المدير التنفيذي للرقابة المصرفية
Executive Director - Banking Supervision

مصرف البحرين المركزي
Central Bank of Bahrain

EDBS/KH/307/2012
27th November 2012

Islamic Banks (Locally Incorporated)
Manama
Kingdom of Bahrain

Dear Sir,

Basel 3 Proforma Reporting

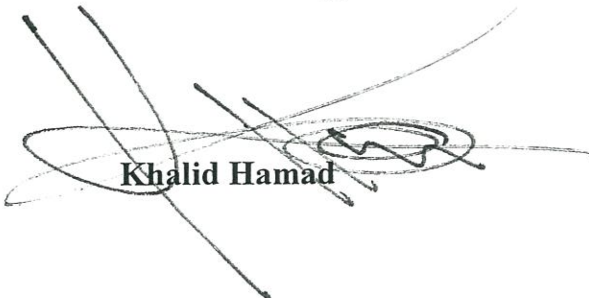
With effect from March 2013 all locally incorporated banks should start reporting proforma Basel 3 ratios using data compiled for their PIR forms. The ratios are shown on the attached sheet. At this point there will be no formal reporting form for this information. These ratios are requested in order that the CBB and bank licensees may have an idea of the likely impact of Basel 3 on their capital adequacy ratios and the extent to which the liquidity requirements may lead to a change in the structure of their balance sheets.

IFSB Exposure Draft 15 – Revised Capital Adequacy Standard

On 1st November 2012, the Islamic Financial Services Board issued its proposals to revise its existing capital adequacy standard in order to encompass the changes brought about by Basel III. The changes are primarily in relation to the definition of capital and to the capital adequacy treatment of equity investments, but there may be other areas where certain banks' business models may be affected. Recipients of this circular are requested to study the Exposure Draft and provide any comments to the Director of Licensing and Policy Directorate by 9th January 2013 in order that the CBB may collate replies (along with its own comments) and forward them to the IFSB.

The Exposure Draft is available at http://www.ifsb.org/exposure.php in soft copy only.

Yours faithfully,



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Required Basel III Ratios to be reported quarterly

	Consolidated	Bank Only
1. Common Equity Capital Ratio	✓	✓
2. Total Capital Ratio	✓	✓
3. Liquidity Coverage Ratio	X	✓
4. Net Stable Funding Ratio	X	✓
5. Leverage Ratio	✓	✓

The calculation process for the *Common Equity Capital Ratio, the Total Capital Ratio and the Leverage Ratio* is outlined in the February 2011 Basel Committee paper titled "Basel III: A global regulatory framework for more resilient banks and banking systems". This process is summarised in the CBB's Basel 2 to Basel 3 Report on the CBB website consultations archive (extract attached).

The methodology for the calculation of the *Liquidity Coverage Ratio* and the *Net Stable Funding* Ratio is in the Basel Committee paper titled "Basel III: International Framework for liquidity risk measurement, standards and monitoring".

Recipients should submit their first Basel 3 proforma reports using March 2013 data in hard copy to the director of Islamic Financial Institutions Supervision Directorate.

Revised Basel 3
Capital Components and Capital Adequacy Calculation – Step-by-step

The items below the revised components of eligible regulatory capital.

1. **Common Equity plus disclosed reserves** (using new criteria in 1/6/2012 Basel Paper) including unaudited or audited losses and including audited profits for the current period – unrealised gains to be included at 45% as previously.

2. **Regulatory Deductions from Common Equity:**

   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 normally only apply to foreign subsidiaries).

   d) **Deduction of any investments in own shares** (treasury stock), **any own share purchases funded by the bank** (e.g. employee stock incentive programs).

   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 are less than 10% of the concerned financial institution's capital (above a 10% threshold for the reporting bank). The **full** amount of such holdings (above the 10% own funds threshold) must be deducted from the reporting bank's common equity. Secondly, the holdings of all common stock in all other financial institutions above 10% of the investee's capital must be aggregated (after performing the above deduction). 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

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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** (Item 1 less item 2)

4. **Additional Going Concern Capital** (using new criteria – for most banks this should be a zero item, but certain preference shares or other loss-bearing instruments may be included here subject to the new Basel limits)

5. **Total Tier One Capital** (Item 3 plus item 4 but subject to cap)

6. **Tier Two Capital** (subject to 2% cap and using new conditions)

7. **Total Eligible Capital** (Item 5 plus item 6)

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 changes in respect of trade finance, securitisations and counterparty credit risk charges). Please note that all significant investments in commercial entities above 15% of capital base must be risk-weighted at 1,250%. Assume no "grandfathering" of concessions.

9. **Calculation of Capital Ratios**

   Calculate the following ratios:

   a) Common Equity Capital Ratio (Item 3 divided by item 8)
   b) Tier One Capital Ratio (Item 5 divided by item 8)
   c) Total Capital Ratio (item 7 divided by item 8)

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.