

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

*In this attachment underlining indicates new text and striking through indicates deleted text.

1.2 Glossary

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

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| Bank | Means a Credit Institution. |
| Closely Related | <p><u>For Large Exposures purposes, Persons are Closely Related if:</u></p> <p><u>(a) the insolvency or default of one of them is likely to be associated with the insolvency or default of the others;</u></p> <p><u>(b) it would be prudent when assessing the financial condition or creditworthiness of one to consider that of the others;</u></p> <p><u>(c) there is, or is likely to be, a close relationship between the financial performance of those Persons; or</u></p> <p><u>(d) they are assessed to be economically interdependent.</u></p> <p><u>Persons are to be assessed as being economically interdependent for the purposes of paragraph (d) where one or more of the following factors are present:</u></p> <p><u>(i) 50% or more of the annual receipts or expenditure of one is derived from transactions with the other;</u></p> <p><u>(ii) a guarantee issued by one party in favour of the other party is likely to result in the default of the provider of that guarantee, if called;</u></p> <p><u>(iii) significant output of one party is sold to the other party and an alternative buyer would not easily be found;</u></p> <p><u>(iv) there is a single source of funds to repay loans for both parties with no alternative; or</u></p> <p><u>(v) common reliance on the same funding provider that is hard to replace.</u></p> <p>Has the meaning given in Rule A4.11.5.</p> |
| Connected Counterparty | <p>For the purposes of Large Exposures, and in relation to a Person to which the Authorised Person has an Exposure, a Connected Counterparty means another Person to whom the Authorised Person has an Exposure and who fulfils one or more of the following conditions:</p> <p>(a) it is Connected to the first Person;</p> <p>(b) it is an Associate of the first Person;</p> |

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| | <p>(c) the same Persons significantly influence the Governing Bbody of each or senior management of both of them; or</p> <p>(d) one of those Persons has an Exposure to the other that was not incurred for the clear commercial advantage of both of them and which is not on arm's length terms; or</p> <p><u>(e) one of those Persons:</u></p> <p><u>(i) has influence over the appointment or dismissal of the Board or senior management of the first Person;</u></p> <p><u>(ii) is entitled to exercise, or controls the exercise of 50% or more of the voting rights in the first Person including through voting agreements; or</u></p> <p><u>(iii) has effective control over the first Person under the criteria adopted by the International Financial Reporting Standards.</u></p> |
| Credit Institution | <p>Means:</p> <p>(a) an undertaking whose business is to receive Deposits or other repayable funds from the public and to grant Credits for its own account; or</p> <p>(b) an Electronic Money Institution.</p> |
| Deposit | <p><u>Has the meaning given in paragraph 85 of Schedule 1 of FSMR.</u></p> <p>(1) — Means a sum of Money paid on terms:</p> <p>(a) under which it will be repaid, with or without interest or a premium, and either on demand or at a time or in circumstances agreed by or on behalf of the Person making the payment and the Person receiving it; and</p> <p>(b) which is not referable to the provision of property (other than currency) or services or the giving of security.</p> <p>(2) — In (1) Money is paid on terms which are referable to the provision of property or services or the giving of security if:</p> <p>(a) it is paid by way of advance or part payment under a contract for the sale, hire or other provision of property or services, and is</p> |

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| | <p>repayable only in the event that the property or services are not in fact sold, hired or otherwise provided;</p> <p>(b) it is paid by way of security for the performance of a contract or by way of security in respect of loss which may result from the non-performance of a contract; or</p> <p>(c) without prejudice to (b), it is paid by way of security for the delivery up of property, whether in a particular state of repair or otherwise.</p> <p>(3) — A sum is not a Deposit if it is paid:</p> <p>(a) by a Person in the course of carrying on a business consisting wholly or to a significant extent of lending Money;</p> <p>(b) by one company to another at a time when both are members of the same Group;</p> <p>(c) by an Authorised Person authorised under its Financial Services Permission to carry on the following Regulated Activities:</p> <p>(i) Accepting Deposits;</p> <p>(ii) Effecting Contracts of Insurance; or</p> <p>(iii) Carrying Out Contracts of Insurance as Principal; or</p> <p>(d) by a Person who is a Close Relative of the Person receiving it or who is a Director, manager or Controller of that Person.</p> <p>(4) — A sum is not a Deposit if it is received:</p> <p>(a) by a lawyer acting in his professional capacity;</p> <p>(b) by an accountant acting in his professional capacity;</p> <p>(c) by an Authorised Person or a Recognised Body authorised under its Financial Services Permission to carry on any one or more of the following Regulated Activities:</p> <p>(i) Dealing in Investments as Principal;</p> <p>(ii) Dealing in Investments as Agent;</p> |
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| | <p> (iii) — Arranging Credit; (iv) — Arranging Deals in Investments; (v) — Managing Assets; (vi) — Operating a Collective Investment Fund; (vii) — Effecting Contracts of Insurance; (viii) — Carrying Out Contracts of Insurance as Principal; (ix) — Insurance Intermediation; (x) — Insurance Management; or (xi) — Managing a Profit Sharing Investment Account; </p> <p> in the course of or for the purpose of any such Regulated Activity disregarding any applicable exclusions in the GEN rules; or </p> <p> (d) by a Person as consideration for the issue by him of a Debenture. </p> |
| <u>Domestic Systemically Important Bank (D-SIB)</u> | <u>An Authorised Person designated by the Regulator in accordance with section 1.4 as a domestic systemically important bank.</u> |
| Large Exposure | An Exposure aggregated across an Authorised Person's Non-Trading Book and Trading Book to a Counterparty, a group of Connected Counterparties or a group of Closely Related Counterparties that equals or exceeds 10% of the Authorised Person's <u>Capital Resources Tier 1 Capital</u> . |

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1.4 Domestic Systemically Important Banks

Guidance

1. This section provides for the Regulator to be able to designate an Authorised Person as a D-SIB. A D-SIB is a bank whose impact, if it were to fail, is likely to cause significant disruption to the domestic financial system and the broader real economy. The Regulator will, in assessing if it should designate an Authorised Person as a D-SIB, take into account the factors suggested by the Basel Committee

in its framework for domestic systemically important banks. Those factors include the size, interconnectedness, substitutability and the complexity of the firm.

2. In order to address the additional risks that D-SIBs pose, they may be subject to specific regulatory and supervisory measures, including more intensive supervision and/or higher capital requirements, amongst other measures.
3. The Regulator may designate an Authorised Person as a D-SIB whether it is a Domestic Firm or a Branch. However, the measures that apply to a D-SIB that is a Branch will be less extensive than those that apply to one that is a Domestic Firm. For example, while both may be subject to more intensive supervision, a D-SIB that is a Branch would not be subject to higher capital requirements as those in chapter 3 do not apply to a Branch as it is subject to the capital requirements of its Home State Regulator.

1.4.1 (1) The Regulator may designate an Authorised Person as a D-SIB where:

- (a) it is a Domestic Firm or Branch in Category 1 or 5; and
- (b) the Regulator considers that the risks associated with the Authorised Person are such that, if it were to fail, it could have a significant impact on the effective working and stability of the domestic banking or financial system.

1.4.2 (1) The Regulator must publish a copy of any designation made under this section or any amendment or cancellation of that designation.

(2) The procedures in Part 21 of FSMR apply to a decision to designate an Authorised Person as a D-SIB or to amend the designation.

(3) Where the Regulator decides to designate an Authorised Person as a D-SIB or to amend the designation, the Authorised Person may refer the matter to the Appeals Panel for review.

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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), including where it designates an Authorised Person as a D-SIB. 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 3.2.4.

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3.18.5 Private sector credit 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) Bbank.

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3.21.3 (1) 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.

(2) The Regulator may set a Leverage Ratio higher than the minimum 3% if it designates an Authorised Person as a D-SIB.

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4.3.4 An Authorised Person must also consider whether it is prudent to set out specific provisioning requirements for any country risk and transfer risks to which it is exposed.

Guidance

Guidance on country risk and transfer risk Exposure is set out in Section A4.1 (Credit Risk systems and controls) in App4.

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4.4.3 The Credit Risk policy must:

- (a) be consistent with the approved Credit Risk strategy, considering a range of factors, including but not limited to an approved degree of risk tolerance, capital allocated to Credit Risk, business strategy and market conditions in its main credit markets;

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- (i) Include comprehensive policies for identifying and managing problem ~~assets~~ Exposures;

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4.4.8 The credit procedures manual must establish:

- (a) sound, well-defined criteria for granting credit, including a thorough understanding of the borrower or Counterparty, the purpose and structure of the credit and its source of repayment;

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- (f) comprehensive processes for identifying problem ~~assets~~ Exposures, managing problem ~~assets~~ Exposures, monitoring their collections and for estimating the required level of provisions.

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- 4.5.2** An Authorised Person must implement and maintain appropriate policies, processes, systems and controls to:
- (a) administer its credit portfolios, including keeping the credit files current, getting up-to-date financial information on borrowers and other Counterparties, funds transfer, and electronic storage of important documents;
 - (b) ensure that the valuations of Credit Risk mitigants employed by the Authorised Person are up-to-date, including periodic assessment of Credit Risk mitigants such as guarantees and Collateral;
 - (c) review all material concentrations in its credit portfolio and report the findings of such reviews to the Governing Body; and
 - (d) measure Credit Risk (including to measure Credit Risk of off-balance sheet products such as Derivatives in credit equivalent terms) and monitor the condition of individual credits to facilitate identification of problem ~~credits~~Exposures and to determine the adequacy of provisions and reserves.
- 4.5.3** The Credit Risk management system and, in particular, the systems, policies and processes aimed at classification of credits, monitoring and identification of problem ~~credits~~Exposures, management of problem ~~credits~~Exposures and provisioning for them must include all the on-balance sheet and off-balance sheet credit Exposures of the Authorised Person.

Guidance

An Authorised Person should ensure that its loan portfolio is properly classified and has an effective early-warning system for problem loans.

- 4.5.4** (1) An Authorised Person must establish clearly defined criteria for identifying its problem ~~credits~~Exposures and/or impaired assets which ensure that credits are classified as impaired in all cases where there is some reason to believe that all amounts due (including principal and interest) will, or may, not be collected in accordance with the contractual terms of the loan agreement.
- (2) For the purpose of (1), and subject to (3), an Authorised Person must categorise its credits into five categories as detailed in the following table, where credits in the substandard, doubtful and loss categories must be considered as problem ~~credits~~Exposures:

| Category | Criteria |
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| Standard | Includes credits <u>Exposures</u> with no element of uncertainty about timely repayment of the outstanding amounts, including principal and interest. Credits <u>Exposures</u> are currently in regular payment status with prompt payments. |

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| Special mention | Includes credits <u>Exposures</u> with deteriorating or potentially deteriorating credit quality which, may adversely affect the borrower's ability to make scheduled payments on time. The credits <u>Exposures</u> in this category warrant close attention by the Authorised Person. |
| Substandard | Includes credits <u>Exposures</u> which exhibit definitive deterioration in credit quality and impaired debt servicing capacity of the borrower. |
| Doubtful | Includes credits <u>Exposures</u> which show strong credit quality deterioration, worse than those in substandard category, to the extent that the prospect of full recovery of all the outstanding amounts from the credit is questionable and consequently the probability of a credit loss is high, though the exact amount of loss cannot be determined yet. |
| Loss | Includes credits <u>Exposures</u> which are assessed as uncollectable and credits <u>Exposures</u> with very low potential for recoverability of amounts due. |

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Guidance

1. With respect to the ratings above, Authorised Persons should consider the following Exposures as being classified:

- (i) special mention;
- (ii) substandard;
- (iii) doubtful; and
- (iv) loss

where the loans are contractually in arrears for a minimum ~~number of days of 30, of more than 60, 90—, 120 and 120—180 days~~ respectively. Authorised Persons should also consider the treatments as set out in Rule 4.5.7 (Evergreening).

2. ~~Credits~~Exposures exhibiting the following characteristics should be included in the special mention category:-

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3. ~~Credits~~Exposures exhibiting the following characteristics should be included in the substandard category:-

- a. the inability of the borrower to meet contractual repayment terms of the Credit Facility;

- b. unfavourable economic and market conditions or operating problems that would affect the profitability and cash flow generation of the borrower;
- c. the weak financial condition or the inability of the borrower to generate sufficient cash flow to service the payments;
- d. difficulties experienced by the borrower in servicing its other debt obligations; or
- e. a breach of any financial covenants by the borrower.

4.5.4A (1) Exposures falling into the following categories must be considered as non-performing:

- (a) the Authorised Person considers that the obligor is unlikely to pay its credit obligations to the Authorised Person in full, without recourse by the Authorised Person to actions such as realisation of collateral, even when it is not past due or has been past due for less than 90 days;
- (b) the obligor is past due 90 days on any material credit obligation; or
- (c) Exposures that are 'impaired' according to the applicable accounting framework.

Guidance

1. Indications of unlikeliness to pay for the purposes of 4.5.4A(1) may include, but are not limited to:

- a. The Authorised Person puts the credit obligation that gives rise to the Exposure on non-accrued status.
- b. The Authorised Person makes a charge-off or account-specific provision resulting from a significant perceived decline in credit quality subsequent to the Authorised Person taking on the Exposure.
- c. The Authorised Person sells the credit obligation that gives rise to the Exposure at a material credit-related economic loss.
- d. The Authorised Person consents to a distressed restructuring of the credit obligation that gives rise to the Exposure where this is likely to result in a diminished financial obligation caused by the material forgiveness, or postponement, of principal, interest or, where relevant, fees.
- e. The Authorised Person has filed for the obligor's bankruptcy or a similar order in respect of the obligor's credit obligation to the Authorised Person's group.
- f. The obligor has sought or has been placed in bankruptcy or similar protection where this would avoid or delay repayment of the credit obligation that gives rise to the Exposure to the Authorised Person's group.

2. Non-performing Exposures should always be categorised for the whole Exposure, including when non-performance relates to only a part of the Exposure, for instance, unpaid interest. For off-balance sheet Exposures, the whole Exposure is the entire nominal amount.

3. The identification of an Exposure as non-performing is not intended to affect its categorisation as impaired for accounting purposes.
4. An Exposure for the purposes of 4.5.4A ceases to be non-performing and may be re-categorised as performing when all of the following criteria are simultaneously met:
 - a. the Counterparty does not have any material Exposure more than 90 days past due;
 - b. repayments have been made when due over a continuous repayment period of at least 12 months;
 - c. the Counterparty's situation has improved so that the full repayment of the Exposure is likely, according to the original or, when applicable, modified conditions; and
 - d. the Exposure is not "impaired" according to the applicable accounting framework.
5. An Exposure may not be re-categorised as performing in the following situations:
 - a. a partial write-off of an existing non-performing exposure, including where an Authorised Person writes off the part of a non-performing exposure that it deems to be uncollectible;
 - b. the repossession of collateral on a non-performing exposure, until the collateral is actually disposed of and the Authorised Person realises the proceeds (when the exposure is kept on-balance sheet, it is deemed to be non-performing); or
 - c. an extension or granting of forbearance measures to an Exposure that has already been identified as non-performing.

4.5.5 An Authorised Person must have detailed policies, processes and resources for managing problem ~~credits~~ Exposures which address the following:

- (a) monitoring of ~~credits~~ such Exposures and early identification of credit quality deterioration;
- (b) review of classification of problem ~~credits~~ Exposures; and
- (c) ongoing oversight of problem ~~credits~~ Exposures, and for collecting on past due obligations.

4.5.6 (1) An Authorised Person must ensure that each and every ~~credit~~ Exposure which qualifies as a Large Exposure and is classified as an impaired ~~credit~~ asset or non-performing Exposure is managed individually. This includes valuation, classification and provisioning for such ~~credits~~ Exposures on an individual item basis.

- (2) In addition, Authorised Persons must consider whether other significant Exposures, which may not necessarily qualify as a Large Exposure, should also be managed on an individual basis. Authorised Persons are responsible for documenting the criteria used to identify significant Exposures that are to

be managed individually and for defining thresholds relevant to their financial or operational capacity to manage or absorb such risk.

4.5.7 (1) Any Evergreening exercise involving refinancing of past due credits or granting forbearance measures to Exposures in arrears must not result in their being classified as a higher into a category associated with better performance. In particular, impaired credits or non-performing exposures cannot be refinanced or granted forbearance with the aim of classifying them as in the standard or special mention eredit categories.

(2) Forbearance occurs when:

(a) a Counterparty is experiencing financial difficulty in meeting its financial commitments; and

(b) the Authorised Person grants a concession that it would not otherwise consider, whether or not the concession is at the discretion of the Authorised Person and/or the Counterparty.

Guidance

For the purposes of Rule 4.5.4A and 4.5.7(2), an Authorised Person should consider the BCBS Guidelines on the Prudential treatment of problem assets – definitions of non-performing exposures and forbearance. These guidelines provide examples of possible indicators of financial difficulty with respect to forbearance, guidance on what constitutes a concession, criteria for exit from a forborne exposure category and guidance on the interaction of forbearance with non-performing exposures.

4.5.8 An Authorised Person's provisioning policy must specify the following minimum provisioning requirements:

- (a) for substandard assets – 20% of the unsecured portion of the credit;
- (b) for doubtful assets – 50% of the unsecured portion of the credit; and
- (c) for loss assets – 100% of the unsecured portion of the credit.

Guidance

The above provisioning requirements are the minimum level of provisions that the relevant Authorised Person must hold.

4.5.9 An Authorised Person must, on a periodic basis, at a minimum monthly frequency, review its problem ~~eredit~~ Exposures (at an individual level or at a portfolio level for credits with homogeneous characteristics) and review the asset classification, provisioning and write-offs for each of those problem ~~eredit~~ Exposures.

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4.10.1 An Authorised Person must categorise any CR Exposure that is not past due for more than 90 days into one of the following asset classes:

- (a) cash items, which consist of:

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~~(e)~~ the international organisation asset class, which consists of any CR Exposure to a group of specified organisations;

~~(f)~~~~(e)~~ bank asset class, which consists of any CR Exposure to a banking institution;

~~(g)~~~~(f)~~ corporate asset class, which consists of any CR Exposure to any corporation, Partnership, sole proprietorship or Trustee in respect of a trust, other than Exposures categorised in sub-paragraphs (a) to ~~(ef)~~, ~~(gh)~~ and ~~(hi)~~;

~~(h)~~~~(g)~~ regulatory retail asset class, which consists of any CR Exposure meeting all of the following conditions:

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~~(i)~~~~(h)~~ residential mortgage asset class, which consists of any CR Exposure meeting all of the following conditions:

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~~(j)~~~~(i)~~ the commercial real estate asset class, which consists of any CR Exposure meeting all of the following conditions:

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~~(k)~~~~(j)~~ other Exposures asset class, which consists of any CR Exposure which does not fall within any of the categories in sub-paragraphs (a) to ~~(ij)~~.

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4.12.7 Subject to Rules ~~4.12.8 and 4.12.9~~, an Authorised Person must risk-weight any CR Exposure in the MDB asset class in accordance with the following table:

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International organisation asset class

4.12.9 An Authorised Person must apply a 0% risk weight to any CR Exposure to the Bank for International Settlements, the International Monetary Fund, the European Central Bank or the European Commission.

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4.13.9 (1) An Authorised Person may recognise the effects of CRM of a guarantee only if it is provided by any of the following entities:

(a) ~~central governments~~ or central banks;

(b) the ~~the~~ MDBs referred to in Rule 4.12.8;

(c) the ~~the~~ international ~~o~~rganisations referred to in Rule 4.12.9;

(d) PSEs;

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4.13.11 (1) An Authorised Person may recognise the effects of CRM of a Credit Derivative only if it is provided by any of the following entities:

(a) central governments or central banks;

(b) the MDBs referred to in Rules 4.12.7 to 4.12.9 4.12.8;

(c) the international organisations referred to in Rule 4.12.9;

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4.15.5 (1) Subject to IFR Rule 5.4.15, an Authorised Person must not incur any Large Exposures in its Non-Trading Book and, subject to Rule 4.15.6, Trading Book after taking into account the effect of any eligible CRM, that exceeds 25% of its Tier 1, except as otherwise provided in (2).

(2) An Authorised Person which is a D-SIB must, if required in writing by the Regulator, apply a Large Exposure limit lower than 25% of its Tier 1 Capital where the Large Exposure is to another D-SIB, or to a subsidiary of a D-SIB, whether inside or outside ADGM.

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7.2.6 (1) Subject to (2), the minimum frequency of the evaluation referred to in Rule 7.2.1 is once each year.

(2) The minimum frequency of an evaluation of the effect of a sudden and unexpected parallel change in interest rates as referred to in Rule 7.2.2 is once each quarter.

Guidance

For the purposes of Rule 7.2.6, an Authorised Person should consider the standards for stress testing recommended in the paper published by the BCBS – Principles for management and supervision of interest rate risk in the banking book – July 2004 (April 2016). In particular, an Authorised Person should include the technical specifications of a standardised interest rate shock detailed in Annex 32 of that paper as part of its systems for measurement of interest rate risk in the Non-Trading Book.

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Non-Trading Book interest rate risk policy

7.4.1 (1) An Authorised Person must implement and maintain a policy which enables it to identify, assess, control and monitor its Non-Trading Book interest rate risk.

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Guidance

1. The Regulator expects that an Authorised Person's strategy towards Non-Trading Book interest rate risk will set out the approach that the Authorised Person will take towards management of the risk, including various quantitative and qualitative targets. It should be communicated to all relevant functions and staff within the organisation and be set out in the Authorised Person's Non-Trading Book interest rate risk policy.

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5. An Authorised Person should consider the standards for stress testing recommended in the paper published in July 2004 by the BCBS – Principles for management and supervision of interest rate risk in the banking book (April 2016) – in developing the stress testing scenarios. In particular, an Authorised Person should include the technical specifications of a standardised interest rate shock detailed in Annex 32 of that paper.

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APP3 CAPITAL AND LEVERAGE**A3.1 Stress and scenario testing****Guidance**

1. Stress and scenario testing is an integral part of an Authorised Person's risk management framework. Stress and scenario testing seek to anticipate possible losses or risks that might occur or become manifest. In applying ~~them~~ stress testing and scenario analysis, an Authorised Person ~~needs to~~ should:
 - a. design its stress testing framework in a manner that is commensurate with its risk profile and systemic importance;
 - b. clearly articulate its intended objectives;
 - c. design an effective governance structure around stress and scenario testing;
 - d. appropriately integrate the results of such testing in its decision-making, risk management processes including contingency arrangements, capital management and business decision-making;
 - e. capture all material and relevant risks including, but not limited to, credit risk, market risk, operational risk, liquidity risk, country risk and transfer risk, concentration risk, climate risk, and apply stresses that are sufficiently severe but plausible;
 - f. dedicate appropriate level of resources to meet the objectives of the stress testing framework;
 - g. ensure availability of sufficiently accurate and granular data as well as robust IT systems to support the analysis;

- h. appropriately document and regularly maintain and update its stress testing framework;
- i. ensure that models and methodologies applied in the testing are fit for purpose;
- j. subject the stress testing models, results and framework to regular challenge and review; and
- k. communicate stress testing practices and findings internally within the firm as well as with appropriate authorities within and across jurisdictions, as relevant.

An Authorised Person should also consider employing the practices contained in the BCBS Stress testing principles (October 2018).

- ~~2.~~ decide how far forward to forecast and may want In undertaking stress and scenario testing, an Authorised Person should take a forward-looking view and decide what time horizons are appropriate and may wish to consider the following factors:
 - a. how quickly it would be able to identify events or changes in circumstances that might lead to a loss occurring or risk crystallising; and
 - b. after ~~the an~~ event or set of circumstances has been identified, how quickly and effectively the Authorised Person could act to prevent or mitigate any resulting loss occurring or risk crystallising and to reduce its Exposure to any further adverse event or change in circumstance.
- 2. For example, the time horizon over which stress and scenario testing would need to be carried out for the Market Risk arising from the holding of Investments would depend upon:
 - a. the extent to which there is a regular, open and transparent market in those assets, which would allow fluctuations in the value of the Investment to be more readily and quickly identified; and
 - b. the extent to which the market in those assets is liquid (and would remain liquid in the changed circumstances contemplated in the stress or scenario test) which would allow the Authorised Person, if needed, to sell its holding so as to prevent or reduce its Exposure to future price fluctuations.
- 3. Authorised Persons should focus on those scenarios and combinations of scenarios that are ~~considered reasonably likely to occur~~ severe, but plausible. For this purpose, other risks and losses include business risk, i.e. the potential impact of changes in business plans, future activities, and the business or economic environment.

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Problem Exposures

47. An Authorised Person should have processes for the timely identification and management of problem Exposures. These processes should be described in the Credit Risk policy.

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55. ~~Requirements~~ Minimum requirements relating to provisioning against loss on problem Exposures are covered in Chapter 4.

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Country risk and transfer risk ~~Exposure~~

~~70. Chapter 4 does not provide limits on the size of an Authorised Person's Exposure to a particular country or region. However, an Authorised Person which has Large Exposures in a country or region should include in its Credit Risk policy:~~

70. Country risk is the risk of exposure to loss caused by events in a foreign country. Country risk includes, among others:

a. political risks i.e., potential of war, civil riot and other politically-motivated events; and

b. sovereign risk i.e., the possibility that a sovereign debtor cannot or is not willing to meet its financial obligations.

County risk covers all forms of lending, trading or investment activity involving individual, corporates, banks or governments.

~~71. Transfer risk is the risk of inability of a debtor in a given country to meet their financial obligations due to lack of availability of the currency in which the obligation is denominated regardless of the debtor's particular financial condition. The inability to convert local currency into another nation's currency could arise due to regulatory, exchange or other restrictions.~~

~~72. An Authorised Person must develop and document its risk management processes for its operations and resources deployed outside the country. An Authorised Person's country risk management framework should include appropriate policies and procedures to identify, measure, evaluate, monitor, report on and mitigate country risk. Such policies and procedures should be proportionate to the nature, size and complexity of an Authorised Persons' operations and resources outside the country.~~

~~73. An Authorised Person's country risk or transfer risk policy should include, among other things:~~

~~a. the methodology of country classification, exposure limits and stress testing, among other aspects, that are proportionate to the degree of size and complexity of country risk and transfer risk arising from its Exposures;~~

- ab. identification of the geographical areas in which the Authorised Person does or intends to do business;
 - bc. its definition of Credit Risk Exposure, procedures to identify country risk and transfer risks (such as exchange restrictions) associated with doing business in each country or region;
 - ed. how to measure its total Exposure in each country or region and across several countries or regions;
 - de. the types of business the Authorised Person intends to undertake in each country or region;
 - ef. limits on Exposures to an individual country or region which the Authorised Person deals with, and sub-limits for different types of business if appropriate;
 - fg. the procedure for setting and reviewing country or regional limits; and
 - gh. the process by which the Authorised Person's actual country or regional Exposures will be monitored against limits and the procedure to be followed if the limits are breached;
 - i. the provisioning policy in relation to country risk and transfer risk, and detailed description of the methodology used for calculation of any such provisions;
 - j. the methodology for conducting stress testing for country risk and transfer risk should include, among other considerations, elements such as the deterioration of macroeconomic conditions locally and globally, contagion effects between countries, liquidity events, impacts on funding sources etc.;
 - k. policies around reporting in their disclosures, including its financial statements or annual reports, such information that will allow users to evaluate its country risk and transfer risk management framework, the amount of provisions for country risk and transfer risk and its overall country risk profile related to its operations, assets, liabilities and contingencies that are maintained outside of ADGM and the UAE; and
 - l. documenting the roles and responsibilities of the different functions of the Authorised Person involved in managing country risk and transfer risk.
7474. When setting country or regional limits, an Authorised Person should consider:
- a. the ~~economic and political~~ macroeconomic circumstances prevailing in the country or region; including its:

- (i) external financial condition i.e., its capacity to fulfil its financial commitments. This will include consideration of indicators such as total debt, foreign debt, maturity profile of debt, debt service as a percentage of its gross domestic product, exports, international reserves, amongst other indicators;
 - (ii) sources of and access to funding whether through voluntary markets, bilaterally or through multilateral organisations, including any sovereign or other guarantees;
 - (iii) macroeconomic conditions, including consideration of indicators such as a country's gross domestic product and its growth, inflation rate, tax conditions, investment and savings trends, balance of payments, restrictions on capital flows, and the condition of its financial sector, amongst other indicators; and
 - (iv) the credit ratings of the country;
- b. the political, social and institutional conditions prevailing in the country, or the wider region if relevant, that could jeopardise its stability;
- bc. the transfer risks associated with any particular country or region;
- ed. the type and maturity of business undertaken by the Authorised Person in a particular country or region; and
- de. the Authorised Person's existing concentration of country or regional risk;
75. The Senior Management of an Authorised Person, including its risk management and/or compliance functions, is responsible for the development and implementation of its country risk and transfer risk management policies and procedures, and providing the results of such efforts to its Governing Body with appropriate details and frequency. The Governing Body of the Authorised person must ensure the adequacy and proportionality of the country risk and transfer risk policy and its implementation, including reviewing the exposure limits set therein and the methodology and/or results of stress testing etc. Independent audit functions within the Authorised Person must have unrestricted access to relevant resources and the information used to assess and implement country risk and transfer risk management policies and procedures.
- e. ~~the source of funding for the country or regional Exposure; and~~
- f. ~~sovereign or other guarantees offered.~~

Provisioning

7276. Depending upon the nature of the Authorised Person and its business, the Authorised Person's provisioning policy should set out:

- a. who has responsibility for reviewing the provisioning policy and approving any changes;
 - ...
 - g. who has responsibility for monitoring its asset portfolio on a regular basis in order to identify problem or potential problem assetsExposures and the factors it takes into account in identifying them;
 - ...
7377. Provisions may be general (against the whole of a given portfolio) or specific (against particular Exposures identified as bad or doubtful), or both. The Regulator expects contingent liabilities and anticipated losses to be recognised in accordance with the applicable accounting standards.
7478. Appropriate systems and controls for provisions vary with the nature, scale and complexity of the credit granted. An Authorised Person for which the extension of credit is a substantial part of its business is expected to have greater regard to developing, implementing and documenting a provisioning policy than an Authorised Person for which Credit Risk is incidental to the operation of its business.
7579. The Regulator recognises that the frequency with which an Authorised Person reviews its provisioning policy once it has been established will vary from firm to firm. However, the Regulator expects an Authorised Person to review its policy to ensure it remains appropriate for the business it undertakes and the economic environment in which it operates. The provisioning policy should be reviewed at least annually by the Governing Body.

...

Group of Closely Related Counterparties

~~A4.11.5 (1) For Large Exposures purposes, Persons are Closely Related if:~~

- ~~(a) the insolvency or default of one of them is likely to be associated with the insolvency or default of the others;~~
- ~~(b) it would be prudent when assessing the financial condition or creditworthiness of one to consider that of the others; or~~
- ~~(c) there is, or is likely to be, a close relationship between the financial performance of those Persons.~~

A4.11.5 (1) An Authorised Person need not assess whether Persons are economically independent for a transaction where the sum of all Exposures to one individual Counterparty is less than 5% of the Authorised Person's Tier 1.

(2) The Regulator may, at its discretion, require an Authorised Person to treat two or more Persons as Closely Related to each other and to aggregate Exposures to such Persons accordingly.

- (23) Persons who are Closely Related to each other are also Connected with each other.
- (4) The requirement to aggregate Exposures where Persons are Closely Related does not apply where an Authorised Person can demonstrate to the Regulator that it is unlikely that Persons who are Closely Related will default at the same time and the Regulator has, by notice in writing, disapplied the requirement.
- A4.11.6** (1) A single group of Closely Related Counterparties means, in relation to an Authorised Person, all the Persons to which the Authorised Person has an Exposure and which are Closely Related to each other.
- (2) An Authorised Person must treat two or more Persons as falling within a group of Closely Related Counterparties if the Authorised Person has Exposures to them all and any loss to the Authorised Person on any of the Exposures to one is likely to be associated with a loss to the Authorised Person with respect to at least one Exposure to each of the others.

Guidance

~~Two or more Counterparties between whom there is no relationship of control as described in Rules A4.11.5 and A4.11.6 will be regarded as constituting a single risk if they are so interconnected that, if one of them were to experience financial problems, in particular funding or repayment difficulties, the other or all of the others would also be likely to encounter funding or repayment difficulties.~~

Connected Counterparties

- ~~**A4.11.7** For Large Exposures purposes, and in relation to a Person, a Connected Counterparty means another Person to whom the first Person has an Exposure and who fulfils one of the following conditions:~~
- ~~(a) it is Connected to the first Person;~~
- ~~(b) it is an Associate of the first Person;~~
- ~~(c) the same Persons significantly influence the Governing Body of each of them; or~~
- ~~(d) one of those Persons has an Exposure to the other that was not incurred for the clear commercial advantage of both of them and which is not on arm's length terms.~~
- A4.11.7** (1) The Regulator may, at its discretion, require an Authorised Person to treat a Person as a Connected Counterparty of another Person and to aggregate Exposures to such Persons accordingly.
- (2) A Person is not considered to be a Connected Counterparty, where an Authorised Person can satisfy the Regulator that effective governance and controls are in place to mitigate risks resulting from effective control of one Person by the other and the Regulator has, by notice in writing, specified that they are not to be so considered.

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A10.2.18 The following table specifies, for each of the various categories and types of contractual receivables, the rates at which they are expected to flow in for the purpose of the calculation of the LCR.

| Cash Inflows | |
|--|--|
| Item | Factor |
| Maturing secured lending (including reverse repos and Securities borrowing), backed by the following as Collateral: <ul style="list-style-type: none"> • Level 1 HQLA • Level 2A HQLA • Level 2B HQLA <ul style="list-style-type: none"> ○ Eligible RMBS ○ Other assets • Margin lending backed by all other Collateral • All other assets • Credit or liquidity facilities provided to the reporting Bank <u>Authorised Person</u> • Operational Deposits held at other Financial Institutions (including Deposits held at centralised institution of network of co-operative banks) | 0% 15% 25% 50% 50% 100% 0% 0% |
| Other inflows by Counterparty: <ul style="list-style-type: none"> • Amounts receivable from retail Counterparties • Amounts receivable from non-financial wholesale Counterparties, from transactions other than those listed in the above inflow categories • Amounts receivable from Financial Institutions and central banks, from transactions other than those listed in the above inflow categories • Net Derivative receivables • Other contractual cash inflows | 50% 50% 100% 100% 100% |

...

Purpose of the IRAP

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8. The IRAP should:

- a. identify and outline all related parties of the Authorised Person, and list the types of transactions that occur between those related parties and the firm;
- b. identify the most significant risks to which the firm is exposed, which should, at a minimum, include the risks identified in Guidance note 911;

...

9. The IRAP should, in addition to the aforementioned factors:

- a. estimate, with the aid of historical data, where available, the range and distribution of possible losses which might arise from each of those risks and consider using stress tests to provide risk estimates (see guidance under App3 in relation to the design of effective stress testing frameworks);

...

Guidance on risks to be covered as part of the IRAP

11. An Authorised Person should consider the following risks, where relevant, in its IRAP and all others that it believes to be material:

- a. Credit Risk, including Large Exposures and concentration risks;

...

12. This Guidance is merely an indicative list of risk categories types, which does not preclude an Authorised Person from assessing other risks that it considers significant (for example, securitisation risks and residual risks). Likewise, certain categories of risks might not be relevant to all Authorised Persons completing the IRAP. In this case, the IRAP should clearly indicate why the risk is considered minimal or not relevant. The IRAP should also consider all risks arising from any non-regulated activities of the Authorised Person, if they are seen as material to the risk profile of the firm

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A11.2 ICAAP

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Purpose and process of the ICAAP

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3. When assessing its capital needs, an Authorised Person should take into account the impact of economic cycles, and sensitivity to other external risks and factors. For larger or more complex institutions, this may mean developing an appropriate stress testing and scenario testing framework (see guidance under App3 in relation to the design of effective stress testing

frameworks). The results of such stress and scenario testing needs to be communicated to the Regulator as part of the ICAAP submission.