{hedge} B_i \right) - \sum_{ind} W_{ind} \cdot M_{ind} \cdot B_{ind} \right)^2 + \sum_i 0.75 \cdot w_i^2 \cdot \left( M_i \cdot EAD_i^{total} - M_i^{hedge} B_i \right)^2}$$

where:

$h$  = the one-year risk horizon (in units of a year);  $h=1$ ;

$w_i$  = the weight applicable to counterparty  $i$ .

Counterparty  $i$  must be mapped to one of the six weights  $w_i$  based on the Credit Quality Grade determined from an external credit assessment by a nominated ECAI, as set out in Table 1. For a counterparty for which a credit assessment by a nominated ECAI is not available, an Authorised Person must assign  $w_i=1.0\%$  to this counterparty;

<u>Credit Quality Grade</u>	<u>Weight <math>w_i</math></u>
<u>1</u>	<u>0.7%</u>
<u>2</u>	<u>0.8%</u>
<u>3</u>	<u>1.0%</u>
<u>4</u>	<u>2.0%</u>
<u>5</u>	<u>3.0%</u>
<u>6</u>	<u>10.0%</u>

$EAD_i^{total}$  = the total Counterparty Risk exposure value of counterparty  $i$  (summed across its netting sets) including the effect of collateral as applicable to the calculation of the capital requirements for Counterparty Risk for that counterparty. The exposure must be discounted by applying the following factor:

$$\frac{1 - e^{-0.05 * M_i}}{0.05 * M_i^{hedge}}$$

$B_i$  = the notional of purchased single name credit default swap hedges (summed if more than one position) referencing counterparty  $i$  and used to hedge CVA risk. That notional amount must be discounted by applying the following factor:

$$\frac{1 - e^{-0.05 * M_i^{hedge}}}{0.05 * M_i^{hedge}}$$

$B_{ind}$  = the full notional of one or more index credit default swap of purchased protection used to hedge CVA risk. That notional amount must be discounted by applying the following factor:

$$\frac{1 - e^{-0.05 * M_{ind}}}{0.05 * M_{ind}}$$

$W_{ind}$  = the weight applicable to index hedges. An Authorised Person must determine  $W_{ind}$  by calculating a weighted average of  $w_i$  that are applicable to the individual constituents of the index;

$M_i$  = the effective maturity of the transactions with counterparty  $i$ .  $M_i$  must be calculated as the notional weighted average maturity of the transactions with counterparty  $i$ ;

$M_i^{hedge}$  = the maturity of the hedge instrument with notional  $B_i$  (the products  $M_i^{hedge} B_i$  are to be summed if these are several positions); and

$M_{ind}$  = the maturity of the index hedge. In the case of more than one index hedge position,  $M_{ind}$  is the notional-weighted maturity.

**A5.3.2** Where a counterparty is included in an index on which a credit default swap used for hedging Counterparty Risk is based, the Authorised Person may subtract the notional amount attributable to that counterparty in accordance with its reference entity weight from the index credit default swap notional amount and treat it as a single name hedge ( $B_i$ ) of the individual counterparty with maturity based on the maturity of the index.

#### **A5.4 Eligible hedges**

**A5.4.1** Hedges must be "Eligible Hedges" for the purposes of the calculation of capital requirements for CVA risk in accordance with Rule A5.3 only where they are used for the purpose of mitigating CVA risk and managed as such, and single-name credit default swaps or other equivalent hedging instruments referencing the counterparty directly.

**A5.4.2** An Authorised Person must not reflect other types of Counterparty Risk hedges in the calculation of the capital requirements for CVA risk. In particular, tranching or nth-to-default credit default swaps and credit linked notes are not Eligible Hedges for the purposes of the calculation of the capital requirements for CVA risk.

**A5.4.3** Eligible Hedges that are included in the calculation of the capital requirements for CVA risk must not be included in the calculation of the capital requirements for specific risk as set out in App6 or treated as credit risk mitigation other than for the Counterparty Risk of the same portfolio of transactions.

**APP6 MARKET RISK**

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**General Market Risk**

...

**Simplified Framework**

...

Zone	Time band		Risk percentage
	Coupon of 3% or more	Coupon of less than 3%	
A <sub>1</sub>	0 ≤ 1month	0 ≤ 1month	0.00%
	> 1 ≤ 3months	> 1 ≤ 3months	0.20%
	> 3 ≤ 6 months	> 3 ≤ 6 months	0.40%
	> 6 ≤ 12 months	> 6 ≤ 12 months	0.70%
B <sub>2</sub>	> 1 ≤ 2 years	> 1.0 ≤ 1.9 years	1.25%
	> 2 ≤ 3 years	> 1.9 ≤ 2.8 years	1.75%
	> 3 ≤ 4 years	> 2.8 ≤ 3.6 years	2.25%
C <sub>3</sub>	> 4 ≤ 5 years	> 3.6 ≤ 4.3 years	2.75%
	> 5 ≤ 7 years	> 4.3 ≤ 5.7 years	3.25%
	> 7 ≤ 10 years	> 5.7 ≤ 7.3 years	3.75%
	> 10 ≤ 15 years	> 7.3 ≤ 9.3 years	4.50%
	> 15 ≤ 20 years	> 9.3 ≤ 10.6 years	5.25%
	> 20 years	> 10.6 ≤ 12.0 years	6.00%
		> 12.0 ≤ 20.0 years	8.00%

Zone	Time band		Risk percentage
	Coupon of 3% or more	Coupon of less than 3%	
		> 20 years	12.50%

...

**A5A6.2.18** The General Market Risk requirement for each currency must be calculated as the sum of the following:

- (a) 10% of the matched weighted positions in each maturity band;
- (b) 40% of the matched weighted position in zone A1;
- (c) 30% of the matched weighted position in zones B2 and €3;
- (d) 40% of the matched weighted position between zones A1 and B2, and between zones B2 and €3;
- (e) 100% of the matched weighted position between zones A1 and €3; and

...



Zone	Maturity Band		Individual Net Positions		Risk percentages	Weighted Individual Net Positions		By Maturity Band		By Zone		Between Zones	
€3	4 - 5 years	3.6 - 4.3 years	\$100	-\$100	2.75%	\$2.75	-\$2.75	\$2.75	\$0.00			Zone 2&3	
	5 - 7 years	4.3 - 5.7 years	\$200	-\$200	3.25%	\$6.50	-\$6.50	\$6.50	\$0.00			\$3.95	
	7 - 10 years	5.7 - 7.3 years	\$300	-\$100	3.75%	\$11.25	-\$3.75	\$3.75	\$7.50				
	10 - 15 years	7.3 - 9.3 years	\$100	-\$200	4.50%	\$4.50	-\$9.00	\$4.50	-\$4.50	\$4.50	\$8.25		
	15 - 20 years	9.3 - 10.6 years	\$200	-\$100	5.25%	\$10.50	\$5.25	\$5.25	\$5.25				
	> 20 years	10.6 - 12 years	\$300	-\$300	6.00%	\$18.00	-\$18.00	\$18.00	\$0.00				
		12 - 20 years			8.00%								
		> 20 years			12.50%								
								\$55.35			\$4.30		

Total General Market Risk requirement = 10% (\$55.35) + 40% (\$0.00) + 30% (\$0.00 + \$4.50) + 40% (\$1.30 + \$3.95) + 100% (\$4.30) + 100% (\$0.00) = \$13.29

## Duration Method

...

Zone	Modified Duration	Assumed move in interest rates (percentage points)
<u>A1</u>	0 ≤ 1 month	1.00
	> 1 ≤ 3 months	1.00
	> 3 ≤ 6 months	1.00
	> 6 ≤ 12 months	1.00
<u>B2</u>	> 1.0 ≤ 1.9 years	0.90
	> 1.9 ≤ 2.8 years	0.80
	> 2.8 ≤ 3.6 years	0.75
<u>€3</u>	> 3.6 ≤ 4.3 years	0.75
	> 4.3 ≤ 5.7 years	0.70
	> 5.7 ≤ 7.3 years	0.65
	> 7.3 ≤ 9.3 years	0.60
	> 9.3 ≤ 10.6 years	0.60
	> 10.6 ≤ 12.0 years	0.60
	> 12.0 ≤ 20.0 years	0.60
	> 20 years	0.60

...

**A5A6.2.22** The General Market Risk requirement for each currency must be calculated as the sum of the following:

- (a) 5% of the matched weighted positions in each time band;
- (b) 40% of the matched weighted position in zone A1;
- (c) 30% of the matched weighted position in zones B2 and €3;

- (d) 40% of the matched weighted position between zones A1 and B2, and between zones B2 and C3;
- (e) 100% of the matched weighted position between zones A1 and C3; and
- (f) 100% of the residual unmatched weighted positions.

...

Zone	Modified Duration	Individual Net Positions		Assumed move in	Modified Duration	Weighted Individual Net Positions		By Timeband		By Zone		Between Zones	
		Long	Short			(%p.a)	(years)	Long	Short	Matched	Unmatched	Matched	Unmatched
<u>A1</u>	< 1 month	\$100.00	-\$50.00	1.00%	0.00	\$0.00	\$0.00	\$0.00	\$0.00	\$0.00	\$1.30		
	1 to 3 months	\$200.00	-\$100.00	1.00%	0.20	\$0.40	-\$0.20	\$0.20	\$0.20				
	3 to 6 months	\$300.00	-\$200.00	1.00%	0.40	\$1.20	-\$0.80	\$0.80	\$0.40				
	6 to 12 months	\$400.00	-\$300.00	1.00%	0.70	\$2.80	-\$2.10	\$2.10	\$0.70				
<u>B2</u>	1 to 1.9 years	\$100.00	-\$200.00	0.90%	1.40	\$1.26	-\$2.52	\$1.26	-\$1.26	\$0.00	-\$5.27	Zone 1&2	
	1.9 to 2.8 years	\$200.00	-\$300.00	0.80%	2.20	\$3.52	-\$5.28	\$3.52	-\$1.76			\$1.30	
	2.8 to 3.6 years	\$300.00	-\$400.00	0.75%	3.00	\$6.75	-\$9.00	\$6.75	-\$2.25				Zones 1&3
													\$0.00
<u>C3</u>	3.6 to 4.3 years	\$100.00	-\$100.00	0.75%	3.65	\$2.74	-\$2.74	\$2.74	\$0.00	\$4.50	\$8.89	Zone 2&3	

Zone	Modified Duration	Individual Net Positions		Assumed move in	Modified Duration	Weighted Individual Net Positions		By Timeband		By Zone		Between Zones	
		Long	Short			(%p.a)	(years)	Long	Short	Matched	Unmatched	Matched	Unmatched
	(years)	Long	Short	(%p.a)	(years)	Long	Short	Matched	Unmatched	Matched	Unmatched	Matched	Matched
	4.3 to 5.7 years	\$200.00	-\$200.00	0.70%	4.65	\$6.51	-\$6.51	\$6.51	\$0.00			\$3.97	
	5.7 to 7.3 years	\$300.00	-\$100.00	0.65%	5.80	\$11.31	-\$3.77	\$3.77	\$7.54				
	7.3 to 9.3 years	\$100.00	-\$200.00	0.60%	7.50	\$4.50	-\$9.00	\$4.50	-\$4.50				
	9.3 to 10.6 years	\$200.00	-\$100	0.60%	9.75	\$11.70	-\$5.85	\$5.85	\$5.85				
	10.6 to 12 years	\$0.00	\$0.00	0.60%	11.00	\$0.00	\$0.00	\$0.00	\$0.00				
	12 to 20 years	\$300.00	-\$300.00	0.60%	14.50	\$26.10	-\$26.10	\$26.10	\$0.00				
	Over 20 years	\$0.00	\$0.00	0.60%	22.00	\$0.00	\$0.00	\$0.00	\$0.00				
								\$64.10			\$4.92		

Total General Market Risk requirement -5% (\$54.10) + 40% (\$0) + 40% (\$5.27) + 100% (\$0) + 100% (\$4.92 = \$11.58

...

## APP67 CALCULATING THE OPERATIONAL RISK CAPITAL REQUIREMENT

### Guidance

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2. The application of various components of the rules on Operational Risk to Authorised Persons with a Financial Services Permission to carry out various Regulated Activities is detailed in the table below:

Regulated Activities	Prudential Category	Capital requirement	Systems and controls requirement	PII cover
...	...	...	...	...
Administering a Specified Benchmark	4	NO	YES	YES
Operating a Credit Rating Agency	4	NO	YES	YES
...	...	...	...	...
Operating a Representative Office	4	NO	YES	YES
Providing Information in Relation to a Specified Benchmark	4	NO	YES	YES
...	...	...	...	...

...

## APP910 LIQUIDITY

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### Cash Outflows

**A9A10.2.15** The following table specifies, for each of the various categories or types of liabilities and off-balance sheet commitments, the rates at which they are expected to run off or be drawn down for the purpose of calculating the LCR.

Cash Outflows	
Item	Factor
...	...
Liquidity needs related to Collateral contractually due from the reporting bank on Derivatives transactions	<del>10</del> % <u>100</u> %

...

## **APP1011 SUPERVISORY REVIEW AND EVALUATION PROCESSES**

### **A101.1 IRAP**

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#### **Purpose of the IRAP**

3. The IRAP is an internal process of an Authorised Person which enables it to identify, assess, aggregate and monitor its risks adequately. The objective of the IRAP is to develop a comprehensive and detailed risk profile for the firm. The IRAP should help the firm ensure that sound risk management systems are in place, address any weaknesses in its risk management framework, and maintain adequate internal capital and liquid financial resources relative to its risk profile and to meet its liquidity risk management needs.

...

**APP1112 PUBLIC DISCLOSURE REQUIREMENTS**

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**Table 3 – Capital Adequacy**

...	...	...
Quantitative Disclosures	(b)	<p>(i) Amount of CRCOM;</p> <p>(ii) Amount of Credit RWA for each asset class giving rise to CR Exposures and <u>Counterparty Risk Exposures, and</u> for SE Exposures; and</p> <p>(iii) Amount of Credit RWAs for Early Amortisation Exposures, included in SE Exposures, if any.</p>
	...	...
	(f)	<p>(i) CET1 Capital ratio as a percentage of <del>total RWAs</del><u>Total Risk Exposure Amount</u>;</p> <p>(ii) T1 Capital ratio as a percentage of <del>total RWAs</del><u>Total Risk Exposure Amount</u>;</p> <p>(iii) Capital Resources as a percentage of <del>total RWAs</del><u>Total Risk Exposure Amount</u>; and</p> <p>(iv) These ratios <del>need to</del><u>must be</u> disclosed at both the Authorised Person level and at the Financial Group level.</p>
	...	...
	(h)	<p>(i) <u>The Leverage Ratio</u>;</p> <p>(ii) <u>the Capital Measure</u>; and</p> <p>(iii) <u>the Exposure Measure</u>.</p>

**Table 4 - Credit Risk – general disclosures**

Qualitative Disclosures	(a)	<p>...</p> <p>For each asset class:</p> <p>(i) the name of each recognised external credit rating agency <del>which ratings are</del> used by the Authorised Person, and the reasons for any changes in the use of a recognised external credit rating agency;</p> <p>...</p>
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**Table 12 – Liquidity Risk**

<u>Quantitative Disclosures</u>	(a)	<p>(i) <u>The Liquidity Coverage Ratio;</u></p> <p>(ii) <u>total high-quality liquid assets (HQLA) – unweighted;</u></p> <p>(iii) <u>total high-quality liquid assets (HQLA) – weighted;</u></p> <p>(iv) <u>total net cash outflows – unweighted; and</u></p> <p>(v) <u>total net cash outflows – weighted.</u></p>
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**END**

