



MODULE	CA: Capital Adequacy
CHAPTER	CA-A: Introduction

## CA-A.1 Purpose

### *Executive Summary*

CA-A.1.1 The purpose of this module is to set out the Central Bank of Bahrain (CBB)'s capital adequacy Rules and provide guidance on the risk measurements for the calculation of capital requirements by Bahraini conventional bank licensees. This requirement is supported by Article 44(c) of the Central Bank of Bahrain and Financial Institutions Law (Decree No. 64 of 2006).

CA-A.1.2 Principle 9 of the Principles of Business requires that conventional bank licensees maintain adequate human, financial and other resources, sufficient to run their business in an orderly manner (see Section PB-1.9). In addition, Condition 5 of CBB's Licensing Conditions (Section LR-2.5) requires conventional bank licensees to maintain financial resources in excess of the minimum requirements specified in Module CA (Capital Adequacy).

CA-A.1.3 This Module also sets out the minimum leverage requirements which relevant banks (referred to in Section CA-B.1) must meet as a condition of their licensing.

CA-A.1.4 The requirements specified in this Module vary according to the inherent risk profile of a licensee, and the volume and type of business undertaken. As one of the principal objectives of the CBB (as outlined in Article 3 of the CBB Law 2006) is the protection of depositors, it is essential to ensure that the capital recognised in regulatory capital measures is readily available for those depositors and to ensure that conventional bank licensees hold sufficient capital to provide some protection against unexpected losses in the normal course of business, and otherwise allow conventional banks to effect an orderly wind-down of their operations. The minimum capital requirements specified here may not be sufficient to absorb all unexpected losses. The CBB therefore may impose more stringent capital requirements than those stated in this Module on certain banks taking into account the riskiness of the activities conducted by the concerned bank (see Paragraph CA-A.1.5A).

### CA-A.1.5

The CBB requires that conventional bank licensees maintain adequate capital, in accordance with the requirements of this Module, against their risks. In particular, all Bahraini conventional bank licensees are required to maintain capital adequacy ratios or CARs (both on a solo and a consolidated basis where applicable) above the minimum levels set out in Chapters CA-B and CA-2. Failure to remain above these ratios will result in enforcement and other measures as outlined in Section CA-1.2 and Module EN. The detailed methodology for calculating the CARs is set out in the instructions for the form PIR.



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## CA-A.1 Purpose (continued)

### CA-A.1.5A

All Bahraini conventional bank licensees must maintain their own target capital ratios above the supervisory CARs mentioned in Section CA-B.2 (on a solo and on a consolidated basis). Each concerned licensee must observe individual target ratios as agreed with the CBB on a case-by-case basis subject to a methodology to be disclosed in due course.

### CA-A.1.6

This module provides support for certain other parts of the Rulebook, mainly:

- (a) Prudential Consolidation and Deduction Requirements;
- (b) Licensing and Authorisation Requirements;
- (c) CBB Reporting Requirements;
- (d) Credit Risk Management;
- (e) Operational Risk Management;
- (f) High Level Controls;
- (g) Relationship with Audit Firms; and
- (h) Enforcement.

### *Legal Basis*

### CA-A.1.7

This Module contains the CBB's Directive (as amended from time to time) relating to the capital adequacy of conventional bank licensees, and is issued under the powers available to the CBB under Article 38 of the CBB Law. The Directive in this Module is applicable in its entirety to all Bahraini conventional bank licensees.

### CA-A.1.8

For an explanation of the CBB's rule-making powers and different regulatory instruments, see Section UG-1.1.



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## CA-A.2 Module History

CA-A.2.1 This module was first issued in July 2004 as part of the conventional principles volume. Material changes took place in January 2008 to implement Basel II. Other changes that have subsequently been made to this module are annotated with the calendar quarter date in which the changes were made. Chapter UG-3 provides further guidance on Rulebook maintenance and version control.

CA-A.2.1A The most recent changes are detailed in the Table below.

### *Summary of Changes*

Module Ref.	Change Date	Description of Changes
CA-A.2	10/07	Change categorising Module as a Directive
CA-1 to CA-8	01/08	Extensive changes to implement Basel II
CA-3.4	04/08	Recognition and mapping of grades for Capital Intelligence
CA-3.2.15-18	01/09	New guidance and rules on SMEs
CA-A	01/2011	Various minor amendments to ensure consistency in CBB Rulebook.
CA-A.2.7	01/2011	Clarified legal basis.
CA-6, CA-8, CA-9, CA-10, CA-14 & CA-16	01/2012	Changes in respect of July 2009 and February 2011 amendments to Basel II.
CA-3.2.10 and CA-3.2.11A	04/2012	Amendment made for claims on banks dealing with self-liquidating letters of credit.
CA-2.1.5, CA-2.1.5A and CA-2.1.5B	04/2013	Clarified Rules dealing with subordinated debt issued.
CA-2.1.5(h)	10/2013	Added Rule to include limited general provision against unidentified future losses as part of Tier 2.
CA-11.3.7	10/2013	Clarified Rules for excluding positions of a structural nature from the calculation of the net open currency positions.
Module CA	01/2015	Extensive changes to implement Basel III.
CA-1.3.3	04/2015	Existing exemptions in respect of PIR review will cease as at 31st December 2014 for all Bahraini conventional bank licensees.
CA-2.1.2	04/2015	Underlined the term 'financial instruments' so that it is linked to the glossary definition.
CA-2.3.5	04/2015	Corrected cross reference.
CA-2.4.2	04/2015	Clarified that intangible assets other than goodwill and mortgage servicing rights are subject to transitional arrangements and are phased out as regulatory adjustments as outlined in Subparagraph CA-B.2.1(d).
CA-2.4.12	04/2015	Clarified that shares of the bank held as collateral are considered as shares held indirectly and are subject to deduction under regulatory adjustments.
CA-2.4.23 and CA-3.2.19A	04/2015	Corrected reference to conventional bank licensee.
CA-2.4.25	04/2015	Clarified the rule on significant investments in commercial entities by adding cross reference to the definition.
CA-2A.3.3	04/2015	Paragraph deleted as not applicable on the implementation of the capital conservation buffer.
CA-B.2.1(d)	07/2015	Amendment made to clarify that during the transition period, the remainder not deducted from capital is subject to the risk weights outlined in the October 2014 version of Chapter CA-3.
CA-2.4.25 and CA-2.4.26	07/2015	Amendment made to reflect the treatment of the risk weighting for exposures below the threshold limits.
CA-2.1.6 and CA-2.1.10	01/2016	Updated criteria for AT1 and T2 instruments.
CA-3.2.4, CA-3.2.4A and CA-3.2.4B	04/2016	Updated risk weightings for claims on non-central government public sector entities (PSEs).



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## CA-A.2 Module History (continued)

### *Evolution of Module*

#### CA-A.2.2

The contents retained from the previous Module (Capital Adequacy – Conventional Banks) are effective from the dates depicted above.



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[Sections CA-A.3 to CA-A.5 were deleted in January 2015.]



MODULE	CA:	Capital Adequacy
CHAPTER	CA-B:	Scope of Application and Transitional Rules

## CA-B.1 Scope

### CA-B.1.1

All Bahraini conventional bank licensees are required to measure and apply capital charges with respect to their credit risk, operational risk and market risks capital requirements.

### CA-B.1.2

Rules in this Module are applicable to Bahraini conventional bank licensees on both a solo (i.e. including their foreign branches) and on a consolidated group basis as described below. The applicable ratios and methodology are described in this Chapter and Chapters CA-1 and CA-2 for solo and consolidated CAR calculations.

### CA-B.1.2A

The scope of this Module includes the parent bank and all its banking subsidiaries and any other financial entities such as Special Purpose Vehicles (SPVs) which are required to be consolidated for regulatory purposes by the CBB. The assets and liabilities of all such subsidiaries must be fully consolidated on a line-by-line basis. In some cases, the assets of foreign banking subsidiaries will be allowed to be included by way of aggregation (see CA-B.1.4 onward). All other financial activities (both regulated and unregulated) must be captured through consolidation where practical to do so. Generally, majority-owned or controlled financial entities must be fully consolidated according to the methodologies outlined in this Module. If any majority-owned financial entities are not consolidated for capital purposes, all equity and other regulatory capital investments in those entities must be deducted and the assets and liabilities as well as third-party capital investments in the entity must be removed from the conventional bank licensee's balance sheet.

### CA-B.1.2B

In addition, this Module applies to conventional bank licensees on a solo basis (also including their foreign branches). This means that the assets and liabilities of subsidiaries referred to in Paragraph CA-B.1.2A must not be included in the balance sheet of the parent bank for the solo capital calculation and all equity and other regulatory capital investments in those entities must be deducted from the applicable components of Total Capital of the parent bank.

### CA-B.1.2C

Where a conventional bank licensee has no subsidiaries as referred to in Paragraph CA-B.1.2A, then the consolidated CAR requirements of this Module apply to the conventional bank licensee on a stand-alone basis.



MODULE	CA: Capital Adequacy
CHAPTER	CA-B: Scope of Application and Transitional Rules

## CA-B.1 Scope (continued)

### CA-B.1.2D

Although consolidation rules outlined in this Module are prescribed only for computing regulatory minimum capital, the procedures applied for such consolidation are performed in accordance with applicable accounting standards and best practices which may be subject to change from time to time.

### CA-B.1.3

If conventional bank licensees have investments in or control over banking or financial entities, including SPVs, they will also need to apply rules set out in Section CA-2.4 for the calculation of their solo and consolidated Capital Adequacy Ratios (CAR).

#### *Full Consolidation versus Aggregation*

### CA-B.1.4

Generally, wherever possible, the assets and liabilities of banking subsidiaries must be consolidated on a line-by-line basis using the risk-weighting and other rules and guidance in this Module. In some cases, foreign banking subsidiaries are subject to slightly differing rules by their host regulator. In such cases it may be more convenient to add in the risk-weighted assets of the subsidiary as calculated by host rules rather than by adding in the assets of the subsidiary and subjecting them to CBB requirements and risk weights. This process of using host risk-weights instead of CBB risk-weights is termed ‘aggregation’. Also host rules may treat some capital items differently to CBB rules. For example, T2 instruments may have different rules in host countries. There may therefore need to be a ‘haircut’ to such capital instruments, if the amount allowed by the host regulator is different to the amount of the investment by the parent bank.

### CA-B.1.5

For the reasons outlined in Paragraphs CA-B.1.2A to CA-B.1.4, banks must agree the proposed regulatory consolidation and aggregation approaches for banking and financial entity subsidiaries with the CBB and their external auditor.

### CA-B.1.6

If a banking or financial entity subsidiary is to be consolidated by way of aggregation, the capital and risk weighted assets (RWAs) of the non-resident entity must be shown separately. The parent bank is required to aggregate the subsidiary’s eligible capital and RWAs (based on the risk weighting of assets reported by the subsidiary to its host central bank) with its own eligible capital and RWAs respectively.

### CA-B.1.7

Appropriate adjustments must be made to eliminate intra-group exposures.



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<b>CHAPTER</b>	<b>CA-B: Scope of Application and Transitional Rules</b>

## CA-B.1 Scope (continued)

CA-B.1.8 If a conventional bank operates an Islamic window, the assets of such Islamic window will be risk weighted in accordance with CBB's guidelines for conventional banks.

### CA-B.1.9

If a bank in Bahrain is a subsidiary of a non-resident parent bank, the capital adequacy of such bank must be determined on a standalone basis.

### CA-B.1.10

Majority-owned or controlled financial entity subsidiaries must be adequately capitalised to reduce the possibility of future potential losses to the parent bank. The parent bank must monitor actions taken by the subsidiary to correct any capital shortfall and, if it is not corrected in a timely manner, the shortfall must also be deducted from the parent bank's solo and consolidated capital for regulatory capital purposes.





<b>MODULE</b>	<b>CA: Capital Adequacy</b>
<b>CHAPTER</b>	<b>CA-B: Scope of Application and Transitional Rules</b>

## CA-B.2 Transitional Arrangements

### CA-B.2.1

The transitional arrangements for implementing the new standards help to ensure that the banking sector can meet the higher capital standards through reasonable earnings retention and capital raising, while still supporting lending to the economy. The transitional arrangements are as follows:

- (a) Implementation of this Module begins on 1 January 2015. As of 1 January 2015, conventional bank licensees are required to meet the following new minimum CAR requirements taking each component of capital as defined in Chapters CA-2 and CA-2A divided by total risk-weighted assets (RWAs) as defined in Paragraph CA-1.1.3:

Components of Consolidated CARs		
	Optional	Minimum Ratio Required
Core Equity Tier 1 (CET 1)		6.5%
Additional Tier 1 (AT1)	1.5%	
Tier 1 (T1)		8%
Tier 2 (T2)	2%	
Total Capital		10%
Capital Conservation Buffer (CCB) (see below)		2.5%
CARs including CCB		
CET 1 plus CCB		9%
Tier 1 plus CCB		10.5%
Total Capital plus CCB		12.5%

Components of Solo CARs		
	Optional	Minimum Ratio Required
Core Equity Tier 1 (CET1)		4.5%
Additional Tier 1 (AT1)	1.5%	
Tier 1 (T1)		6.0%
Tier 2 (T2)	2%	
Total Capital		8.0%
Capital Conservation Buffer (CCB) (see below)		0%
CARs including CCB		
CET 1 plus CCB		N/A
Tier 1 plus CCB		N/A
Total Capital plus CCB		N/A



MODULE	CA: Capital Adequacy
CHAPTER	CA-B: Scope of Application and Transitional Rules

## CA-B.2 Transitional Arrangements (continued)

- (b) The difference between the Total Capital plus CCB (Capital Conservation Buffer – see Chapter CA-2A for more details) of 12.5% and the T1 plus CCB requirement (10.5%) for the consolidated CAR can be met with T2 and higher forms of capital;
- (c) The regulatory adjustments (i.e. deductions), including amounts above the aggregate 15% limit for significant investments in financial institutions, mortgage servicing rights, and deferred tax assets from temporary differences, are fully deducted from CET1 by 1 January 2019;
- (d) The regulatory adjustments (refer to Section CA-2.4) begin at 20% of the required adjustments to CET 1 on 1 January 2015, 40% on 1 January 2016, 60% on 1 January 2017, 80% on 1 January 2018, and reach 100% on 1 January 2019. The same transition approach applies to deductions from AT1 and T2 capital. Specifically, the regulatory adjustments to AT1 and T2 capital begin at 20% of the required deductions on 1 January 2015, 40% on 1 January 2016, 60% on 1 January 2017, 80% on 1 January 2018, and reach 100% on 1 January 2019. During the transition period, the remainder of exposures held prior to 1<sup>st</sup> January 2015 not deducted from capital is subject to the risk weights outlined in the October 2014 version of Chapter CA-3;
- (e) The treatment of capital issued out of subsidiaries and held by third parties (e.g. minority interest) is also phased in. Where such capital is eligible for inclusion in one of the three components of capital according to Paragraphs CA-2.3.1 to CA-2.3.5, it can be included from 1 January 2015. Where such capital is not eligible for inclusion in one of the three components of capital but is included under the existing treatment, 20% of this amount must be excluded from the relevant component of capital on 1 January 2015, 40% on 1 January 2016, 60% on 1 January 2017, 80% on 1 January 2018, and reach 100% on 1 January 2019; and
- (f) Capital instruments that no longer qualify as non-common equity T1 capital or T2 capital are phased out beginning 1 January 2015. Fixing the base at the nominal amount of such instruments outstanding on 1 January 2015, their recognition is capped at 90% from 1 January 2015, with the cap reducing by 10 percentage points in each subsequent year. This cap is applied to AT1 and T2 separately and refers to the total amount of instruments outstanding that no longer meet the relevant entry criteria. To the extent an instrument is redeemed, or its recognition in capital is amortised, after 1 January 2015, the nominal amount serving as the base is not reduced. In addition, instruments with an incentive to be redeemed are treated as follows:



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<b>CHAPTER</b>	<b>CA-B: Scope of Application and Transitional Rules</b>

## CA-B.2 Transitional Arrangements (continued)

- (i) For an instrument that has a call and a step-up prior to 1 January 2015 (or another incentive to be redeemed), if the instrument is not called at its effective maturity date and on a forward-looking basis meets the new criteria for inclusion in T1 or T2, it continues to be recognised in that tier of capital;
- (ii) For an instrument that has a call and a step-up on or after 1 January 2015 (or another incentive to be redeemed), if the instrument is not called at its effective maturity date and on a forward looking basis meets the new criteria for inclusion in T1 or T2, it continues to be recognised in that tier of capital. Prior to the effective maturity date, the instrument would be considered an “instrument that no longer qualifies as AT1 or T2” and is therefore phased out from 1 January 2015;
- (iii) For an instrument that has a call and a step-up between 12 September 2012 and 1 January 2015 (or another incentive to be redeemed), if the instrument is not called at its effective maturity date and on a forward looking basis does not meet the new criteria for inclusion in T1 or T2, it is fully derecognised in that tier of regulatory capital from 1 January 2015;
- (iv) For an instrument that has a call and a step-up on or after 1 January 2015 (or another incentive to be redeemed), if the instrument is not called at its effective maturity date and on a forward looking basis does not meet the new criteria for inclusion in T1 or T2, it is derecognised in that tier of regulatory capital from the effective maturity date. Prior to the effective maturity date, the instrument would be considered an “instrument that no longer qualifies as AT1 or T2” and is therefore phased out from 1 January 2015; and
- (v) For an instrument that had a call and a step-up on or prior to 12 September 2012 (or another incentive to be redeemed), if the instrument was not called at its effective maturity date and on a forward looking basis does not meet the new criteria for inclusion in T1 or T2, it is considered an “instrument that no longer qualifies as AT1 or T2” and is therefore phased out from 1 January 2015.

### CA-B.2.2

Capital instruments that do not meet the criteria for inclusion in CET1 are excluded from CET1 as of 1 January 2015.

### CA-B.2.3

Only those instruments issued before 12 September 2012 qualify for the transition arrangements outlined in Paragraph CA-B.2.1.



MODULE	CA: Capital Adequacy
CHAPTER	CA-1: General Requirements

## CA-1.1 Capital Adequacy Ratio (Definition and Methodology)

### CA-1.1.1

A conventional bank licensee's consolidated capital adequacy ratio is calculated by dividing its Consolidated Total Capital by its consolidated risk-weighted assets (RWAs). These items are defined and described in Paragraphs CA-1.1.2 to CA-1.1.8. A diagrammatic description of the formula used to calculate the consolidated CAR is given below.

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#### Consolidated Total Capital

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RWAs (Credit + Market + Operational Risks)

#### *Consolidated Total Capital*

### CA-1.1.2

Consolidated Total Capital consists of the sum of the following elements:

- (a) T1 (Going-concern):
  - (i) CET1 (as defined in Paragraph CA-2.1.2);
  - (ii) AT1 (as defined in Paragraph CA-2.1.4); and
- (b) T2 (Gone-concern) as defined in Paragraph CA-2.1.8.

#### *Consolidated Risk-weighted Assets*

### CA-1.1.3

Consolidated Total RWAs are determined by:

- (a) Multiplying the capital requirements for market risk (see CA-1.1.7) and operational risk (see CA-1.1.6) by 12.5 for the conventional bank licensee and all its consolidated subsidiaries; and
- (b) Adding the resulting figures to the sum of RWAs for credit risk (see CA-1.1.4) and securitisation risk for the conventional bank licensee and all its consolidated subsidiaries (see CA-1.1.5).

### CA-1.1.4

For the measurement of their credit risks, conventional bank licensees measure the risks in the standardised approach, applying the measurement framework described in Chapter CA-3 and subject to the credit mitigation techniques outlined in Chapter CA-4 of this Module.

### CA-1.1.5

The securitisation framework is set out in Chapter CA-6. Conventional bank licensees must apply the securitisation framework for determining regulatory capital requirements on exposures arising from traditional and synthetic securitisations or similar structures that contain features common to both.



MODULE	CA: Capital Adequacy
CHAPTER	CA-1: General Requirements

## CA-1.1 Capital Adequacy Ratio (continued)

### CA-1.1.6

For the measurement of their operational risks, conventional bank licensees have a choice, subject to the written approval of the CBB, between two broad methodologies:

- (a) The basic indicator approach, by applying the measurement framework described in Chapter CA-7 of this Module; and
- (b) The standardised approach (also in Chapter CA-7) this approach is subject to certain conditions (outlined in Chapter OM-8) and requires the explicit approval of the CBB.

### CA-1.1.7

For the measurement of their market risk, conventional bank licensees have a choice, subject to the written approval of the CBB, between two broad methodologies:

- (a) One alternative is to measure the risks in a standardised approach, applying the measurement frameworks described in Chapters CA-9 to CA-13 of this Module; and
- (b) The second alternative methodology (i.e. the IMM or internal models approach) is set out in detail in Chapter CA-14 including the procedure for obtaining the CBB's approval. This methodology is subject to the fulfilment of certain conditions. The use of this methodology is, therefore, conditional upon the explicit approval of the CBB.

### CA-1.1.8

In light of Paragraphs CA-1.1.3 to CA-1.1.7, each conventional bank licensee's overall capital requirement consists of:

- (a) The credit risk requirements laid down in Chapters CA-2 to CA-6, and including the credit counterparty risk on all over-the-counter derivatives whether in the trading or the banking books (see Chapter CA-8);
- (b) The capital charges for operational risk described in Chapter CA-7; and
- (c) The capital charges for market risks:
  - (i) Described in Chapters CA-9 to CA-13 summed arithmetically;
  - (ii) Derived from the models approach set out in Chapter CA-14; or
  - (iii) A mixture of (i) and (ii) summed arithmetically.



MODULE	CA:	Capital Adequacy
CHAPTER	CA-1:	General Requirements

## CA-1.1 Capital Adequacy Ratio (continued)

### CA-1.1.9

All transactions, including forward sales and purchases, must be included in the calculation of capital requirements as from the date on which they were entered into. Although regular reporting takes place quarterly, conventional bank licensees must manage their risks in such a way that the capital and leverage requirements are being met on a continuous basis, i.e. at the close of each business day. Conventional bank licensees must not “window-dress” by showing significantly lower credit or market risk positions on reporting dates. Conventional bank licensees must maintain strict risk management systems to ensure that intra-day exposures are not excessive. If a conventional bank licensee fails to meet the capital requirements of this Module, the bank must take immediate measures to rectify the situation as detailed in Section CA-1.2.

#### *Solo Capital Adequacy Ratio*

### CA-1.1.10

A conventional bank licensee’s solo capital adequacy ratio is calculated by dividing its Solo Total Capital by its Solo RWAs as described in Paragraph CA-1.1.11 and CA-1.1.12 without consolidating the assets and liabilities of subsidiaries referred to Paragraph CA-B.1.2A into the balance sheet of the parent bank.

#### *Solo Total Capital*

### CA-1.1.11

Solo Total Capital consists of the sum of the following elements:

- (a) T1 (Going-concern):
  - (i) CET1 for the parent bank only (as defined in Paragraph CA-2.1.2 but deducting item (c) before applying regulatory adjustments in item (d));
  - (ii) AT1 for the parent bank only (as defined in Paragraph CA-2.1.4 but deducting item (c) before applying regulatory adjustments in item (d)); and
- (b) T2 (Gone-concern) for the parent bank only as defined in Paragraph CA-2.1.8 but deducting item (c) before applying regulatory adjustments in item (d).

#### *Solo Risk-weighted Assets*

### CA-1.1.12

Solo Total RWAs are determined by:

- (a) Multiplying the capital requirements for market risk (see CA-1.1.7) and operational risk (see CA-1.1.6) by 12.5 for the parent bank alone; and



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CHAPTER	CA-1:	General Requirements

### CA-1.1 Capital Adequacy Ratio (continued)

- (b) Adding the resulting figures to the sum of risk-weighted assets for credit risk (see CA-1.1.4) and securitisation risk for the parent bank alone (see CA-1.1.5).

#### CA-1.1.13

For the purpose of this Module the solo CAR may be shown diagrammatically as below.

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Total Capital

RWAs (Credit + Market + Operational Risks)



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CHAPTER	CA-1: General Requirements

## CA-1.2 Reporting

### CA-1.2.1

Formal reporting to the CBB of capital adequacy must be made in accordance with the requirements set out under Section BR-3.1.

### CA-1.2.2

All Bahraini conventional bank licensees must provide the CBB, with immediate written notification (i.e. by no later than the following business day) of any actual breach of the minimum ratios outlined in Subparagraph CA-B.2.1 (a). Where such notification is given, the conventional bank licensee must also:

- (a) Provide the CBB no later than one calendar week after the notification, with a written action plan setting out how the conventional bank licensee proposes to restore the relevant ratios to the required minimum level(s), further, describing how the conventional bank licensee will ensure that a breach of such ratios will not occur again in the future;
- (b) Provide the CBB with weekly reports basis thereafter on the conventional bank licensee's relevant ratios until such ratios have reached the required minimum, level(s) described in Subparagraph CA-B.2.1(a); and
- (c) Take additional note of the Capital Conservation plan requirements in Chapter CA-2A where additional action is required when the Capital Conservation Buffer has been breached.

### CA-1.2.3

The conventional bank licensee is required to submit form PIR to the CBB on a weekly basis, until the concerned CARs identified in Paragraph CA-1.2.2 exceed the required minimum ratios.

### CA-1.2.4

The CBB will notify conventional bank licensees in writing of any action required of them with regard to the corrective and preventive action (as appropriate) proposed by the conventional bank licensee pursuant to the above, as well as of any other requirement of the CBB in any particular case.

### CA-1.2.5

Conventional bank licensees must note that the CBB considers the breach of regulatory CARs to be a very serious matter. Consequently, the CBB may (at its discretion) subject a conventional bank licensee which breaches its CAR(s) to a formal licensing reappraisal. Such reappraisal may be effected either through the CBB's own inspection function or through the use of appointed experts, as appropriate. Following such appraisal, the CBB will notify the conventional bank licensee concerned in writing of its conclusions with regard to the continued licensing of the conventional bank licensee.

### CA-1.2.6

The CBB recommends that the conventional bank licensee's compliance officer support and cooperate with the CBB in the monitoring and reporting of the CARs and other regulatory reporting matters. Compliance officers should ensure that their conventional bank licensees have adequate internal systems and controls to comply with these rules.





<b>MODULE</b>	<b>CA: Capital Adequacy</b>
<b>CHAPTER</b>	<b>CA-1: General Requirements</b>

### CA-1.3 Review of Prudential Information Returns

**CA-1.3.1** The CBB requires all conventional bank licensees to request their external auditor to conduct a review of the prudential returns on a quarterly basis in accordance with the requirements set out under Section BR-3.1.

CA-1.3.2 If a conventional bank licensee provides prudential returns without any reservation from auditors for two consecutive quarters, it can apply for exemption from such review for a period to be decided by CBB.

CA-1.3.3 For Bahraini conventional bank licensees, all existing exemptions in respect of PIR review as at 31<sup>st</sup> December 2014 will cease.

**CA-1.3.4** Conventional bank licensees' daily compliance with the capital requirements for credit and market risk must be verified by the independent risk management department and the internal auditor.



MODULE	CA: Capital Adequacy
CHAPTER	CA-2: Regulatory Capital

## CA-2.1 Regulatory Capital

### *Tier 1 (T1)*

#### CA-2.1.1

The predominant form of T1 capital must be common shares and retained earnings (hereafter referred to as CET1). Deductions from capital and prudential filters are applied at the level of CET1 (see CA-2.1 to CA-2.4 for a more detailed explanation). The remainder of the T1 capital base must be comprised of instruments that are subordinated, have fully discretionary non-cumulative dividends or coupons and have neither a maturity date nor an incentive to redeem.

### *Common Equity Tier 1 (CET1)*

#### CA-2.1.2

CET1 capital consists of the sum of the following items (a) to (d) below:

- (a) Issued and fully paid common shares that meet the criteria for classification as common shares for regulatory purposes (see Paragraph CA-2.1.3);
- (b) Disclosed reserves including:
  - (i) General reserves;
  - (ii) Legal / statutory reserves;
  - (iii) Share premium;
  - (iv) Fair value reserves arising from fair valuing financial instruments; and
  - (v) Retained earnings or losses (including net profit and loss for the reporting period, whether reviewed or audited);
- (c) Common shares issued by consolidated banking subsidiaries of the conventional bank licensee and held by third parties (i.e. minority interest) that meet the criteria for inclusion in CET1. See Section CA-2.3 for the relevant criteria; and
- (d) Regulatory adjustments applied in the calculation of CET1 (see Section CA-2.4).

#### CA-2.1.2A

For unrealised fair value reserves relating to financial instruments to be included in CET1 Capital, conventional bank licensees and their auditor must only recognise such gains or losses that are prudently valued and independently verifiable (e.g. by reference to market prices). The CBB will closely review the components and extent of unrealised gains and losses and will exclude any that do not have reference to independent valuations (i.e. those made by bank management alone will not be included) or which are not deemed to be made on a prudent basis. As such, the prudent valuations, and the independent verification thereof, are mandatory. Unrealised gains and losses that have resulted from changes in the fair value of liabilities that are due to changes in the bank's own credit risk must be derecognised in the calculation of CET1.



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## CA-2.1 Regulatory Capital (continued)

### CA-2.1.3

For a common share to be included in CET1, it must meet the following criteria:

- (a) It is directly issued to shareholders and fully paid in;
- (b) It is non-cumulative;
- (c) It is able to absorb losses within the conventional bank licensee on a going-concern basis;
- (d) It is neither secured nor covered by a guarantee of the issuer or a related entity or any other arrangement that legally or economically enhances the seniority of the claim vis-à-vis bank creditors;
- (e) It represents the most subordinated claim in liquidation of the conventional bank licensee (i.e. it is junior to depositors, general creditors, and subordinated debt of the bank);
- (f) It is entitled to a claim on the residual assets that is proportional with its share of issued capital, after all senior claims have been repaid in liquidation (i.e. it has an unlimited and variable claim, not a fixed or capped claim);
- (g) Its principal is perpetual and never repaid outside of liquidation;
- (h) The conventional bank licensee does nothing to create an expectation at issuance that the instrument will be bought back, redeemed or cancelled nor do the statutory or contractual terms provide any feature which might give rise to such an expectation;
- (i) Distributions are paid out of distributable items (retained earnings included). The level of distributions is not in any way tied or linked to the amount paid in at issuance and is not subject to a contractual cap (except to the extent that a bank is unable to pay distributions that exceed the level of distributable items);
- (j) There are no circumstances under which the distributions are obligatory. Non-payment is therefore not an event of default;
- (k) Distributions are paid only after all legal and contractual obligations have been met and payments on more senior capital instruments have been made. This means that there are no preferential distributions;
- (l) It is the issued capital that takes the first and proportionately greatest share of any losses as they occur;
- (m) The paid in amount is recognised as equity capital (i.e. it is not recognised as a liability) for determining balance sheet insolvency;
- (n) The paid in amount is classified as equity under IFRS and disclosed separately in the financial statements;



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## CA-2.1 Regulatory Capital (continued)

- (o) The conventional bank licensee cannot directly or indirectly have funded the purchase of the instrument (i.e. treasury shares and shares purchased or funded by the conventional bank licensee for employee share purchase schemes must be deducted from CET1, and are subject to the 10% limit under the Commercial Companies' Law. Any of the conventional bank licensee's own shares used as collateral for the advance of funds to its customers must be deducted from CET1 and are also subject to the above 10% limit); and
- (p) It is only issued with the approval of the shareholders of the issuing conventional bank licensee.

### *Additional Tier 1 Capital (AT1)*

#### CA-2.1.4

AT1 capital consists of the sum of the items (a) to (d):

- (a) Instruments issued by the bank that meet the criteria for inclusion in AT1 outlined in Paragraph CA-2.1.6;
- (b) Stock surplus (share premium) resulting from the issue of instruments included in AT1;
- (c) Instruments issued by consolidated subsidiaries of the bank and held by third parties that meet the criteria for inclusion in AT1 and are not included in CET1. See section CA-2.3 for the relevant criteria; and
- (d) Regulatory adjustments applied in the calculation of AT1 (see CA-2.4).

CA-2.1.5 [This paragraph has been left blank.]

#### CA-2.1.6

For an instrument to be included in AT1, it must meet or exceed all the criteria below:

- (a) It is issued and paid-in;
- (b) It is subordinated to depositors, general creditors and subordinated debt of the conventional bank licensee;
- (c) It is neither secured nor covered by a guarantee of the issuer or related entity or other arrangement that legally or economically enhances the seniority of the claim vis-à-vis conventional bank licensee creditors;
- (d) It is perpetual, i.e. there is no maturity date and there are no step-ups or other incentives to redeem;



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### CA-2.1 Regulatory Capital (continued)

- (e) It may be callable at the initiative of the issuer only after a minimum of five years and a conventional bank licensee must not do anything which creates an expectation that the call will be exercised. A conventional bank licensee may not exercise such a call option without receiving prior written approval of the CBB and the called instrument is replaced with capital of the same or better quality; or the conventional bank licensee demonstrates that its capital position is well above the minimum capital requirements after the call option is exercised;
- (f) In all early call situations, replacement of existing capital must be done at conditions which are sustainable for the income capacity of the conventional bank licensee;
- (g) Any repayment of principal (e.g. through repurchase or redemption) must be with prior written approval of the CBB and the conventional bank licensee must not assume or create market expectations that supervisory approval will be given;
- (h) The conventional bank licensee must have full discretion at all times to cancel distributions/payments. This means that 'dividend pushers' are prohibited. A dividend pusher obliges a bank to make a dividend or coupon payment on an instrument if it has made a payment on another capital instrument or share. Also features that require the conventional bank licensee to make distributions in kind are not permitted;
- (i) Cancellation of discretionary payments must not be an event of default;
- (j) Conventional bank licensees must have full access to cancelled payments to meet obligations as they fall due;
- (k) Cancellation of distributions/payments must not impose restrictions on the conventional bank licensee except in relation to distributions to common stockholders;
- (l) Dividends/coupons must be paid out of distributable items;
- (m) The instrument cannot have a credit sensitive dividend feature (this might serve to increase the dividend payable if a bank's credit rating falls from A to BBB, for example) which may lead to the dividend/coupon being reset periodically based in whole or in part on the conventional bank licensee's credit standing;
- (n) The instrument cannot contribute to liabilities exceeding assets if such a balance sheet test forms part of national insolvency law. This means that instruments accounted for as liabilities must be able to be written down in some way as described in subparagraph (o);



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### CA-2.1 Regulatory Capital (continued)

- (o) All instruments must have principal loss absorption through either (i) conversion to common shares at an objective pre-specified trigger event; or (ii) a write-down mechanism which allocates losses to the instrument at a pre-specified trigger event. The write-down will reduce the claim of the instrument in liquidation and reduce the amount that will be re-paid when a call is exercised and partially or fully reduce coupon/dividend payments on the instrument;
- (p) Neither the conventional bank licensee nor a related party over which it exercises control or significant influence can have purchased the instrument, nor can the conventional bank licensee directly or indirectly have funded the purchase of the instrument. This also means that own holdings of AT1 instruments and AT1 instruments purchased or funded by the bank for employee share purchase schemes must be deducted from AT1. Any of the conventional bank licensee's AT1 instruments used as collateral for the advance of funds to its customers must be deducted from AT1 ;
- (q) The instrument cannot have any features that hinder recapitalisation, such as provisions that require the issuer to compensate investors if a new instrument is issued at a lower price during a specified time frame; and
- (r) If the instrument is not issued out of a fully consolidated subsidiary bank or the parent conventional bank licensee in the consolidated group (e.g. a special purpose vehicle – “SPV”), proceeds must be immediately available without limitation to the parent bank in the consolidated group in a form which meets or exceeds all of the other criteria for inclusion in AT1.

CA-2.1.7 [This paragraph has been left blank.]

#### CA-2.1.7A

The issuance of any new shares as a result of a trigger event must occur prior to any public sector injection of capital so that the capital provided by the public sector is not diluted.



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## CA-2.1 Regulatory Capital (continued)

**CA-2.1.7B** Where an issuing bank or SPV is part of a banking group and the issuer wishes the instrument to be included in the capital base of the group (in addition to its solo capital where applicable), the terms and conditions must specify an additional trigger event.

**CA-2.1.7C** Any common stock paid as compensation to the holders of the instrument must be common stock of either the issuing bank or the parent bank of the group (including any successor in resolution).

### *Write Down or Conversion of Additional Tier 1 Instruments*

**CA-2.1.7D** For the purposes of Subparagraph CA-2.1.6(o), the following provisions apply to AT1 instruments accounted for as liabilities:

- (a) A trigger event occurs when the CET1 capital ratio of the conventional bank licensee institution referred to in Subparagraph CA-B.2.1(a) falls below either of the following:
  - (i) 7.0%;
  - (ii) A level higher than 7.0 %, where determined by the conventional bank licensee and specified in the provisions governing the instrument; and
- (b) Conventional bank licensees may specify in the provisions governing the instrument one or more trigger events in addition to that referred to in Subparagraph (a).

**CA-2.1.7E** Where the provisions governing AT1 instruments require them to be converted into CET1 instruments upon the occurrence of a trigger event, those provisions must specify either of the following:

- (a) The rate of such conversion and a limit on the permitted amount of conversion; or
- (b) A range within which the instruments will convert into CET1 instruments.



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## CA-2.1 Regulatory Capital (continued)

### CA-2.1.7F

Where the provisions governing AT1 instruments require their principal amount to be written down upon the occurrence of a trigger event, the write down must reduce all the following:

- (a) The claim of the holder of the instrument in the insolvency or liquidation of the conventional bank licensee;
- (b) The amount required to be paid in the event of the call or redemption of the instrument; and
- (c) The distributions made on the instrument.

### CA-2.1.7G

Write down or conversion of an AT1 instrument must, under the applicable accounting framework, generate items that qualify as CET1 items.

### CA-2.1.7H

The amount of AT1 instruments recognised in AT1 items is limited to the minimum amount of CET1 items that would be generated if the principal amount of the AT1 instruments were fully written down or converted into CET1 instruments.

### CA-2.1.7I

The aggregate amount of AT1 instruments that is required to be written down or converted upon the occurrence of a trigger event must be no less than the lower of the following:

- (a) The amount required to restore fully the CET1 ratio of the conventional bank licensee to 7.0 %; and
- (b) The full principal amount of the instrument.

### CA-2.1.7J

When a trigger event occurs conventional bank licensees must do the following:

- (a) Immediately inform the CBB;
- (b) Inform the holders of the AT1 instruments; and
- (c) Write down the principal amount of the AT1 instruments, or convert the instruments into CET1 instruments without delay, but no later than within one month, in accordance with the requirement laid down in this Section.





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## CA-2.1 Regulatory Capital (continued)

**CA-2.1.7K** A conventional bank licensee issuing AT1 instruments that convert to CET1 on the occurrence of a trigger event must ensure that its authorised share capital is at all times sufficient, for converting all such convertible AT1 instruments into shares if a trigger event occurs.

**CA-2.1.7L** All necessary authorisations must be obtained at the date of issuance of such convertible AT1 instruments. The conventional bank licensee must maintain at all times the necessary prior authorisation from the CBB to issue the CET1 instruments into which such AT1 instruments would convert upon occurrence of a trigger event.

**CA-2.1.7M** A conventional bank licensee issuing AT1 instruments that convert to CET1 on the occurrence of a trigger event must ensure that there are no procedural impediments to that conversion by virtue of its incorporation or statutes or contractual arrangements.

### *Consequences of the Conditions for AT1 Instruments Ceasing to Be Met*

**CA-2.1.7N** The following must apply where, in the case of an AT1 instrument, the conditions laid down in Paragraph CA-2.1.6 cease to be met:

- That instrument must immediately cease to qualify as an AT1 instrument; and
- The part of the share premium accounts that relates to that instrument must immediately cease to qualify as an AT1 item.

### *Tier 2 Capital (T2)*

**CA-2.1.8** T2 capital consists of the sum of the following items:

- Instruments issued by the conventional bank licensee that meet the criteria for inclusion in T2 outlined in Paragraph CA-2.1.10;
- Stock surplus (share premium) resulting from the issue of instruments included in T2;
- Instruments issued by consolidated subsidiaries of the conventional bank licensee and held by third parties that meet the criteria for inclusion in T2 capital and are not included in T1. See CA-2.3 for the relevant criteria;



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## CA-2.1 Regulatory Capital (continued)

- (d) General loan loss provisions held against future, presently unidentified losses and are freely available to meet losses which subsequently materialise and qualify for inclusion within T2. Such general loan loss provisions which are eligible for inclusion in T2 will be limited to a maximum of 1.25 percentage points of credit risk-weighted risk assets. Provisions ascribed to identified deterioration of particular assets or known liabilities, whether individual or grouped, must be excluded;
- (e) Regulatory adjustments applied in the calculation of T2 (see CA-2.4); and
- (f) Asset revaluation reserves which arise from the revaluation of fixed assets from time to time in line with the change in market values, and are reflected on the face of the balance sheet as a revaluation reserve. Similarly, gains may also arise from revaluation of Investment Properties (real estate). These reserves (including the net gains on investment properties) may be included in T2 capital, with the concurrence of the external auditor, provided that the assets are prudently valued, fully reflecting the possibility of price fluctuation and forced sale.

CA-2.1.9 The treatment of instruments issued out of consolidated subsidiaries of the conventional bank licensee and the regulatory adjustments applied in the calculation of T2 are addressed in Section CA-2.3.

### CA-2.1.10

For an instrument to be included in T2(see CA-2.1.8(a)), it must meet all the criteria below:

- (a) It is issued and paid-in;
- (b) It is subordinated to depositors and general creditors of the conventional bank licensee;
- (c) It is neither secured nor covered by a guarantee of the issuing conventional bank licensee or related entity or other arrangement that legally or economically enhances the seniority of the claim vis-à-vis depositors and general creditors of the conventional bank licensee;
- (d) It must have a minimum maturity of at least 5 years and it will be amortised on a straight line basis in the remaining five years before maturity and there are no step-ups or other incentives to redeem;



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### CA-2.1 Regulatory Capital (continued)

- (e) It may be callable at the initiative of the conventional bank licensee only after a minimum of five years and the conventional bank licensee must not do anything which creates an expectation that the call will be exercised. The conventional bank licensee may not exercise such a call option without receiving written prior approval of the CBB and the called instrument must be replaced with capital of the same or better quality; or the conventional bank licensee demonstrates that its capital position is well above the minimum capital requirements after the call option is exercised. In all early call situations, any replacement of existing capital must be done at conditions which are sustainable for the income capacity of the conventional bank licensee;
- (f) The investor must have no rights to accelerate the repayment of future scheduled payments (coupon or principal), except in bankruptcy and liquidation;
- (g) The instrument cannot have a credit sensitive dividend/coupon that is reset periodically based in whole or in part on the conventional bank licensee's credit standing;
- (h) Neither the conventional bank licensee nor a related party over which the bank exercises control or significant influence can have purchased the instrument, nor can the conventional bank licensee directly or indirectly have funded the purchase of the instrument. This means own holdings of T2 instruments and T2 purchased or funded by the conventional bank licensee for employee share purchase schemes must be deducted from T2. Any of the conventional bank licensee's own T2 instruments used as collateral for the advance of funds to its customers must be deducted from T2;
- (i) If the instrument is not issued out of a fully consolidated subsidiary bank or the parent conventional bank licensee in the consolidated group (e.g. a special purpose vehicle – “SPV”), proceeds must be immediately available without limitation to the parent conventional bank licensee in the consolidated group in a form which meets or exceeds all of the other criteria for inclusion in T2; and
- (j) All T2 Instruments must have principal loss absorption through either (i) conversion to common shares at an objective pre-specified trigger event; or (ii) a write-down mechanism which allocates losses to the instrument at a pre-specified trigger event. The write-down will reduce the claim of the instrument in liquidation and reduce the amount that will be re-paid when a call is exercised and partially or fully reduce coupon/dividend payments on the instrument;



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## CA-2.1 Regulatory Capital (continued)

CA-2.1.11 [This paragraph has been left blank.]

**CA-2.1.11A** The issuance of any new shares as a result of a trigger event must occur prior to any public sector injection of capital so that the capital provided by the public sector is not diluted.

**CA-2.1.11B** Where an issuing bank or SPV is part of a banking group and the issuer wishes the instrument to be included in the capital base of the group (in addition to its solo capital where applicable), the terms and conditions must specify an additional trigger event.

**CA-2.1.11C** Any common stock paid as compensation to the holders of the instrument must be common stock of either the issuing bank or the parent bank of the group (including any successor in resolution).

### *Write Down or Conversion of Tier 2 Instruments*

**CA-2.1.11D** For the purposes of Subparagraph CA-2.1.10(j), the following provisions apply to T2 instruments accounted for as liabilities:

- (a) A trigger event occurs when the CET1 capital ratio of the conventional bank licensee institution referred to in Subparagraph CA-B.2.1(a) falls below either of the following:
  - (i) 7.0%; or
  - (ii) A level higher than 7.0%, where determined by the conventional bank licensee and specified in the provisions governing the instrument; and
- (b) Conventional bank licensees may specify in the provisions governing the instrument one or more trigger events in addition to that referred to in Subparagraph (a).



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## CA-2.1 Regulatory Capital (continued)

**CA-2.1.11E** Where the provisions governing T2 instruments require them to be converted into CET1 instruments upon the occurrence of a trigger event, those provisions must specify either of the following:

- (a) The rate of such conversion and a limit on the permitted amount of conversion; or
- (b) A range within which the instruments will convert into CET1 instruments.

**CA-2.1.11F** Where the provisions governing T2 instruments require their principal amount to be written down upon the occurrence of a trigger event, the write down must reduce all the following:

- (a) The claim of the holder of the instrument in the insolvency or liquidation of the conventional bank licensee;
- (b) The amount required to be paid in the event of the call or redemption of the instrument; and
- (c) The distributions made on the instrument.

**CA-2.1.11G** Write down or conversion of a T2 instrument must, under the applicable accounting framework, generate items that qualify as CET1 items.

**CA-2.1.11H** The amount of T2 instruments recognised in T2 items is limited to the minimum amount of CET1 items that would be generated if the principal amount of the T2 instruments were fully written down or converted into CET1 instruments.

**CA-2.1.11I** The aggregate amount of T2 instruments that is required to be written down or converted upon the occurrence of a trigger event must be no less than the lower of the following:

- (a) The amount required to restore fully the CET1 ratio of the conventional bank licensee to 7.0 %; and
- (b) The full principal amount of the instrument.

**CA-2.1.11J** When a trigger event occurs conventional bank licensees must do the following:

- (a) Immediately inform the CBB;
- (b) Inform the holders of the T2 instruments; and
- (c) Write down the principal amount of the T2 instruments, or convert the instruments into CET1 instruments without delay, but no later than within one month, in accordance with the requirement laid down in this Section.



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## CA-2.1 Regulatory Capital (continued)

**CA-2.1.11K** A conventional bank licensee issuing T2 instruments that convert to CET1 on the occurrence of a trigger event must ensure that its authorised share capital is at all times sufficient, for converting all such convertible T2 instruments into shares if a trigger event occurs.

**CA-2.1.11L** All necessary authorisations must be obtained at the date of issuance of such convertible T2 instruments. The conventional bank licensee must maintain at all times the necessary prior authorisation from the CBB to issue the CET1 instruments into which such T2 instruments would convert upon occurrence of a trigger event.

**CA-2.1.11M** A conventional bank licensee issuing T2 instruments that convert to CET1 on the occurrence of a trigger event must ensure that there are no procedural impediments to that conversion by virtue of its incorporation or statutes or contractual arrangements.

### *Consequences of the Conditions for T2 Instruments Ceasing to Be Met*

**CA-2.1.11N** The following must apply where, in the case of a T2 instrument, the conditions laid down in CA-2.1.10 cease to be met:

- (a) That instrument must immediately cease to qualify as a T2 instrument; and
- (b) The part of the share premium accounts that relates to that instrument must immediately cease to qualify as a T2 item.



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## CA-2.2 Limits and Minima on the Use of Different Forms of Capital

### *Consolidated T1 Capital and Total Capital*

#### CA-2.2.1

CAR components and CARs outlined in Paragraph CA-B.2.1 must meet or exceed the following minimum ratios relative to total risk-weighted assets:

- (a) CET1 must be at least 6.5% of risk-weighted assets at all times;
- (b) T1 Capital must be at least 8% of risk-weighted assets at all times;
- (c) Total Capital (T1 Capital plus T2 Capital) must be at least 10% of risk-weighted assets at all times;
- (d) In addition, conventional bank licensees must meet the minimum Capital Conservation Buffer (CCB) requirement of 2.5% of risk-weighted assets. The CCB must be composed of CET1 and so this gives an aggregate 9% CET1 including the CCB minimum capital requirement;
- (e) A minimum 10.5% T1 Capital Adequacy Ratio including the above CCB requirement; and
- (f) A 12.5% minimum Total Capital Adequacy Ratio including the above CCB requirement.

### *Solo Tier 1 Capital and Total Capital*

#### CA-2.2.1A

CAR components and CARs outlined in Paragraph CA-B.2.1 must meet or exceed the following minimum ratios on a solo basis relative to total risk-weighted assets:

- (a) CET1 must be at least 4.5% of risk-weighted assets at all times;
- (b) T1 Capital must be at least 6% of risk-weighted assets at all times;
- (c) Total Capital (T1 Capital plus T2 Capital) must be at least 8% of risk-weighted assets at all times; and
- (d) The minimum Capital Conservation Buffer (CCB) requirement of 2.5% of risk-weighted assets does not apply on a solo basis.

#### CA-2.2.2

CET1 must be the predominant form of capital. Accordingly, the contribution of AT1 instruments towards the Minimum T1 Capital Ratios mentioned in Paragraphs CA-2.2.1 and CA-2.2.1A is limited to 1.5%.



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## CA-2.2 Limits and Minima on the Use of Different Forms of Capital (continued)

CA-2.2.3 The limits on AT1 instruments and T2 instruments are based on the amount of CET1 after deductions pursuant to CA-2.4 (see Appendices CA-22 and CA-23 for examples of the threshold deduction effects and the caps).

### *Tier 2: Supplementary Capital*

**CA-2.2.4** The contribution of T2 capital towards the Minimum Total Capital Ratios and Minimum Total Capital plus Capital Conservation Buffer Ratios mentioned in Paragraphs CA-2.2.1 (consolidated) and CA-2.2.1A (solo) is limited to 2.0%.

CA-2.2.5 To explain the limits outlined in Paragraph CA-2.2.4 on the contributions of AT1 and T2 Capital to T1 and Total Capital, a simple example is given below where a conventional bank licensee has BD650mn of Core Equity Tier One Capital and BD200mn of AT1 and BD300mn of T2 Capital and BD10,000mn of total risk-weighted assets:

- (a) 6.5% CET1 = BD650mn;
- (b) 8.0% T1 = BD800mn (i.e. only BD150mn of the AT1 may be included in the T1 minimum requirement);
- (c) 10% Total Capital = BD1,000 mn (i.e. only BD200mn of the T2 Capital may be included in the Total Capital requirement).

This means that if the conventional bank licensee only has BD650mn of CET1, it cannot comply with the additional Capital Conservation Buffer Requirement of 2.5% nor can it use excess AT1 or T2 Capital to meet this requirement. Although it would appear that the conventional bank licensee has BD1,150mn of total capital, only BD1,000 can be used to meet the minimum ratios. This example serves to underline the importance of CET1. Unless a conventional bank licensee can meet the CET1 minimum CARs of 6.5% and 9.0% mentioned above, it may not be able to meet any of the other minimum capital adequacy ratios outlined in Paragraph CA-2.2.1.





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### CA-2.3 Minority Interest Held by Third Parties in Consolidated Banking Subsidiaries

#### *Common Shares issued by Consolidated Banking Subsidiaries*

##### CA-2.3.1

In order for minority interest arising from the issue of common shares by a fully consolidated subsidiary of the conventional bank licensee to be recognised in CET1 for the consolidated CAR calculation, it must meet the following conditions:

- (a) The instrument giving rise to the minority interest would, if issued by the conventional bank licensee, meet all of the criteria for classification as common shares for regulatory capital purposes;
- (b) The subsidiary that issued the instrument is itself a bank<sup>1,2</sup>; and
- (c) The subsidiary meets the limits outlined in Paragraph CA-2.3.2.

##### CA-2.3.2

The amount of minority interest meeting the criteria above that will be recognised in consolidated CET1 will be calculated as follows:

- (a) Total minority interest meeting the criteria in Paragraph CA-2.3.1 minus the amount of the surplus CET1 of the subsidiary attributable to the minority shareholders;
- (b) Surplus CET1 of the subsidiary is calculated as the CET1 of the subsidiary minus the lower of:
  - (i) The minimum CET1 requirement of the subsidiary plus the capital conservation buffer (CCB) (i.e. 7.0% of risk weighted assets or more as required by the concerned supervisor) and;
  - (ii) The portion of the consolidated minimum CET1 requirement plus the CCB (i.e. 9.0% of consolidated risk weighted assets) that relates to the subsidiary; and
- (c) The amount of the surplus CET1 that is attributable to the minority shareholders is calculated by multiplying the surplus CET1 by the percentage of CET1 that is held by minority shareholders.

CA-2.3.2A Appendix CA-1 outlines an example of the effect of an allocation of minority interest between the parent bank and minority shareholders in the fully consolidated subsidiary.

<sup>1</sup> For the purposes of this paragraph, any institution that is subject to the same minimum prudential standards and level of supervision as a bank may be considered to be a bank.

<sup>2</sup> Minority interest in a subsidiary that is a bank is strictly excluded from the parent bank's common equity if the parent bank or affiliate has entered into any arrangements to fund directly or indirectly minority investment in the subsidiary whether through an SPV or through another vehicle or arrangement. The treatment outlined above, thus, is strictly available where all minority investments in the bank subsidiary solely represent genuine third party common equity contributions to the subsidiary.



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### CA-2.3 Minority Interest Held by Third Parties in Consolidated Banking Subsidiaries (continued)

#### *AT1 Qualifying Capital issued by Consolidated Banking Subsidiaries*

##### CA-2.3.3

AT1 capital instruments issued by a fully consolidated banking subsidiary of the conventional bank licensee to third party investors (including amounts under Paragraph CA-2.3.2) may receive recognition in T1 capital only if the instruments would, if issued by the conventional bank licensee, meet all of the criteria for classification as T1. The amount of this AT1 that will be recognised in consolidated AT1 will exclude amounts recognised in consolidated CET1 under Paragraph CA-2.3.2 and will be calculated as follows:

- (a) T1 of the subsidiary issued to third parties minus the amount of the surplus T1 of the subsidiary attributable to the third party investors;
- (b) Surplus T1 of the subsidiary is calculated as the T1 of the subsidiary minus the lower of: (1) the minimum T1 requirement of the subsidiary plus the CCB and (2) the portion of the consolidated minimum T1 requirement plus the CCB that relates to the subsidiary; and
- (c) The amount of the surplus T1 that is attributable to the third party investors is calculated by multiplying the surplus T1 by the percentage of T1 that is held by third party investors.

#### *T2 Qualifying Capital issued by Consolidated Banking Subsidiaries*

##### CA-2.3.4

T2 instruments issued by a fully consolidated banking subsidiary of the conventional bank licensee to third party investors (including amounts under Paragraphs CA-2.3.2 and CA-2.3.3) may receive recognition in consolidated Total Capital only if the instruments would, if issued by the conventional bank licensee, meet all of the criteria for classification as T2. The amount of this T2 that will be recognised in the parent bank's T2 will exclude amounts recognised in CET1 under Paragraph CA-2.3.2 and amounts recognised in AT1 under Paragraph CA-2.3.3 and will be calculated as follows:

- (a) Total capital instruments of the subsidiary issued to third parties minus the amount of the surplus Total Capital of the subsidiary attributable to the third party investors;



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### CA-2.3 Minority Interest Held by Third Parties in Consolidated Banking Subsidiaries (continued)

- (b) Surplus Total Capital of the subsidiary is calculated as the Total Capital of the subsidiary minus the lower of:
  - (i) The minimum Total Capital requirement of the subsidiary plus the capital conservation buffer; and
  - (ii) The portion of the consolidated minimum Total Capital requirement plus the capital conservation buffer that relates to the subsidiary; and
- (c) The amount of the surplus Total Capital that is attributable to the third party investors is calculated by multiplying the surplus Total Capital by the percentage of Total Capital that is held by third party investors.

#### CA-2.3.5

Where capital has been issued to third parties out of a special purpose vehicle (SPV), none of this capital can be included in consolidated CET1. However, such capital can be included in consolidated AT1 or T2 and treated as if the conventional bank licensee itself had issued the capital directly to the third parties only if it meets all the relevant entry criteria and the only asset of the SPV is its investment in the capital of the conventional bank licensee in a form that meets or exceeds all the relevant entry criteria<sup>3</sup> (as required by CA-2.1.6(r) for AT1 and CA-2.1.10(i) for T2). In cases where the capital has been issued to third parties through an SPV via a fully consolidated subsidiary of the conventional bank licensee, such capital may, subject to the requirements of this paragraph, be treated as if the subsidiary itself had issued it directly to the third parties and may be included in the conventional bank licensee's consolidated AT1 or T2 in accordance with the treatment outlined in Paragraphs CA-2.3.3 and CA-2.3.4.

<sup>3</sup> Assets that relate to the operation of the SPV may be excluded from this assessment if they are de minimis.



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## CA-2.4 Regulatory Adjustments (Solo and Consolidated)

### CA-2.4.1

This section sets out the regulatory adjustments to be applied to Regulatory Capital. There are four stages of adjustments for CET1. In most cases these adjustments are applied in the calculation of CET1. The first set of adjustments is applied in Paragraphs CA-2.4.2 to CA-2.4.15. A subtotal for CET1 is obtained (this can be called CET1a). A second regulatory adjustment described in Paragraphs CA-2.4.16 to CA-2.4.19 is then applied to CET1a (this adjustment results in CET1b). A third regulatory adjustment described in Paragraphs CA-2.4.20 to CA-2.4.21 is then applied to CET1b (this adjustment results in CET1c). Then a final regulatory adjustment described in Paragraph CA-2.4.23 is then applied to CET1c (this adjustment results in CET1d). This is the amount of CET1 that can be used for the calculation of the CAR and determining all other applicable caps on T1 and T2. An example of the effects of the regulatory deductions is given in Appendix CA-22.

#### *Goodwill and other Intangibles (Except Mortgage Servicing Rights)*

### CA-2.4.2

Goodwill must be deducted in the calculation of CET1, including any goodwill included in the valuation of significant investments in the capital of banking, financial and insurance entities that are outside the scope of regulatory consolidation. The full amount is to be deducted net of any associated deferred tax liability which would be extinguished if the goodwill becomes impaired or derecognised under IFRS. The amount to be deducted in respect of mortgage servicing rights is set out in Paragraph CA-2.4.23A. Intangible assets other than goodwill and mortgage service rights are subject to transitional arrangements and are phased out as regulatory adjustments as outlined in Subparagraph CA-B.2.1(d).

### CA-2.4.3

Conventional bank licensees must use the IFRS definition of intangible assets to determine which assets are classified as intangible and are thus required to be deducted.



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## CA-2.4 Regulatory Adjustments (continued)

### *Deferred Tax Assets*

#### CA-2.4.4

Deferred tax assets (DTAs) that rely on future profitability of the conventional bank licensee to be realised are to be deducted in the calculation of CET1. Deferred tax assets may be netted with associated deferred tax liabilities (DTLs) only if the DTAs and DTLs relate to taxes levied by the same taxation authority and offsetting is permitted by the relevant taxation authority. Where these DTAs relate to temporary differences (e.g. allowance for credit losses) the amount to be deducted is set out in Paragraph CA-2.4.23. All other such assets, e.g. those relating to operating losses, such as the carry forward of unused tax losses, or unused tax credits, are to be deducted in full net of deferred tax liabilities as described above. The DTLs permitted to be netted against DTAs must exclude amounts that have been netted against the deduction of goodwill, intangibles and defined benefit pension assets, and must be allocated on a pro rata basis between DTAs subject to the threshold deduction treatment and DTAs that are to be deducted in full.

#### CA-2.4.5

An over instalment of tax or, in some jurisdictions, current year tax losses carried back to prior years may give rise to a claim or receivable from the government or local tax authority. Such amounts are typically classified as current tax assets for accounting purposes. The recovery of such a claim or receivable would not rely on the future profitability of the conventional bank licensee and must be assigned the relevant sovereign risk weighting.

### *Cash Flow Hedge Reserve*

#### CA-2.4.6

The amount of the cash flow hedge reserve that relates to the hedging of items that are not fair valued on the balance sheet (including projected cash flows) must be derecognised in the calculation of CET1. This means that positive amounts must be deducted and negative amounts must be added back.

#### CA-2.4.7

This treatment specifically identifies the element of the cash flow hedge reserve that is to be derecognised for prudential purposes. It removes the element that gives rise to artificial volatility in common equity, as in this case the reserve only reflects one half of the picture (the fair value of the derivative, but not the changes in fair value of the hedged future cash flow).



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## CA-2.4 Regulatory Adjustments (continued)

### *Gain on Sale Related to Securitisation Transactions*

CA-2.4.8

Any increase in equity capital resulting from a securitisation transaction (see Section CA-6.4) must be deducted from the calculation of CET1.

CA-2.4.9

[This paragraph has been left blank.]

### *Defined Benefit Pension Fund Assets and Liabilities*

CA-2.4.10

Defined benefit pension fund liabilities, as included on the balance sheet, must be fully recognised in the calculation of CET1 (i.e. CET1 cannot be increased through derecognising these liabilities). For each defined benefit pension fund that is an asset on the balance sheet, the asset must be deducted in the calculation of CET1 net of any associated deferred tax liability which would be extinguished if the asset should become impaired or derecognised under the relevant accounting standards. Assets in the fund to which the conventional bank licensee has unrestricted and unfettered access can, with supervisory approval, offset the deduction. Such offsetting assets must be given the risk weight they would receive if they were owned directly by the conventional bank licensee.

CA-2.4.11

Paragraph CA-2.4.10 only applies to conventional bank licensees which have subsidiaries which are located in jurisdictions where there are defined benefit pension schemes and addresses the concern that assets arising from pension funds may not be capable of being withdrawn and used for the protection of depositors and other creditors of a bank. The concern is that their only value stems from a reduction in future payments into the fund. The treatment allows for banks to reduce the deduction of the asset if they can address these concerns and show that the assets can be easily and promptly withdrawn from the fund.



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## CA-2.4 Regulatory Adjustments (continued)

### *Investments in Own Shares*

#### CA-2.4.12

All of a conventional bank licensee's investments in its own common shares, whether held directly or indirectly must have already been deducted in the calculation of CET1 as required by Subparagraph CA-2.1.3(o). In addition, any own stock which the conventional bank licensee could be contractually obliged to purchase must be deducted in the calculation of CET1. The treatment described applies irrespective of the location of the exposure in the banking book or the trading book. In addition:

- (a) Gross long positions may be deducted net of short positions in the same underlying exposure only if the short positions involve no counterparty risk (i.e. this would normally mean that the long and short positions are with the same counterparty and a valid close-out netting agreement is in place);
- (b) Conventional bank licensees must look through holdings of index securities to deduct exposures to own shares. However, gross long positions in own shares resulting from holdings of index securities may be netted against short positions in own shares resulting from short positions in the same underlying index where they are undertaken with the same counterparty. In such cases the short positions may still involve counterparty risk (which is subject to the relevant counterparty credit risk charge); and
- (c) Any shares of the conventional bank licensee held as collateral against exposures to customers are considered to be held indirectly and are subject to deduction.

#### CA-2.4.13

The deductions under Subparagraphs CA-2.1.3(o) and Paragraph CA-2.4.12 are necessary to avoid the double counting of a conventional bank licensee's own capital. The treatment seeks to remove the double counting that arises from direct holdings, indirect holdings via index funds and potential future holdings as a result of contractual obligations to purchase own shares.

#### CA-2.4.14

Conventional bank licensee must deduct investments in their own AT1 in the calculation of their AT1 capital and must deduct investments in their own T2 in the calculation of their T2 capital.



MODULE	CA:	Capital Adequacy
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## CA-2.4 Regulatory Adjustments (continued)

### *Reciprocal Cross Holdings in the Capital of Banking and Financial Entities*

#### CA-2.4.15

Reciprocal cross holdings of capital that are designed to artificially inflate the capital position of conventional bank licensees will be deducted in full. Conventional bank licensees must apply a “corresponding deduction approach” to such investments in the capital of other banks and financial entities. This means the deduction must be applied to the same component of capital for which the capital would qualify if it was issued by the conventional bank licensee itself. The above adjustments (CA-2.4.2 to CA-2.4.15) must now be aggregated and applied to CET1 to obtain a subtotal (CET1a). This new adjusted CET1a is used for the purpose of calculating the next adjustment.

*Investments in the capital of banking and financial entities that are outside the scope of regulatory consolidation and where the bank does not own more than 10% of the issued common share capital of the entity*

#### CA-2.4.16

The regulatory adjustment described in Paragraph CA-2.4.17 applies to investments in the capital of banking and financial entities that are outside the scope of regulatory consolidation and where the conventional bank licensee does not own more than 10% of the issued common share capital of the entity. In addition:

- (a) Investments include direct, indirect<sup>4</sup> and synthetic holdings of capital instruments. For example, conventional bank licensees must look through holdings of index securities to determine their underlying holdings of capital;<sup>5</sup>
- (b) Holdings in both the banking book and trading book must be included. Capital includes common stock and all other types of cash and synthetic capital instruments (e.g. subordinated debt). It is the net long position that is to be included (i.e. the gross long position net of short positions in the same underlying exposure where the maturity of the short position either matches the maturity of the long position or has a residual maturity of at least one year);

<sup>4</sup> Indirect holdings are exposures or parts of exposures that, if a direct holding loses its value, will result in a loss to the bank substantially equivalent to the loss in value of the direct holding.

<sup>5</sup> If banks find it operationally burdensome to look through and monitor their exact exposure to the capital of other financial institutions as a result of their holdings of index securities, the CBB may permit banks, subject to prior CBB approval, to use a conservative estimate of the amount to be deducted.





MODULE	CA: Capital Adequacy
CHAPTER	CA-2: Regulatory Capital

#### CA-2.4 Regulatory Adjustments (continued)

- (c) Underwriting positions held for five working days or less can be excluded. Underwriting positions held for longer than five working days must be included; and
- (d) If the capital instrument of the entity in which the conventional bank licensee has invested does not meet the criteria for CET1, AT1, or T2 (see CA-2.1.2(f)) of the concerned bank, the capital is to be considered common shares for the purposes of this regulatory adjustment. However, if the investment is issued out of a regulated financial entity and not included in regulatory capital in the relevant jurisdiction of the financial entity, it is not required to be deducted.

##### CA-2.4.17

If the total of all holdings listed in Paragraph CA-2.4.16 in aggregate exceed 10% of the conventional bank licensee's CET1a (i.e. after applying all other regulatory adjustments from Paragraph CA-2.4.2 to Paragraph CA-2.4.15) then the amount above 10% is required to be deducted, applying a corresponding deduction approach. This means the deduction must be applied to the same component of capital for which the capital would qualify if it was issued by the conventional bank licensee itself. Accordingly, the amount to be deducted from CET1a must be calculated as the total of all holdings which in aggregate exceed 10% of the conventional bank licensee's CET1a (as per above) multiplied by the common equity holdings as a percentage of the total capital holdings. This would result in a CET1a deduction which corresponds to the proportion of Total Capital holdings held in CET1a. Similarly, the amount to be deducted from AT1 must be calculated as the total of all holdings which in aggregate exceed 10% of the conventional bank licensee's CET1a (as per above) multiplied by the AT1 holdings as a percentage of the Total Capital holdings. The amount to be deducted from T2 must be calculated as the total of all holdings which in aggregate exceed 10% of the conventional bank licensee's CET1a (as per above) multiplied by the T2 holdings as a percentage of the Total Capital holdings.

##### CA-2.4.18

See Paragraph CA-2.4.21 for further details on what to do if, under the corresponding deduction approach, a conventional bank licensee is required to make a deduction from a particular tier of capital and it does not have enough of that tier of capital to satisfy that deduction.



MODULE	CA:	Capital Adequacy
CHAPTER	CA-2:	Regulatory Capital

## CA-2.4 Regulatory Adjustments (continued)

### CA-2.4.19

Amounts below the threshold, which are not deducted, will continue to be risk weighted. Thus, instruments in the trading book will be treated as per the market risk rules and instruments in the banking book must be treated as per Chapter CA-3. For the application of risk weighting the amount of the holdings must be allocated on a pro rata basis between those below and those above the threshold. The above adjustments (CA-2.4.16 to CA-2.4.18) must now be aggregated and applied to CET1a to obtain a new subtotal (CET1b). This new adjusted CET1b is used for the purpose of calculating the next adjustment.

### *Significant Investments in the Capital of Banking and Financial Entities that are Outside the Scope of Regulatory Consolidation<sup>6</sup>*

### CA-2.4.20

The regulatory adjustment described in Paragraph CA-2.4.21 applies to investments in the capital of banking and financial entities that are outside the scope of regulatory consolidation where the conventional bank licensee owns more than 10% of the issued common share capital of the issuing entity or where the entity is an affiliate of the conventional bank licensee. In addition:

- (a) Investments include direct, indirect and synthetic holdings of capital instruments. For example, conventional bank licensee must look through holdings of index securities to determine their underlying holdings of capital;<sup>7</sup>
- (b) Holdings in both the banking book and trading book are to be included. Capital includes common stock and all other types of cash and synthetic capital instruments (e.g. subordinated debt). It is the net long position that is to be included (i.e. the gross long position net of short positions in the same underlying exposure where the maturity of the short position either matches the maturity of the long position or has a residual maturity of at least one year);
- (c) Underwriting positions held for five working days or less can be excluded. Underwriting positions held for longer than five working days must be included; and

<sup>6</sup> Investments in entities that are outside the scope of regulatory consolidation refers to investments in entities that have not been consolidated at all or have not been consolidated in such a way as to result in their assets being included in the calculation of consolidated risk-weighted assets of the group.

<sup>7</sup> If banks find it operationally burdensome to look through and monitor their exact exposure to the capital of other financial institutions as a result of their holdings of index securities, the CBB may permit banks, subject to prior CBB approval, to use a conservative estimate.



MODULE	CA: Capital Adequacy
CHAPTER	CA-2: Regulatory Capital

#### CA-2.4 Regulatory Adjustments (continued)

- (d) If the capital instrument of the entity in which the conventional bank licensee has invested does not meet the criteria for CET1, AT1, or T2 (see CA-2.1.2 (f)) of the concerned bank, the capital is to be considered common shares for the purposes of this regulatory adjustment. However, if the investment is issued out of a regulated financial entity and not included in regulatory capital of the financial entity, it is not required to be deducted.

##### CA-2.4.21

All investments in Paragraph CA-2.4.20 that are not common shares must be fully deducted following a corresponding deduction approach. This means the deduction must be applied to the same tier of capital for which the capital would qualify if it was issued by the conventional bank licensee itself. If the conventional bank licensee is required to make a deduction from a particular tier of capital and it does not have enough of that tier of capital to satisfy that deduction, the shortfall will be deducted from the next higher tier of capital (e.g. if a conventional bank licensee does not have enough AT1 capital to satisfy a particular deduction, the shortfall will be deducted from CET1c as applicable).

##### CA-2.4.22

Investments in Paragraph CA-2.4.20 that are common shares are subject to the threshold treatment described in paragraph CA-2.4.23. The above adjustments (CA-2.4.20 to CA-2.4.21) must be aggregated and applied to CET1b to obtain a new subtotal (CET1c). This new adjusted CET1c is used for the purpose of calculating the next adjustment.

#### *Threshold Deductions*

##### CA-2.4.23

If the total of all common equity holdings listed in Paragraph CA-2.4.20 in aggregate exceeds 10% of the conventional bank licensee's CET1c, then the amount above 10% is required to be deducted from CET1c (see Appendices CA-22 and CA-23 for examples). After this deduction, the conventional bank licensee must deduct the amount by which each of items b) and c) in Paragraph CA-2.4.23A individually exceeds 10% of its CET1c. After these individual deductions, the aggregate of the three items below which exceeds 15% of its CET1c (calculated prior to the deduction of these items but after application of all other regulatory adjustments to CET1 applied in paragraphs CA-2.4.2 to CA-2.4.21) must be deducted from CET1c. The adjustments in this Paragraph are applied to CET1c to obtain a new subtotal (CET1d). This new adjusted CET1d is used for calculating the consolidated CAR and the applicable caps on AT1 and T2 Capital. The items included in the 15% aggregate limit are subject to full disclosure.



MODULE	CA: Capital Adequacy
CHAPTER	CA-2: Regulatory Capital

#### CA-2.4 Regulatory Adjustments (continued)

##### CA-2.4.23A

As of 1 January 2020, the calculation of the 15% limit will be subject to the following treatment: the sum of the three items below that remains recognised after the application of all regulatory adjustments must not exceed 15% of CET1d (See Appendix CA-3 for an example):

- (a) Significant investments in the common shares of unconsolidated banks and other financial entities as referred to in Paragraph CA-2.4.20;
- (b) Mortgage servicing rights (MSRs); and
- (c) Deferred Tax Assets (DTAs) that arise from temporary differences.

##### CA-2.4.24

The amount of the three above items that are not deducted in the calculation of CET1d is risk weighted at 250% (see Paragraph CA-3.2.26).

##### *Former Deductions from Capital*

##### CA-2.4.25

The following items receive the following risk weights:

- (a) Certain securitisation exposures outlined in Chapter CA-6: 1,250%;
- (b) Non-payment/delivery on non-DvP and non-PvP transactions (see Appendix CA-4): 1,250%;
- (c) The amount of any significant investments in commercial entities, as defined in Paragraph CM-5.5.1E, which exceed the materiality thresholds is risk weighted at 800%. The materiality thresholds for these investments are: 15% of Total Capital for individual significant investments; and 60% of Total Capital for the aggregate of such investments; and
- (d) Any exposures above the large exposures limits set by the CBB in Chapter CM-5 of the CBB Rulebook: 800%.

##### CA-2.4.26

For Subparagraphs CA-2.4.25 (c) and (d), amounts below the materiality thresholds and large exposure limits continue to be risk weighted in accordance with Chapter CA-3. Where the remaining holdings are made up of holdings carrying different risk weights, the application of the risk weighting must be allocated on a pro rata basis for those exposures that are not subject to the 800% risk weight. Appendix CA-21 gives an example of the way to calculate the risk weighted assets and the effect of the limits outlined in Subparagraphs CA-2.4.25 (c) and (d).



MODULE	CA: Capital Adequacy
CHAPTER	CA-2A: Capital Conservation Buffer

## CA-2A.1 Capital Conservation Best Practice

CA-2A.1.1 This section outlines the operation of the capital conservation buffer, which is designed to ensure that banks build up capital buffers outside periods of stress which can be drawn down as losses are incurred. The requirement is based on simple capital conservation rules designed to avoid breaches of minimum capital requirements.

**CA-2A.1.2** Outside of periods of stress, conventional bank licensees must hold buffers of capital above the regulatory minimum.



MODULE	CA: Capital Adequacy
CHAPTER	CA-2A: Capital Conservation Buffer

## CA-2A.2 The Capital Conservation Buffer (CCB) Requirement

**CA-2A.2.1** Conventional bank licensees are required to hold a Capital Conservation Buffer (CCB) of 2.5%, comprised of CET1 above the regulatory minimum Total Capital ratio of 10%.<sup>8</sup> Capital distribution constraints will be imposed on a conventional bank licensee when the CCB falls below 2.5%. The constraints imposed only relate to distributions, not the operation of the conventional bank licensee.

**CA-2A.2.2** Conventional bank licensees must note that they are required to maintain a minimum consolidated Total Capital Ratio of 12.5% and a solo Total Capital Ratio of 8% regardless of whether they do or do not have AT1 or T2 Capital and therefore conventional bank licensees will be required to retain 100% of the annual net profit unless their consolidated Total Capital Ratio is above 12.5% and their solo Total capital Ratio is above 8%.

**CA-2A.2.3** Elements subject to the restriction on distributions: Items considered to be distributions include dividends and share buybacks, discretionary profit distributions on other T1 capital instruments and discretionary bonus payments to staff. Payments that do not result in a depletion of CET1, which may for example include certain scrip dividends, are not considered distributions.

### *Capital Conservation Plan*

**CA-2A.2.4** Where a conventional bank licensee fails to meet the required level of capital conservation buffer, it must prepare a Capital Conservation Plan (hereinafter referred to as “Plan”) clearly outlining the information mentioned in this Paragraph. The conventional bank licensee must submit this Plan to the CBB within one week of becoming aware of the shortfall (see also CA-1.2.2). The conventional bank licensee must already have prepared such a Plan on a contingency basis. The Plan must include the following:

- (a) Estimates of income and expenditure and a forecasted balance sheet;
- (b) Measures to be taken to increase the conventional bank licensee’s capital ratios;
- (c) A plan and time frame for the increase of capital with the objective of meeting fully the buffer requirement; and
- (d) Any other information the CBB deems necessary to carry out the assessment required, as indicated in Paragraph CA-2A.2.5.

<sup>8</sup> Common Equity Tier 1 must first be used to meet the minimum capital requirements (including the 8% Tier 1 and 10% Total Capital requirements if necessary), before the remainder can contribute to the capital conservation buffer.



<b>MODULE</b>	<b>CA: Capital Adequacy</b>
<b>CHAPTER</b>	<b>CA-2A: Capital Conservation Buffer</b>

## CA-2A.2 The Capital Conservation Buffer (CCB) Requirement

CA-2A.2.5 The CBB shall review the Plan submitted by the conventional bank licensee and shall approve it provided it considers that the Plan provides a reasonable basis for conserving or raising sufficient capital that will enable the conventional bank licensee to meet the buffer requirements within a period acceptable to the CBB. While reviewing the Plan, the CBB will also evaluate whether the conventional bank licensee has deliberately reduced its CET1 so as to operate in the buffer range (i.e. below the capital conservation buffer requirement) in order to reduce its cost of capital for competitive purposes.

CA-2A.2.6 If the Plan is not approved by the CBB, it may take one or more of the following steps, inter alia, as deemed necessary:

- (a) Ask the conventional bank licensee to revise the Plan and resubmit it within a specified time period;
- (b) Require the conventional bank licensee to raise new capital from private sources to specified levels within specified periods; or
- (c) Impose more stringent restrictions on distributions than those required by Paragraph CA-2A.2.3



MODULE	CA: Capital Adequacy
CHAPTER	CA-2A: Capital Conservation Buffer

### CA-2A.3 Implementation Date

**CA-2A.3.1** The capital conservation buffer will be implemented on 1 January 2015. It will be set at 2.5% of RWAs.

**CA-2A.3.2** Conventional bank licensees must maintain prudent earnings retention policies with a view to meeting the conservation buffer at all times.

**CA-2A.3.3** [This Paragraph was deleted in April 2015.]

CA-2A.3.4 The CBB will issue rules and guidance on the countercyclical buffer in due course. The CBB reserves the right to use its discretion on the timing and amount of the countercyclical buffer, depending on economic conditions in the region and globally.