



EDBS/KH/0191/2010

6 October 2010

The General Manager

All Locally Incorporated Banks

Manama

Kingdom of Bahrain

Dear Sir,

“Basel 3” – Quantitative Impact Assessment

As you are probably aware, the Basel Committee issued on 12th September 2010 a Press Release announcing higher global minimum standards for banks. The Press Release is available on the B.I.S. website (www.bis.org). Its key points are the raising of the minimum required amount of common equity to 7%, the introduction of a countercyclical buffer and a non-risk based leverage ratio.

There are also new measures in respect of a maximum aggregate limit of 15% of common equity for investments in financial institutions, and some new treatments for items such as deferred tax assets and mortgage servicing rights. Some of these items are also explained in earlier documents and press releases by the Basel Committee (see Basel Press releases and documents dated 12 September 2010, 26 July 2010 and 17 December 2009).

Although certain of the Basel Committee's proposals have not as yet been fully outlined in a formal new Basel 3 paper, the CBB would like to request that all locally incorporated banks perform an impact assessment of the new proposals on their solo and consolidated capital adequacy ratios using information as presented in the June PIR forms.

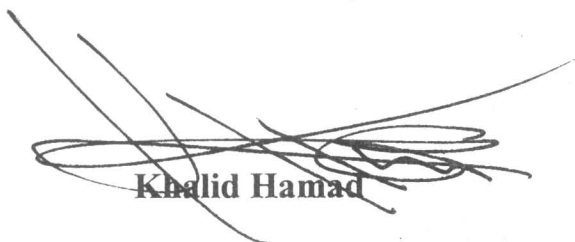
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The CBB acknowledges that certain assumptions may need to be made and therefore the impact assessment should be on a “best efforts” basis, and should assume no “grandfathering”. This would mean that the impact assessment should be on a “worst case” basis. A suggested template is attached. The results of this assessment will then be used by the CBB in the development of a timetable and transitional period for the implementation of Basel 3 in the Kingdom of Bahrain.

Your completed assessment should be submitted to the undersigned at the CBB in by 4th November 2010. Your cooperation in this exercise is greatly appreciated.

Yours faithfully,



Khalid Hamad

Encl.

Quantitative Impact Assessment – June 2010
Capital Components (issued and paid up as at 30 June 2010)

The items below are a stage by stage guide to completing the impact assessment, using data from the June 2010 PIR.

1. **Common Equity** (using new criteria in 17/12/2009 Basel Paper) less losses and including profits for the current period – unrealised gains to be included at 45% as previously.
2. **Common Equity Deductions**
 - a) **Deduction of minority interests in subsidiaries** (no longer included in Common Equity – assume worst case).
 - b) **Deduction of goodwill and all other intangibles.**
 - c) **Deduction of any deferred tax assets** (should only apply to foreign subsidiaries).
 - d) **Deduction of any investments in own shares** (treasury stock), **or employee stock incentive programs funded by the bank.**
 - e) **Deduction of investments in the capital of financial institutions** (including banking and insurance and investment business institutions). This deduction will include **all** holdings of common equity in other financial institutions which exceed 10% of the concerned financial institution. The **full** amount of such holdings (not just the amount above 10%) must be deducted from the reporting bank's common equity. Secondly, the holdings of all common stock in all other financial institutions must be aggregated (after performing the above deduction for holdings above 10% of the reporting bank's capital). Where the aggregate of any such holdings exceeds 15% of the reporting bank's

common equity, then the amount over 15% of the reporting bank's common equity must be deducted. Note that these deductions will apply irrespective of the location of the exposure in the trading book or in the banking book.

3. **Common Equity after regulatory deductions**
4. **Additional Going Concern Capital** (using new criteria – for most banks this should be a zero item, but certain banks that have issued preference shares or other innovative instruments may include them here subject to the new Basel limits).
5. **Total Tier One Capital**
6. **Tier Two Capital** (subject to 2% cap).
7. **Total Eligible Capital**

Deductions previously made for significant investments in commercial entities shall now be risk-weighted at 1,250%. Any large exposures to non-financial entities above the 15% capital limit must be risk-weighted at 1,250%. Assume no “grandfathering” of concessions.

8. **Risk-Weighted Assets**

Calculate total risk weighted assets for the banking book, the trading book and operational risk as under existing PIR/Rulebook requirements, but subject to the large exposures and significant investments weightings noted above at 1,250%.

9. **Calculation of Capital Ratios**

Calculate the following ratios:

- a) Common Equity Capital Ratio.
- b) Tier One Capital Ratio.
- c) Total Capital Ratio.



For the **solo capital adequacy** calculation, **all** shareholdings in subsidiaries must be deducted from common equity in addition to the deductions made in item 2e) above. Also all risk-weighted assets of subsidiaries for items 7 and 8 above must be deducted from the risk-weighted asset base of the reporting bank, prior to calculation of the solo capital ratios.

