



# **CAPITAL ADEQUACY MODULE**



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<b>CHAPTER</b>	<b>CA-A: Introduction</b>

## **CA-A.1 Purpose**

### *Executive Summary*

- CA-A.1.1 This Module lays down requirements that apply to all investment firm licensees, with respect to the minimum level of capital they must maintain. Category 1 investment firms are also required to make their own assessment of the appropriate level of capital that they need to hold.
- CA-A.1.2 Principle 9 of the Principles of Business requires that investment firm 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 the Central Bank of Bahrain's ('CBB') Licensing Conditions (Section AU-2.5) requires investment firm licensees to maintain financial resources in excess of the minimum requirements specified in Module CA (Capital Adequacy).
- CA-A.1.3 The requirements specified in this Module vary according to the Category of investment firm licensee concerned, their inherent risk profile, and the volume and type of business undertaken. The purpose of such requirements is to ensure that investment firm licensees hold sufficient capital to provide some protection against unexpected losses, and otherwise allow investment firms to effect an orderly wind-down of their operations, without loss to their customers or those of other firms. The minimum capital requirements specified here are not sufficient to absorb all unexpected losses.

### *Legal Basis*

- CA-A.1.4** This Module contains the CBB's Directive (as amended from time to time) relating to the capital adequacy of investment firm licensees, and is issued under the powers available to the CBB under Article 38 of the Central Bank of Bahrain Financial Institutions Law 2006 ('CBB Law'). The Directive in this Module is applicable to all investment firm licensees.
- CA-A.1.5 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

### *Evolution of Module*

- CA-A.2.1 This Module was first issued in April 2006 by the BMA, as part of the first phase of Volume 4 (Investment Business) to be released. It is dated April 2006. Any material changes that have subsequently been made to this Module are annotated with the calendar quarter date in which the change was made: Chapter UG-3 provides further details on Rulebook maintenance and version control.
- CA-A.2.2 When the CBB replaced the BMA in September 2006, the provisions of this Module remained in force. Volume 4 was updated in July 2007 to reflect the switch to the CBB; however, new calendar quarter dates were only issued where the update necessitated changes to actual requirements.
- CA-A.2.3 A list of recent changes made to this Module is provided below:

Module Ref.	Change Date	Description of Changes
CA-A.1	07/2007	New Rule CA-A.1.4 introduced, categorising this Module as a Directive.
CA-1.1	07/2007	Minor change to notification period in Rule CA-1.1.4.
CA-2.1.5	01/2008	Clarified the definition of Tier 1 capital re preference shares.
CA-2.1.8	01/2008	Clarified definition of Tier 2 capital
CA-B.1	10/2009	New Rules CA-B.1.4 and CA-B.1.3 introduced to clarify calculation of regulatory capital for overseas investment firm licensees.
CA-1.1	10/2009	New Rule CA-1.1.4 introduced regarding CBB's requirements for maintaining capital in Bahrain.
CA-1.2 and CA-2.1.5	10/2009	Amended terminology.
CA-2.1.8	10/2009	Clarified definition of Tier 2 capital.
CA-3.4	10/2009	Clarified definition of foreign exchange requirement.
CA-A.1.4	01/2011	Clarified legal basis.
CA-B.1	01/2011	New title given to this section.
CA-1	01/2011	Restructured by moving Paragraphs in Section CA-B.1 and categorised capital adequacy requirements for different legal forms of investment firms (Bahraini and Overseas) and added new Rule on the booking of assets and liabilities.
CA-1.1.5A	01/2011	Added Guidance on alternative to increase capital.
CA-1.2.11 and CA-1.2.12	01/2011	Paragraphs relocated from Section CA-1.1.
CA-2.1.8	01/2011	Added dated subordinated term debt with an original term of over 5 years to Tier 2 capital instruments.
CA-1.2.9 and CA-1.2.9A	04/2011	Clarified notification requirements where investment firm licensees do not meet certain requirements.
CA-3.1	04/2011	Provided new Rule to deal with newly established investment firm licensees.
CA-A.2.3	01/2012	Corrected typo.
CA-2.2.3	01/2012	Corrected cross reference.
CA-1.2.9A	10/2012	Clarified Rule.
CA-1.1.5A to CA-1.1.5C	01/2013	Updated Rules and Guidance dealing with issuance of subordinated debt.
CA-2.2.2	01/2013	Corrected typo and added cross reference.
CA-3.1.3	10/2013	Removed reference to appointed representatives.
CA-4.1	10/2014	Added new guidance for capital for underwriting purposes.



MODULE	CA: Capital Adequacy
CHAPTER	CA-A: Introduction

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

### *Superseded Requirements*

CA-A.2.4 This Module supersedes the following provisions contained in circulars or other regulatory instruments:

Circular / other reference	Provision	Subject
Standard Conditions and Licensing Criteria: investment advisers/ brokers.	Article 1	Capital Funds
Standard Conditions and Licensing Criteria: broking company	Article 1	Minimum Capital
Standard Conditions and Licensing Criteria: stockbrokerage	Article 1	Minimum Capital

CA-A.2.5 Guidance on the implementation and transition to Volume 4 (Investment Business) is given in Module ES (Executive Summary).



MODULE	CA: Capital Adequacy
CHAPTER	CA-B: Scope of Application

## CA-B.1 Scope

**CA-B.1.1** This Module applies to both Bahraini investment firm licensees and overseas investment firm licensees.

**CA-B.1.2** [This Paragraph was moved to CA-1.1.A]

**CA-B.1.3** [This Paragraph was moved to CA-1.1A.3]

**CA-B.1.4** [This Paragraph was moved to CA-1.1A.1]

**CA-B.1.5** [This Paragraph was moved to CA-1.1A.2]



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

## CA-1.1 Bahraini Investment Firm Licensees

### *Obligation to Maintain Adequate Capital*

**CA-1.1.A** Bahraini investment firm licensees must calculate their Regulatory Capital based on their shareholders' equity (and other eligible components of Regulatory Capital, as defined in Chapter CA-2).

**CA-1.1.1** In accordance with Principle of Business 9 (cf. Section PB-1.9), investment firm licensees must maintain adequate human, financial and other resources sufficient to run their business in an orderly manner. This includes meeting the minimum capital requirements specified in Section CA-1.2 onwards.

**CA-1.1.2** In addition to the minimum capital requirements specified in Section CA-1.2 onwards, the CBB may, at its discretion, require investment firm licensees to hold additional capital, should this be necessary (in the CBB's view) to meet additional risks that are not sufficiently addressed in either the Risk Based Capital Requirement or the Minimum Capital Requirement.

CA-1.1.3 The CBB would typically invoke Rule CA-1.1.2 in rare circumstances – for instance, where in its assessment a licensee was running high-levels of operational risk because of a particularly weak controls environment.

**CA-1.1.4** Investment firm licensees are required to maintain, at all times, the Minimum Capital Requirement specified in Section CA-1.2, free from any pledge or any other restriction, in a retail bank licensed to operate in the Kingdom of Bahrain. They must provide, upon request, evidence to the CBB of the deposited amount.

**CA-1.1.5** In the event that an investment firm licensee fails to meet any of the requirements specified in this Module, it must, on becoming aware that it has breached these requirements, immediately notify the CBB in writing. Unless otherwise directed, the licensee must in addition submit to the CBB, within 30 calendar days of its notification, a plan demonstrating how it will achieve compliance with these requirements.

**CA-1.1.5A** Should the CBB direct an investment firm licensee to inject additional working capital in order to maintain the minimum capital requirements for its category of license, the investment firm licensee may inject cash in the form of a subordinated loan from the shareholders, subject to the CBB's prior approval. Such amount will be included as Tier 2 capital and must have a minimum original fixed term to maturity of more than 5 years (See Rule CA-2.1.8 (g)).



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

## **CA-1.1 Bahraini Investment Firm Licensees (continued)**

### **CA-1.1.5B**

Subject to the CBB's prior approval, an investment firm licensee may settle a subordinated debt, partially or in full, prior to the end of its term.

CA-1.1.5C Where Paragraph CA-1.1.5B applies, the CBB will take into consideration whether the investment firm licensee has received confirmation from its external auditor that the investment firm licensee's financial position has improved and its capability to repay the debt (see Paragraph BR-2.3.27B).

CA-1.1.6 Should an investment firm licensee fail to comply with the requirements of this Module, the CBB may impose enforcement measures, as described in Module EN.

CA-1.1.7 Investment firms licensed after the initial publication of Volume 4 (Investment Business), in April 2006, must comply with the requirements of this Module at the point of being issued a license. Investment firms already licensed prior to the initial publication of Volume 4 are required to comply with the requirements of this Module from 1 January 2007 onwards. Further details on transition arrangements are given in Module ES (Executive Summary).

CA-1.1.8 In addition to the requirements contained in this Module, investment firm licensees will also be subject to qualitative high-level controls and risk management requirements, in Modules HC (High-level Controls) and RM (Risk Management) (to be issued later in 2007, as part of the second phase release of Volume 4). Some of these requirements are relevant to the capital requirements in this Module.

### ***Booking of Assets and Liabilities***

### **CA-1.1.9**

Bahraini investment firm licensees must not book any obligation/liabilities in their books, without booking the corresponding asset in Bahrain.

CA-1.1.10 [This Paragraph was amended and moved to CA-1.2.12]





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

## CA-1.1A Overseas Investment Firm Licensees

### *Obligation to Maintain Adequate Capital*

#### CA-1.1A.1

Overseas investment firm licensees must calculate their Regulatory Capital based on the audited net assets booked in the Bahrain branch, determined in accordance with accounting standards that would be applicable if they were a joint stock company incorporated in Bahrain. Overseas investment firm licensees must ensure that their Regulatory Capital meets the minimum capital requirements specified in Section CA-1.2 onwards.

#### CA-1.1A.2

While the capital adequacy requirements for Bahraini investment firm licensees and for overseas investment firm licensees are identical (and are defined in CA-1 and CA-3), the calculation of the licensee's regulatory capital varies, according to whether the investment firm licensee is locally incorporated or a branch operation.

### *Booking of Assets and Liabilities*

#### CA-1.1A.3

Overseas investment firm licensees must book in Bahrain all assets pertaining to the operations of the Bahrain branch.

#### CA-1.1A.4

Overseas investment firm licensees must not book any obligation/liabilities in their Bahrain branch, without booking the corresponding asset in Bahrain.



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

## CA-1.2 Initial and Risk-Based Capital Requirements

### *Key Requirements*

**CA-1.2.1** Investment firm licensees must ensure that, at all times, their Regulatory Capital is in excess of their Regulatory Capital Requirement. They must monitor compliance with this requirement on an on-going basis.

**CA-1.2.2** For Category 1 and Category 2 investment firms, their Regulatory Capital Requirement is defined as the higher of their Risk-based Capital Requirement and their Minimum Capital Requirement.

**CA-1.2.3** For Category 3 investment firms, their Regulatory Capital Requirement is their Minimum Capital Requirement.

CA-1.2.4 The above requirements reflect the different risk profiles of the 3 investment firm categories. Risk-based Capital Requirements vary according to the level of position and other risks undertaken, and the size of the firm (measured in terms of adjusted annual expenditure). For larger firms, or those exposed to relatively higher levels of risk, Risk-based Capital Requirements are therefore likely to exceed the relevant Minimum Capital Requirement. Because of the limited nature of their activities, which pose limited risks to counterparties or customers, Category 3 investment firms are not required to apply Risk-based Capital Requirements. They are only required to comply with their Minimum Capital Requirement.

### *Definitions*

**CA-1.2.5** For Bahraini investment firm licensees, Regulatory Capital is capital held by the firm that satisfies the criteria set out in Chapter CA-2. For overseas investment firm licensees, Regulatory Capital is defined as audited net assets booked in the Bahrain branch, determined in accordance with accounting standards that would be applicable if they were a joint stock company incorporated in Bahrain.

CA-1.2.6 See Section CA-B.1 above, regarding scope of application. Overseas investment firms are also required to provide information – and meet certain requirements – with respect to the capital adequacy of their parent entity and – where relevant – their wider group. See Module GS (Group Supervision).

**CA-1.2.7** Minimum Capital Requirements are:

- (a) Category 1 investment firms: BD 1,000,000;
- (b) Category 2 investment firms: BD 1,000,000 if undertaking the activity of safeguarding financial instruments (i.e. custodian), BD 250,000 in all other cases; and
- (c) Category 3 investment firms: BD 125,000.



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

## CA-1.2 Initial and Risk-Based Capital Requirements (continued)

**CA-1.2.8** The Risk-based Capital Requirement is the sum of a firm's Expenditure Requirement, Position Risk Requirement (PRR), Counterparty Risk requirement (CRR), and Foreign Exchange Risk Requirement (FER), as defined in Chapter CA-3.

### *Notification Requirements*

**CA-1.2.9** Category 1 and Category 2 investment firms must notify the CBB if:

- (a) The ratio of Regulatory Capital to their Regulatory Capital Requirement falls below 110% (see Paragraph CA-1.1.5);
- (b) Any single probable contingency, financial commitment or large exposure exceeds 25% of their Regulatory Capital; and
- (c) Any instrument, transaction or situation does not appear to be catered for under Module CA.

**CA-1.2.9A** Investment firm licensees must submit to the CBB, within 30 calendar days of the event occurring, a plan demonstrating how it will:

- (a) Raise its regulatory capital to bring it to a level in excess of its regulatory capital requirement (refer to Paragraph CA-1.2.1); or
- (b) Reduce the single contingency, financial commitment or large exposure to below 25% of the regulatory capital.

### *Group Risks*

CA-1.2.10 Investment firm licensees that are members of a wider group are also subject to additional requirements, aimed at addressing group risks: see Module GS (Group Supervision).

### *Firm Assessment*

**CA-1.2.11** Investment firm licensees must regularly carry out their own assessment of their capital needs, appropriate to their risk profile, and maintain a process for monitoring and maintaining their actual capital in line with their assessment.

CA-1.2.12 Rule CA-1.2.12 is in addition to the other requirements in Module CA. If a firm's own assessment suggests its required capital is less than the regulatory minima specified in this Module, the latter must still be complied with. Where a firm's assessment suggests that a higher level of capital should be held, the CBB would expect firms to hold capital in line with their assessment. The CBB is not prescribing the detailed form such assessments should take, in order to give firms flexibility to develop their own approaches. Nonetheless, the CBB would expect the sophistication of such assessments to match the risk profile of the firm concerned.



<b>MODULE</b>	<b>CA: Capital Adequacy</b>
<b>CHAPTER</b>	<b>CA-2: Definition of Regulatory Capital</b>

## CA-2.1 Eligible Components

### CA-2.1.1

Regulatory Capital is the sum of the following three components (as defined in Rules CA-2.1.5 to CA-2.1.13), subject to the restrictions set out in Section CA-2.2:

- (a) Tier 1: Core capital;
- (b) Tier 2: Supplementary capital; and
- (c) Tier 3: Ancillary capital.

CA-2.1.2 Limits apply to the proportion of Tier 2 and 3 capital allowed, relative to Tier 1. Any excess held is not taken into account in calculating total Regulatory Capital held. See Section CA-2.2.

### CA-2.1.3

Tiers 1 and 2 can be used to satisfy all elements of the Regulatory Capital Requirement. Tier 3 capital can only be used to meet the Position Risk Requirement (as defined in Section CA-3.2).

CA-2.1.4 Any Tier 3 capital held in excess of the Position Risk Requirement, therefore, is not taken into account when calculating total Regulatory Capital held. See Section CA-2.2.

### *Tier 1 Capital*

### CA-2.1.5

Tier 1 capital comprises:

- (a) Paid-up ordinary shares (net of treasury shares);
- (b) Share premium reserve;
- (c) Perpetual non-cumulative preference shares;
- (d) General reserves, including statutory reserves, but excluding revaluation reserves;
- (e) Unappropriated retained earnings brought forward;
- (f) Audited retained profits net of declared dividends and tax expenses;
- (g) Current year appropriations including statutory reserves, general reserves and other appropriations; and
- (h) Minority interests, arising on consolidation, in the equity of subsidiaries which are less than wholly owned.

LESS:

- (i) Goodwill; and
- (j) Current year's cumulative net losses which have been reviewed or audited as per the International Standards on Auditing (ISA) by external auditors.



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

## CA-2.1 Eligible Components (continued)

### CA-2.1.6

Tier 1 capital elements included under Paragraph CA-2.1.5 (a) to (c) can only be so included if:

- (a) They are issued by the investment firm licensee;
- (b) They are fully paid (only that portion of the shares for which payment has been received may be included);
- (c) They:
  - (i) Cannot be redeemed or can only be redeemed on a winding up of the investment firm licensee; or
  - (ii) They are only redeemable at the option of the investment firm licensee and comply with any conditions applicable to joint stock companies in Bahrain;
- (d) Any coupon is non-cumulative, and can only be paid out of accumulated realised profits;
- (e) They are able to absorb losses;
- (f) They rank for repayment, upon winding up, no higher than a share of a company incorporated under the Joint Stock companies law of Bahrain; and
- (g) The proceeds of the issue are immediately and fully available to the investment firm licensee.

### CA-2.1.7

An investment firm licensee must not redeem any Tier 1 instrument that it has included in its Regulatory Capital for the purpose of satisfying its Regulatory Capital Requirement without the prior written approval of the CBB.

### *Tier 2: Supplementary Capital*

### CA-2.1.8

Tier 2 capital comprises:

- (a) Interim retained profits reviewed by external auditors in accordance with International Standards on Auditing (ISA);
- (b) Limited life redeemable preference shares with an original term of at least five years;
- (c) Asset revaluation reserves, comprising:
  - (i) The revaluation of fixed assets to reflect changes in market values, that are reflected in the balance sheet as a revaluation reserve;
  - (ii) Hidden or 'latent' revaluation reserves represented by long-term holdings of equity securities valued in the balance sheet at the historical cost of acquisition; and
  - (iii) 'Latent' revaluation reserves represented by revaluation of 'available for sale' securities to reflect changes in the market value;
- (d) Dated subordinated debt with an original term of over 5 years.



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

## CA-2.1 Eligible Components (continued)

### CA-2.1.8

All types of revaluation reserve may be included, with the concurrence of the external auditor, provided that the assets are prudently valued, fully reflecting the possibility of price fluctuation and forced sale. In the case of 'latent' revaluation reserves, a discount of 55% must be applied to the difference between the historical cost book value and the market value to reflect the potential volatility of this form of unrealized capital;

- (a) General provisions held against future, presently unidentified losses, providing these are freely available to meet losses that subsequently materialise, subject to a maximum of 1.25% of Tier 1 capital. Provisions ascribed to impairment of particular assets or known liabilities are excluded;
- (b) Cumulative preference shares;
- (c) Hybrid instruments, that combine characteristics of equity capital and of debt, and which meet the requirements in CA-2.1.9 and CA-2.1.10;
- (d) Subordinated term debt, comprising conventional unsecured borrowing subordinated (in respect of both interest and principal) to all other liabilities of the investment firm licensee except the share capital and limited life redeemable preference shares. To be eligible for inclusion in Tier 2 capital, subordinated debt capital instruments must have a minimum original fixed term to maturity of over five years. During the last five years to maturity, a cumulative discount (or amortisation) factor of 20% per year will be applied to reflect the diminishing value of these instruments as a continuing source of strength. Unlike instruments included in item (f) above, these instruments are not normally available to participate in the losses of an investment firm licensee which continues trading. For this reason, these instruments will be limited to a maximum of 50% of tier 1 capital; and
- (e) 45% of unrealised gains on equity securities held as available-for-sale (on an aggregate net-basis).

### CA-2.1.9

A hybrid capital instrument may only be included in Regulatory Capital, as a Tier 2 component, if it meets the following conditions:

- (a) It is unsecured, subordinated and fully paid-up;
- (b) It is not redeemable at the initiative of the holder, nor without the prior consent of the CBB;
- (c) It is available to participate in losses without the investment firm licensee being obliged to cease trading (unlike conventional subordinated debt); and



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

## CA-2.1 Eligible Components (continued)

### CA-2.1.9 continued

- (d) Although the capital instrument may carry an obligation to pay interest that cannot permanently be reduced or waived (unlike dividends on ordinary shareholders' equity), it allows such obligations to be deferred (as with cumulative preference shares) where the profitability of the investment firm licensee would not support payment.

### CA-2.1.10

In addition to those contained in Rule CA-2.1.9, the following conditions also apply:

- (a) The only events of default must be non-payment of any amount falling due under the terms of the instrument or the winding-up of the investment firm licensee;
- (b) The remedies available to the subordinated creditor in the event of non-payment or other breach of the written agreement or instrument must be limited to petitioning for the winding up of the investment firm licensee or proving the debt in a liquidation of the investment firm licensee;
- (c) Any events of default and any remedy described in (b) must not prejudice the matters in (a);
- (d) The debt must not become due and payable before its stated final maturity date (if any) except on an event of default complying with (a);
- (e) The debt agreement or terms of the instrument are governed by the laws of Bahrain;
- (f) To the fullest extent permitted under the laws of the relevant jurisdictions, creditors must waive their right to set off amounts they owe the investment firm licensee against subordinated amounts included in the investment firm licensee's capital resources owed to them by the investment firm licensee;
- (g) The terms of the instrument must be set out in a written agreement that contains terms that provide for the conditions set out in (a) to (f); and
- (h) The investment firm licensee has obtained an external legal opinion stating that the requirements in (a) to (g) have been met.





<b>MODULE</b>	<b>CA: Capital Adequacy</b>
<b>CHAPTER</b>	<b>CA-2: Definition of Regulatory Capital</b>

## CA-2.1 Eligible Components (continued)

### *Tier 3: Ancillary Capital*

- CA-2.1.11** Tier 3 capital consists of short-term subordinated debt that meets the following conditions:
- (a) It is unsecured, subordinated and fully paid up;
  - (b) It has an original maturity of at least two years;
  - (c) It is not repayable before the agreed repayment date; and
  - (d) It is subject to a lock-in clause which stipulates that neither interest nor principal may be paid (even at maturity) if such payment means that the investment firm licensee's Regulatory Capital would fall below its Regulatory Capital Requirement.

### *Deductions, etc.*

- CA-2.1.12** No value, for Regulatory Capital purposes, may be attributed to any other instrument or resource, without the CBB's written consent. Without limiting the generality of this rule, no value is attributed to any of the following:
- (a) Any implicit items (which relate to future profits and hidden reserves); and
  - (b) The unpaid element of any issued shares some or all of which are not 'fully paid' shares.

- CA-2.1.13** Significant investments in and lending of a capital nature to subsidiaries and associated companies engaged in financial activities must be deducted from the sum of Tiers 1 and 2.

- CA-2.1.14 For the purposes of CA-2.1.4, 'significant investments' are investments where the investment firm licensee holds more than 20% of the share capital of the investee company. The underlying assets associated with those investments are not included in the investment firm's assets for the purpose of computing its Regulatory Capital Requirement. See also Module GR (Group Supervision).





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

## CA-2.2 Limits on Components

### *Tier 1: Core Capital*

#### CA-2.2.1

Tier 1 capital must constitute at least half of total Regulatory Capital, i.e. the sum of Tier 2 and Tier 3 capital must not exceed total Tier 1 capital.

### *Tier 2: Supplementary Capital*

#### CA-2.2.2

Long-term subordinated term debt may not comprise more than 50% of Tier 1 (see Paragraph CA-1.1.5A).

#### CA-2.2.3

Rule CA-2.1.8 (h) sets out the requirements regarding long-term subordinated debt.

### *Tier 3: Ancillary Capital*

#### CA-2.2.4

Tier 3 capital may only be used to satisfy an investment firm's Position Risk Requirement (PRR). It is limited to 250% of the portion of Tier 1 capital also used to meet the Position Risk Requirement (PRR).

#### CA-2.2.5

Tier 2 elements may be substituted for Tier 3 up to the Tier 3 limit of 250% (cf. Rule CA-2.2.4), in so far as eligible Tier 2 capital does not exceed total Tier 1 capital, and long-term subordinated debt does not exceed 50% of Tier 1 capital.

#### CA-2.2.6

Investment firm licensees may hold capital elements in excess of the above limits, but any excess is ignored for the purposes of calculating Regulatory Capital.



MODULE	CA: Capital Adequacy
CHAPTER	CA-3: Calculation of Risk-Based Capital Requirement

## CA-3.1 Expenditure Requirement

**CA-3.1.1** The Expenditure Requirement is equal to one quarter of the relevant annual expenditure.

**CA-3.1.2** Except in instances noted under Paragraph CA-3.1.2A, relevant annual expenditure equals the total annual expenditure (based on audited financial statements) less those items of expenditure that could be reduced or eliminated within a short period of time if required. Subject to prior CBB written approval, exceptional items of expenditure may also be excluded.

**CA-3.1.2A** For newly established investment firm licensees, for the first year of operations, the total annual expenditure is based on the projected annual expenditure figure for the first year as stated in the business plan submitted during the authorisation stage in accordance with Paragraph AU-5.1.6.

**CA-3.1.3** Items that could be reduced or eliminated within a short period for the purposes of Rule CA-3.1.2 are:

- (a) Bonuses paid out of the relevant year's profits which have not been guaranteed;
- (b) Profit shares and other appropriations of profit, except for fixed or guaranteed remuneration which is payable even if the investment firm licensee makes a loss for the year;
- (c) Paid commissions shared, other than to employees or Directors of the investment firm licensee;
- (d) Fees, brokerage and other charges paid to clearing houses, clearing firms, exchanges, and intermediate brokers for the purposes of executing, registering or clearing transactions;
- (e) Interest payable to counterparties; and
- (f) Interest payable on borrowings to finance the investment firm licensee's investment firm and associated firm.



MODULE	CA: Capital Adequacy
CHAPTER	CA-3: Calculation of Risk-Based Capital Requirement

## CA-3.2 Position Risk Requirement (PRR)

### CA-3.2.1

An investment firm licensee's Position Risk Requirement is the sum of its individual Position Risk Requirements, calculated as a percentage of the market or realisable value of each financial instrument held, as specified in Schedule 1 below:

Schedule 1 - Position Risk Requirement				
(a) Debt	<90 days	90 days–1 yr	1–5 yrs	>5 yrs
OECD	2% x MV	2% x MV	5% x MV	10% x MV
Issued or accepted by banks	2% x MV	2% x MV	5% x MV	10% x MV
Other marketable financial instruments	10% x MV	10% x MV	20% x MV	30% x MV
Floating rate notes	<20 yrs	5% x MV		
	>20 yrs	10% x MV		
(b) Equities				
Listed on a regulated financial instrument exchange		25% x MV		
Listed on Bahrain Stock Exchange		25% x MV		
Traded on a regulated financial instrument exchange		35% x MV		
Traded on Bahrain Stock Exchange		35% x MV		
Other		100% x MV		
(c) Commodities				
Stock positions in physical commodities associated with an <u>investment firm licensee's</u> investment firm		30% of realisable value		



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### **CA-3.2 Position Risk Requirement (PRR) (continued)**

<b>(d) Futures, options and contracts for differences</b>	
<b>Exchange traded futures and written options</b>	<b>4 x initial margin requirement</b>
<b>Off exchange futures and written options</b>	<b>The appropriate percentage shown in a, b and c above should be applied to the value of the underlying position.</b>
<b>Purchased options</b>	<b>As for off exchange written options but limited to the current value of the option.</b>
<b>Contracts for differences</b>	<b>20% of the market value of the contract.</b>

<b>(e) Other investments</b>	
<b>Single premium unit linked bonds and units in regulated collective investment scheme unless covered below</b>	<b>25% of realisable value</b>
<b>Units in a regulated scheme which is a geared futures and options fund, or a property fund, or a warrant fund</b>	<b>50% of realisable value</b>
<b>With profit life policies</b>	<b>20% of surrender value</b>
<b>Any other investments</b>	<b>100% of amount of asset</b>



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### CA-3.3 Counterparty Risk Requirement (CRR)

#### CA-3.3.1

An investment firm licensee's Counterparty Risk Requirement is the sum of its individual Counterparty Risk Requirements, calculated in accordance with Schedule 2 below:

Schedule 2 - Counterparty Risk Requirement				
<i>(a) Cash against document transactions</i>				
Where an <u>investment firm licensee</u> has unsettled deals in any securities it must calculate the price difference to which it is exposed and then multiply this by the appropriate percentage below to calculate the CRR for each separate unsettled deal.				
Calendar days after settlement		Percentage		
0 – 15		Nil		
16 – 30		25%		
31 – 45		50%		
46 - 60		75%		
Over 60		100%		

<i>(b) Free deliveries</i>				
Where an <u>investment firm licensee</u> makes payment or delivers securities to a counterparty without receiving the certificate/good title or payment respectively, it must calculate a CRR for each free delivery by applying the appropriate percentage below:				
Business days since delivery				
Where free delivery has been made to:				
	0-3	4-15	>15	
A manager, underwriter or member of a selling syndicate to whom payment for securities has been made	0%	0%	100%	
An <u>investment firm licensee</u> to whom securities have been delivered or payment has been made with the expectation that market practice will result in a settlement date longer than three days from delivery date.	15%	15%	100%	
Any other counterparty	0%	100%	100%	



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### CA-3.3 Counterparty Risk Requirement (CRR) (continued)

<i>(c) Options purchased for a counterparty</i>		
<p>Where an <u>investment firm licensee</u> has purchased an option on behalf of a counterparty on terms which do not impose on the purchaser any actual or contingent margin requirement or liability to make any payment other than the initial purchase price of the option, and the counterparty has not paid the price by three days after trade date, the CRR is the amount by which the purchase price exceeds the current realisable value of the option.</p> <p>Where an <u>investment firm licensee</u> has purchased a traditional option for its own account or on behalf of a counterparty that has not paid the <u>investment firm licensee</u>, then, if the <u>investment firm licensee</u> has paid the option premium to the writer, it must calculate a CRR equal to the option premium.</p>		
<i>(d) Amounts owed in respect of exchange traded margined transactions</i>		
<p>(i) Where, as a result of a traded margined transaction, a counterparty of the <u>investment firm licensee</u> has an initial margin and/or variation margin requirement and has not met it fully with cash, acceptable collateral or a positive equity balance not used to meet variation margin, an <u>investment firm licensee</u> must calculate a CRR by multiplying the shortfall (or the relevant part of the shortfall) by the appropriate percentage contained in the schedule below:</p>		
Initial and variation margin percentage schedule		
Business days since shortfall occurred	0-3 days	4 days and over
Where the shortfall is for the account of:		
A. A market counterparty who has been granted a credit line under an adequate credit management policy available to cover the relevant Category of margin and to the extent that it is sufficient to cover the shortfall.	5%	5%
B. A client who has been granted a credit line under an adequate credit management policy available to cover the relevant Category of margin and to the extent that it is sufficient to cover the shortfall.	10%	10%



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### CA-3.3 Counterparty Risk Requirement (CRR) (continued)

C. A market counterparty or client not within A or B above, or to the extent that he is not within A or B (the shortfall then being limited to the excess).	0%	100%
(ii) Local or traded option market makers. An <u>investment firm licensee</u> must calculate a 100% CRR for amounts of initial and variation margin not met with acceptable collateral or a positive equity balance and owed to it by a local (or by a traded option market maker) in respect of a traded margined transaction from the date of any shortfall, unless the <u>investment firm licensee</u> treats the local's (or market maker's) position as if it were its own (in which case the PRR rules under Section CA-3.2 will apply instead).		
(iii) Sums owed on closed out exchange traded margined transactions. When, as a result of a traded margined transaction which has been closed out, a counterparty of the <u>investment firm licensee</u> owes any amounts to it arising out of losses on those transactions, and has not fully met that amount through the deposit of cash, acceptable collateral or a positive equity balance not otherwise used, the <u>investment firm licensee</u> must after three days from the date of crystallisation of the loss calculate a CRR equal to the unpaid amount.		
(iv) Margin percentages. An <u>investment firm licensee</u> may, with the prior approval of the CBB, opt to calculate the CRR using a higher or the highest initial margin or variation margin percentage, in order to avoid undue complication.		
(e) Concentrated risk to one counterparty		
If the total amount due to a licensee for free deliveries or other debts attracting a CRR from a single counterparty (or a group of closely related counterparties) exceeds 25% of the licensee's <u>capital available</u> , it must calculate CRR by applying the appropriate percentage below:		
Amount of <u>capital available</u>	Additional CRR	
0 - 25%	Nil	
25.01 - 50%	15% (or the entire excess if less)	
Over 50%	40% (or the entire excess if less)	



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### CA-3.3 Counterparty Risk Requirement (CRR) (continued)

*(f) Repurchase and reverse repo transactions, including sale and buy back and securities lending*

An investment firm licensee shall notify the CBB if it has counterparty exposures in these investments.

*(g) Swaps, forward contracts, over the counter options, contracts for differences and off-exchange futures*

An investment firm licensee shall notify the CBB if it has counterparty exposures in these investments.

*(h) Loans to counterparties (including free delivery payments)*

An investment firm licensee must calculate a 100% CRR on the amount by which a loan to a counterparty is not properly secured, or offset against an amount owed by the investment firm licensee to the counterparty (provided there is an agreement in writing that the investment firm licensee deems to be legally enforceable and effective to secure such set-off).

*(i) Other receivables and accrued income*

Other receivables and accrued income not covered elsewhere attract 100% CRR from the time that they become due.





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## **CA-3.4 Foreign Exchange Risk Requirement (FER)**

**CA-3.4.1** The foreign exchange requirement is 10% of the net open foreign currency position.

**CA-3.4.2** For each foreign currency (that is, any other currency other than that in which the investment firm licensee's financial statements are presented) in which the investment firm licensee has monetary assets or liabilities or any off balance sheet contracts which would give rise to a position in that currency, the investment firm licensee should calculate the net open position (netting assets and liabilities). This should be converted into the presentation currency. Where the price of an investment is quoted in more than one currency, a position in the investment shall be treated as an asset or a liability in the currency of the country in which the main or principal market in the investment is based. (Options included in the position risk requirement are to be excluded from these calculations).

CA-3.4.3 Monetary assets or liabilities or any off balance sheet contracts which would give rise to a position in currencies of Gulf Cooperation Council countries or United States dollar are exempted for the purposes of calculating regulatory capital requirement.

**CA-3.4.4** An investment firm licensee's foreign exchange risk calculation must include the following items regardless of whether they are trading or non-trading positions

- (a) All spot positions in foreign currency (that is, all asset items less all liability items, including accrued interest, in the foreign currency in question); and
- (b) All forwards positions in foreign currency (net present value in respect of notional position).

**CA-3.4.5** An investment firm licensee's foreign exchange risk calculation shall not include the following:

- (a) Foreign currency assets which have been deducted in full from the firm's capital resources under the calculation under the capital resources table;
- (b) Position hedging where it is of a non trading or structural nature;
- (c) Positions of a non trading or structural nature that a firm has deliberately taken in order to hedge against the adverse effect of the exchange rate on the ratio of its capital resources to its capital resources requirements; and
- (d) Transactions to the extent that they fully hedge net future foreign currency income or expenses which are known but not yet accrued.



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#### CA-3.4 Foreign Exchange Risk Requirement (FER) (Continued)

##### CA-3.4.6

Where an Investment firm licensee does not include position hedging in its foreign exchange risk calculation, it shall:

- (a) Notify the CBB before such exclusion and the terms on which the relevant item will be excluded;
- (b) Document its policy in the use of that exclusion in its trading book policy statement.

##### CA-3.4.7

The net overall position is the sum of all the spot and forward **positions**. (Note that all the positions should be converted into the presentation currency)

##### CA-3.4.8

Spot net position is calculated as the difference between the gross spot assets and gross spot liabilities. Forward net position is calculated as the difference between the gross forward purchases and gross forward sales.



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CHAPTER	CA-4: Underwriting

## CA-4.1 General Requirements

CA-4.1.1 In assessing the financial ability of a Category 1 investment firm licensee to underwrite transactions, the CBB will consider, amongst other factors, the licensee's capital adequacy, its capacity to undertake the activity, and its track record in complying with applicable regulatory requirements. Any underwriting activities require the prior approval of the CBB's Capital Market Supervision Directorate and are subject to Module OFS (Offering of Securities) of Volume 6 of the CBB Rulebook.