Industry Comments & the CBB Feedback Statement on the Second Consultation on the proposed amendments to Large Exposures Limits – CM Module
Rulebook-Volumes 1 & 2 – Conventional/Islamic bank licensees
January 2011

Specific comments:		
Proposed Rule	**Bank's comments**	**CBB Initiative**
1.3 The limits introduced in this paper on both underwriting exposures/syndicated loan arrangements and temporary exposures arising from banks' investment business (with the intention to securitize assets or place them with investors) are considered a precautionary but flexible measure to limit the maximum size of such exposures (above the normal 15% counterparty exposure limit) during the 90-day period where the bank has obtained the CBB's prior approval. Both limits are considered single counterparty limits. The risk weighting of exposures is separate from concentration limits.	**A Bank** noted that there is a distinction drawn between the two "exemptions" in that the Underwriting "Exemption" would permit a temporary exposure of up to 30% of a bank's consolidated capital base, whereas the Investment Business "Exemption" would only permit a temporary exposure of up to 25% of a bank's consolidated capital base. The bank did not understand why the maximum temporary exposure level in the Investment Business Exemption should be lower than that provided for in the Underwriting Exemption. Although engaging in an underwriting and an investment business are two very distinct activities, the bank was of the opinion that the risks associated were essentially the same, i.e. a bank has an exposure to securities on its balance sheet pending the placement of the securities with investors. **A Bank** requested the CBB to reconsider increasing the proposed 25% limit to 30% in line with the limits for syndicated credit facility underwriting (para 2.1.1 of the CP). A higher limit would enable banks to pursue larger transactions, given that prior approval of CBB is required to undertake such business when in excess of 15% of regulatory capital base and the requirement to deduct any unsold exposures beyond the 90day time limit, the bank was of the view that a 30% limit will be properly utilized by institutions.	**It should be noted that August paper does not give any blanket exemption for either underwriting exposures or the temporary investment exposures. The rules state that any underwriting exposure/syndicated loan commitment to an unconnected counterparty or temporary investment with the intention for resale above the 15% single exposure limit must be subject to the CBB's prior approval; However, the maximum level of such exposures per counterparty that the CBB may approve, must not exceed 30% & 25% of the concerned bank's consolidated capital base for a maximum 90-day period with regards to the underwriting exposures & temp investment exposures respectively . The normal deduction rules would apply in both cases after the 90- day period.** **The CBB has decided purposely to differentiate between the introduced cap on both the underwriting exposure & the temporary investment**

		as the resultant risks that arises from direct investment business where the underlying assets are originated by the bank itself with the intention to securitize such assets or place them with investors (where banks already have the exposure on their balance sheet) is greater than the risk associated with underwriting business (where banks do not have the exposure on their balance sheet but off-balance sheet). Therefore, it is unfair to impose the same cap on the two above stated exposures.
2.1 Amendments to the existing rules on underwriting exposures for both Conventional & Islamic banks: 2.1.1 In this paper, "underwriting" refers to securities underwriting and is defined below. In addition, these requirements deal with syndicated loan arrangements, as defined below. The Proposed definitions are suggested to be as follows: *"Underwriting" is defined as "A binding commitment by the reporting bank to purchase securities issued by an unconnected party ("the issuer") at a mutually agreed price between the issuer and the underwriter". Underwriting does not take place if a bank commits to purchase its*	**A Bank** stated that there is a need to define the term "syndicated loans" under section 2.1.1 - second paragraph, since this is bridge finance exclusively extended to meet the financing requirements of the company during the underwriting period. **A Bank** stated that the 90 day period within which a placement/syndication must be arranged is a little tight.	**It is already defined as : "Syndicated *loan arrangements exist where a bank has entered into "A binding commitment by the reporting bank to provide syndicated credit facilities to an unconnected party at a mutually agreed price between the bank and the concerned counterparty".*** **Disagree-The 90 days period is sufficient**

own securities or securities issued by a party connected to it as there is no transfer of risk; therefore a bank may not utilise this temporary underwriting limit for the issue of its own securities or securities issued by connected counterparties. *Syndicated loan arrangements exist where a bank has entered into "A binding commitment by the reporting bank to provide syndicated credit facilities to an unconnected party at a mutually agreed price between the bank and the concerned counterparty".* *Banks may not utilise the limits concerned with these definitions in connection with any commitments to any connected counterparties."*	A bank stated that from legal view point, the concerned connected counterparty is a separate legal entity that has its own capital, liability, etc. provided an undertaking or a commitment is given after due consideration and on an arm's length basis, it noted that it sees no reason why to exclude such undertaking or commitment given by such third party merely on the basis that the concerned third party is considered as "a connected counterparty" within the definition given in CM-4.4.10.	**Disagree, the definition of underwriting clearly states "*A binding commitment by the reporting bank to purchase securities issued by an <u>unconnected party</u>*". In order for the issuer to transfer the risk involved, the underwriter should be totally unconnected to the issuer.**
	• **<u>A Bank</u>** stated that with respect to the proposed definitions, it did not believe they are reflective of the activity actually being undertaken. The term "Syndicated Loan Arrangement" is used to describe a business activity, which is not the case. The underlying activity is underwriting, and the underwriting of a syndicated loan (or credit facility) is similar to the underwriting of a security. It, therefore, suggested a definition which is universally applicable to the act of underwriting, regardless of the asset being underwritten, e.g. engaging in a binding commitment to purchase securities of or provide syndicated loans/credit facilities to (as the case may be) an unconnected party (the "issuer" or the "borrower") at a mutually agreed price.	**There is no material difference between the proposed definition and the bank's suggestion. The wordings are different but both have the same meaning. The definition can be slightly amended to use the wording suggested by the bank. The definition has been amended to :** **"*Underwriting" is defined as "A binding commitment by the reporting bank to purchase securities of or provide syndicated loans/credit facilities to (as the case may be) an unconnected***

	For the sake of clarity, the consequential activity to that of underwriting is the activity of syndication of the underlying asset/risk (which is the same as distribution, sell down, etc.). This entails syndicating or selling down the underwritten exposure, with the objective of the underwriter reaching an approved final hold level. *In the interests of not stifling business a bank recommended that the CBB allow banks to underwrite transactions without reference to the existing exposures. This would force banks to put pressure on their syndication units to sell exposure down to a level where it does not exceed the single obligor limit of 15%, when aggregated. Any excess over this level could be deducted from capital."* **A Bank** stated that it is in support of the new definition of "underwriting" as well as the proposed amendments in the existing rules of underwriting exposures.	***party ("the issuer" or the "borrower") at a mutually agreed price. Underwriting does not take place if a bank commits to purchase its own securities or securities issued by a party connected to it as there is no transfer of risk; Banks may not utilise the limits concerned with these definitions in connection with any commitments to any connected counterparties."*** **Disagree, the existing exposure for counterparty should be taken into account (i.e. aggregated) whenever the bank is entering into a new transaction with such counterparty (i.e. increasing the exposure to such counterparty). Ignoring the existing exposure would create unnecessary overconcentration of risk which the CBB is trying to avoid by the implementation of these Rules.**
2.1 Amendments to the existing rules on underwriting exposures for both Conventional & Islamic banks:	**A Bank** stated that the introduction of the requirement to seek the pre-approval of the CBB to underwrite securities or syndicated loans in excess of 15% of a Bank's capital (a)	**Disagree, blanket exemptions are considered imprudent based on the lessons learned from failed**

2.1.1 (Supposed to be 2.1.2) The proposed rule suggests that any underwriting exposure/syndicated loan commitment to unconnected counterparty above the 15% single exposure limit must be subject to the CBB prior approval; the 15% limit refers to the consolidated capital base as defined in Paragraph CM-5.5.2. The maximum level of such exposures per counterparty that the CBB may approve, must not exceed 30% of the concerned bank's consolidated capital base for a maximum 90-day period. Any residual holdings of securities or loan commitments held for more than 90 days from the commitment date are subject to normal large exposure limits and must be deducted from capital where there are any excesses above 15% of consolidated capital base. Proposed rules are suggested to be as follows: **"A bank may not incur an <u>exposure</u> which arises when a bank enters into a legally binding commitment to underwrite a securities issue or to provide a syndicated loan for another party not connected to the bank, which exceeds 15% of the bank's consolidated capital base without the prior written approval of the CBB. The maximum level of such exposures per counterparty that the CBB may approve must not exceed 30% of the concerned bank's consolidated capital base during the 90-day period.** **Such securities underwriting exposures must**	would be a material change in the regulatory regime as far as underwriting securities and credit facilities (including syndicated loans) are concerned, (b) would be extremely restrictive for banks which compete extensively with other international and regional banks in this line of business, and (c) would be a significant departure from the existing provisions, as well as the proposals originally made in the First Consultation Paper. As underwriting mandates are generally secured through a competitive bidding process, where banks are required to compete with banks incorporated in other countries with more flexible rules, a CBB pre-approval process might make it difficult from a practical perspective for the bank to respond in a timely manner. **<u>A Bank</u>** stated that the existing rule - whereby commitments in relation to underwriting securities and syndicated loans are classified as exempt exposure up to 90 days from the date the commitment becomes legally effective - **<u>is practical</u>** in its opinion(from a commercial perspective) and, in its view, it should be retained. The CBB may additionally want to give consideration to allowing an extension to this 90-day syndication or sell down period upon application by the underwriter in case of delays in the syndication process resulting from circumstances beyond the underwriter's control.	**placements both prior to and during the Global Financial Crises. Therefore, the CBB is upgrading its rule to be more prudent, and to encourage banks to syndicate more of their securities and large credit facilities.** **Disagree-The lead time for large credit facilities and securitizations is measured in months rather than weeks.** **Disagree-the 90 days is considered sufficient**

be included in the trading book policy statement of a bank wishing to use this higher temporary limit. Any residual holdings of securities or syndicated loan commitments held for more than 90 days from the commitment date must be deducted from capital where there are any excesses above 15% of the consolidated capital base. Where the lead bank has obtained legally binding irrevocable (i.e. "full") commitments from other institutions to participate in the concerned securities issue or to participate in providing the syndicated loan facilities, the lead underwriter or syndicate manager may show the participations to the concerned sub-underwriting/participating institution rather than to the issuer of the security or to the loan obligor. The CBB will not allow any bank to include syndicated credit facilities to, or holdings of securities issued by the concerned bank or its connected counterparties (including SPVs connected through ownership, control or establishment) to be included in this temporary 30% limit ."	Underwriting a security or a syndicated loan initially involves the assumption of market risk, i.e. the risk of change in the secondary market value of the relevant security or loan, but if the underwriter were to hold the relevant asset for more than 90 days (or any approved extended period), the exposure could be considered as equal to investing in the relevant security or providing the relevant loan. Accordingly, a bank concurred with the principle that legally binding underwriting commitments beyond 90 days should not be treated as exempt exposure and should be subject to normal large exposure limits. • A core business activity of **the Bank** (in its role as a merchant bank) is the underwriting of capital market transactions (securities and syndicated loans) and their subsequent syndication/distribution, which is a direct function of the expertise developed within the bank over the last so many years. Accordingly, **one Bank** sought allowance for the underwriting of securities and syndicated loan commitments, without the prior approval of CBB, up to 25% of a bank's capital base, in order to be able to play a meaningful role in arranging issuance of securities by, and provision of syndicated loans to, GCC obligors. The single obligor exposure limits applicable to banks in some of our key markets is up to 25% of the capital base, and it was felt important to have the same flexibility to be able to compete effectively in those markets. One bank stated that prior to underwriting securities or syndicated loan commitments, a detailed internal assessment of the market appetite is made and the terms of underwriting	**Disagree, blanket exemptions are considered imprudent based on the lessons learned so far. Therefore, the CBB is upgrading its rule to be more prudent. Also, there is liquidity risk to consider. Such exposures may need to be funded if they cannot be placed or sold down (in the case of securities underwriting).There is also credit risk as witnesses by the experience with subprime and CDP securities.** **Disagree, blanket exemptions are considered imprudent based on the lessons learned so far. Therefore, the CBB is upgrading its rule to be more prudent. Furthermore, these measures are designed to encourage banks to assemble a syndicate at an early stage rather than holding onto a large risk exposure.**

	are negotiated in such a manner so as to minimize the risk of devolvement of the underwriting commitment. For example, in a large number of underwriting arrangements for syndicated loans, appropriate language is incorporated into the mandate documents which allows the underwriter to amend/adjust certain terms of the transaction (such as, the structure, the pricing, etc), to ensure successful syndication or sell down; thus, protecting the bank against market risk and minimizing the risk of devolvement.	
	• **A Bank** stated that the suggested 25% limit should be allowed for underwriting - for a maximum of 90 days (or such approved extended period) - regardless of other outstanding credit exposures. The rationale for this suggestion stems from the fact that this limit is primarily established to underwrite and distribute securities or syndicated loans, and does not represent a credit exposure of the bank. At the end of the stipulated 90-day period (or such approved extended period), any outstanding underwriting exposure could be aggregated with the existing credit exposure and, to the extent it is in excess of the stipulated 15% single obligor limit, can be deducted from the capital base.	**The underwriting cap is 30% & not 25% .The existing exposure for any counterparty should be taken into account (i.e. aggregated) whenever the bank is entering into a new transaction with such counterparty (i.e. increasing the exposure to such counterparty) because the bank may be required to fund any residual exposure it cannot place. This liquidity risk must be recognized. Ignoring the existing exposure would create unnecessary overconcentration which the CBB is trying to avoid by introducing the rule in this paper.**

	A Bank stated that if the CBB's prior approval will be required, the rules should include a clear provision on the applicable process to obtain the CBB's approval. For example, it may be stipulated that the CBB would respond within a given number of working days following the receipt of a licensee's request for the approval.	**To amend the rule by stating that the CBB would respond with 2 weeks from the date of receiving a complete set of all the required documents .**

2.2 New introduced rules for temporary exposures arising from banks' investment business with the intention to securitize assets or place them with investors. 2.2.1 The proposed rule suggests that any temporary exposure arising from banks' investment business (with the intention to securitize assets or place them with investor) which is above the 15% single exposure limit must be subject to the CBB prior approval. The maximum level of such temporary exposures that the CBB may approve per individual exposure, must not exceed 25% of the concerned bank's consolidated capital base for a 90-day period subject to having in place written detailed due diligence policy & procedures for such business which should be approved by the bank's board of directors for both Conventional & Islamic Banks. Proposed rules are suggested to be as follows: **A bank may not incur any temporary large exposures arising from investment business (where the intention by the concerned bank is to securitize such assets or place them with investors), which exceeds 15% of the bank's (consolidated) capital base without the prior written approval of the CBB. The maximum level of such temporary exposures that the CBB may approve per individual exposure must not exceed 25% of the concerned bank's consolidated capital base for a maximum 90-day period. Any such exposures held for**	**A Bank** inquired: how such a prior approval requirement would be implemented in the context of proposed investment business acquisitions? Which are by their nature very dynamic and often fast moving transactions? A Bank further stated that it does not believe that this is an issue for underwriting transactions because it should be fairly straight forward for an underwriting bank to identify the likely maximum level of a proposed securities offering and seek Central Bank approval for that maximum amount of underwriting. In contrast, when should a bank seek CBB's approval for an Investment Business Exemption? If the CBB approval was sought and obtained before a definitive acquisition agreement is signed and there were a subsequent change in the terms of the acquisition, would any change in exposure, however small, require further CBB approval? Given the rapid pace of many acquisitions, we and other banks would be very concerned about the timeframe for obtaining such further approval and our ability to proceed with the acquisition. Conversely, if a bank waited to seek CBB approval until a definitive acquisition agreement had been drafted and agreed, it is very unlikely that any counterparty would agree that the bank could terminate the transaction if the Central Bank did not approve the acquisition because of concern by the counterparty that the Central Bank approval requirement could be manipulated by the acquirer.	**Banks should seek the CBB approval at the outset of the transaction, prior to committing itself to the transaction.** **For the sake of the rules introduced in this paper, the CBB would look at the level of exposure. Therefore any subsequent change in the amount of exposure at a later stage would require the CBB prior approval.** **The CBB is concerned at the size of the potential and actual risk exposure. Changes to margins would not require resubmission to the CBB.**

more than 90 days from the originating date of the exposure must be deducted from the consolidated capital base where there are any excesses above 15%. In order for a bank to be allowed such exposures, it must have in place written detailed due diligence policy & procedures for such business which should be approved by the bank's board of directors.	A bank expressed concerns at the prospect of expending significant resources on a potential transaction without knowing whether the Central Bank will approve the transaction. On this basis, a bank requested that the Central Bank (i) agree that banks may seek approval for an Investment Business Exemption at the outset of a transaction prior to the expenditure of significant resources and (ii) establish parameters within which a proposed transaction can be modified without requiring further Central Bank approval. **A Bank** requested that the Central Bank increase the maximum temporary exposure limit for the Underwriting and Investment Business Exemptions to 40% which is the same as the investment concentration limit on the Real Estate Directive issued by the CBB in Jul 2009.	**Disagree-this is irrelevant, the 40% was a sectoral concentration limit**
Exposures to connected counterparties - Conventional Bank Licensees		
2.3 Amendments to the existing rules on exposures to connected counterparties 2.3.1 The current large exposure limits for directors and associated companies have been reduced on an aggregate basis to a limit of 25% for both instead of 20% for each and therefore the total aggregate limit has dropped down to 25% instead of 40%. Proposed rules are suggested to be as	**A Bank** wished to point out that its exposure to its major shareholder, is deemed as exempt exposure (and therefore not subject to these rules) given that its major shareholder is part of a government ministry of a GCC country. **A Bank** highlighted that the new proposed connected party limits are extremely stringent, and will put Bahraini incorporated banks at a competitive disadvantage with their peers in the region. Similar limits proposed by other	**Agree** **Disagree- Basel requires that the connected exposures to be tough or tougher than the third party exposure limits.**

<table>
<tr>
<td>follows:
<table>
<tr><td>Connected Counterparties</td><td>Individual Limit</td><td>Aggregate Limit</td></tr>
<tr><td>Shareholders with ‘significant ownership (i.e. 10% and above)’</td><td>0%</td><td>0%</td></tr>
<tr><td>Other connected Counterparties (mentioned in CM-5.5.9)</td><td>Individual Limit</td><td>Aggregate Limit</td></tr>
<tr><td>Directors</td><td>10%</td><td rowspan="2">(Proposed: 25% in aggregate) (current:20% for Directors in aggregate & 20% for Associated Companies/ Unconsolidated subsidiaries in aggregate)</td></tr>
<tr><td>Associated Companies/ Unconsolidated subsidiaries</td><td>15%</td></tr>
<tr><td colspan="2">Total (including management)</td><td>(Proposed: 25%) (Current: 40%)</td></tr>
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<td>jurisdiction within GCC are considerably more flexible. To note a few examples:

The UAE Central Bank caps aggregate exposures within the Banking Group and to Directors at 60% and 25% respectively.
The Central Bank of Qatar has aggregate limits of 35% each to the Banking Group and Directors,
The Central Bank of Kuwait has a 50% limit for exposures to Directors and a 60% aggregate limit for investment in associates and affiliates.

In light of the above, <u>A Bank</u> recommended that the current limits remain unaltered and ask that emphasis be placed on adherence with the current limit structure as opposed to proposing more stringent limits.

<u>A Bank</u> stated that the proposed reduction in the aggregate limit of 40% for connected counterparties exposures should be reduced to only 30% instead of 25%.

The proposed reduced aggregate limit for connected counterparties’ exposures should explicitly exempt the investment exposures to associates that are pre-approved by CBB. Such exposures are currently deducted from the bank’s regulatory capital and should be excluded from connected counterparties exposure limit to avoid duplication. Any restrictions on such CBB approved exposures would adversely affect the ability of <u>the Bank</u> or any other Bahraini incorporated commercial bank to expand its operations.</td>
<td>Basel core principles requires lower exposure for connected counterparties

Agreed, any current connected counterparty exposure that is currently deducted from the bank’s regulatory capital as per the PCD Module will not be subject to the connected counterparty limits introduced in this paper. A guidance paragraph will be added to confirm this fact.</td>
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Industry Comments & the CBB Feedback Statement on the Second Consultation on the proposed amendments to Large Exposures Limits – CM Module Rulebook-Volumes 1 & 2 – Conventional/Islamic bank licensees January 2011

<table>
<tr><th colspan="3">Exposures to connected counterparties - Islamic Bank Licensees</th></tr>
<tr>
<td>2.3.3 The current limit for on-balance sheet exposures (i.e. direct) is currently 15% for both directors and associated companies; the proposed rules have split this limit into 10% & 15% for directors and associated companies respectively.

Proposed rules are suggested to be as follows:

<table>
<tr><th>Connected Counterparties</th><th colspan="2">Individual Limit</th><th>Aggregate Limit</th></tr>
<tr><td>Shareholders with ‘significant ownership (i.e. 10% and above)</td><td colspan="2">0%</td><td>0%</td></tr>
<tr><td>Other connected Counterparties (mentioned in CM-4.4.10)</td><td colspan="2">Individual Limit</td><td>Aggregate Limit</td></tr>
<tr><td>Directors</td><td>(Proposed: 10%)</td><td rowspan="2">(Current: 15% for both in aggregate)</td><td rowspan="2">Proposed: 25%)
(Current: 25%)</td></tr>
<tr><td>Associated Companies /Unconsolidated subsidiaries</td><td>(Proposed: 15%)</td></tr>
<tr><td colspan="3">Total (including management)</td><td>(Proposed: 25%)
(Current: 25%)</td></tr>
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</td>
<td>A Bank stated that the individual direct exposure limit for associate and unconsolidated subsidiaries is appropriate. However, for the purpose of calculating aggregate direct exposure limit of 25% of capital base, equity exposures in associates and unconsolidated subsidiaries should be excluded and any other exposure/funding provided should be considered for the purpose of aggregate limit.

• It further inquired whether the CBB had undertaken any quantity impact study in relation to the proposed amendment.

• Inquired what is the basis and rationale for the imposing further limit in relation to connected counterparties.</td>
<td>Disagree- Equity exposures must be part of the aggregate. Please refer to the definition of Exposure in the Glossary.

The quantitative impact assessment should be done by the banks themselves as part of the assessment of the consultation paper

Basel requires that the connected exposures to be as tough or tougher than the 3rd party exposure limits</td>
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	• It also stated that the CBB rulebook provides guidelines to calculate risk weighted assets and this should appropriately reflect the risk in large exposures. On the other hand, the limits on large exposures require a CBB licensee to allocate appropriate risk weight for large exposures up to the prescribed limits and thereafter deduct the excess from the concerned licensee's capital. This leads to huge capital charge for banks and grossly overstates the risk in these exposures, undermining the objective of setting the limit what's more reducing the existing limits.	**These are two different measures, the risk weighting rules are counterparty based measures whereas the connected counterparties limits are a measure to prevent excessive risk concentration in a small number of counterparties.**
	It will be appropriate to provide guidelines in relation to a counterparty that subsequently becomes a connected counterparty, in term of applicability of rule, any exemption(s), the appropriate period given to the concerned bank to address such change and adjust its position, etc.	**These would have to be looked at on a case-by-case basis.**

	• A Bank stated that it did not see a proper justification for placing an individual limit on associated companies without taking into account the degree of association, i.e., the 10% ownership may be significant in public companies but not necessarily in other types of companies and further, equity ownership does not necessarily entail votes or any right to manage the company. • The concerned bank recommended replacing the 10% ownership test with the "control" test by stipulating that a person or entity is deemed to be a connected counterparty if such person or entity has the 20% ownership or more of voting equity. • There appears to be no quantitative rationale for the setting of limits. If ratios such as the Capital Adequacy Ratio are satisfactory, why enforce these limits?	**The justification is risk mitigation.** **Disagree** **Basel requires that the connected exposures to be as tough or tougher than the 3rd party exposure limits. The capital ratio is one means of assessing a bank's general availability of capital to aggregate risks. Individual risk limits are also necessary to complement the capital ratio.**

	• In terms of lending limits, the ratios do not consider the security on the lending obtained. The more secure the lending, the safer the debt and the higher the individual limits should be.	**These limits would be part of the CM Module, therefore it should be read within the overall context of this Module Collateral can improve the credit rating of a customer however. As a matter of principle, collateral should not replace a careful assessment of the borrower's ability to repay.**
	• Thus, the recommendation would be either to remove the limit or to increase the limit for each individual connected counterparty to 25% or a preset amount, whichever is the higher.	**Disagree**
	• one bank did not see proper justification to combine the limits in aggregate. Different counterparties may have different risk aspects.	**Aggregation limits are currently existing and therefore it is not newly introduced concept . it is more prudent to have an aggregate limit**

	• The Committee of European Banking Supervisors (CEBS) recognizes that putting limits on the intra-group exposures could restrict liquidity flow to where it is most needed. As a consequence, a subsidiary in need of liquidity may be forced into the interbank market (more unstable and expensive) despite liquidity available at a group level. This is not only contrary to the spirit of the CBB rules that allow its licensee to act as a central treasury for a group of connected parties, it will also result in operational risk for small entities would ultimately have to set up their own treasury departments. • For the above reason the European Parliament has adopted an approach that sets the limit at 25% or a preset limit (i.e., EUR 150 Million) whichever is higher. In the event the CBB will impose a limit to connected counterparties exposure, the bank recommended that the CBB follows this approach, i.e. to set the limit of not less than 25% or a preset limit appropriate to the nature of Islamic banking business in the Kingdom of Bahrain, whichever is higher.	**The CM Module has an exemption for treasury transactions for regulated entities within a financial group.** **Basel requires that the connected exposures to be as tough or tougher than the 3rd party exposure limits.**
2.3.4 The current large exposure limits for off-balance sheet exposures (i.e. financed by RIA) to connected counterparties is currently 25% on an individual basis & 35% on an aggregate basis. The proposed rules have reduced the above stated two limits to 15% & 25% respectively.	• **A Bank** inquired**-** As long as RIA is disclosed and investors are aware of the riskiness of the product, why have such a low exposure limit?	**Disagree. The bank still has a fiduciary duty to invest and could be sued in the event of negligence , particularly if the concerned exposure is to a party connected to the bank, therefore, there should**

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<td>Proposed rules are suggested to be as follows:
<table>
<tr><td>Connected Counterparties</td><td>Individual Limit</td><td>Aggregate Limit</td></tr>
<tr><td>Restricted investment accounts (funded or not funded)</td><td>A bank may not incur an exposure (whether funded or not funded) to an individual connected counterparty where the exposure is funded by restricted investment accounts which exceeds (proposed: 15%) (Current: 25%) of the reporting bank's (consolidated) capital base.</td><td>The aggregate exposures to all counterparties within this category should not exceed (proposed: 25%) (Current: 35%) of the bank's consolidated capital base.</td></tr>
<tr><td>Total</td><td></td><td>(Proposed: 25%) (Current: 35%)</td></tr>
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<td><u>A Bank</u> stated that in its opinion the existing limits to connected parties are adequate. It further added that the CBB should reconsider the proposed decrease in connected party’s restricted investment account and combined exposure limits and these should remain at present levels.</td>
<td colspan="2">be limits on off balance sheet exposures . Currently there are limits on RIA however this paper has toughened these limits.

Basel requires that the connected exposures to be as tough or tougher than the 3rd party exposure limits.</td>
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<td>2.3.5 The current large exposure limits for combined exposures (on- and off-balance sheet) to connected counterparties is currently 25% on an individual basis & 60% on an aggregate</td>
<td><u>A Bank</u> stated that in its opinion the existing limits to connected parties are adequate. It further added that the CBB should reconsider the proposed decrease in connected party’s restricted investment account and</td>
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<td>Basel requires that the connected exposures to be tough or tougher</td>
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<td>basis. The proposed rules have reduced the above stated two limits to 20% & 50% respectively.

<table>
<tr><th>Connected Counterparties</th><th>Individual Limit</th><th>Aggregate Limit</th></tr>
<tr><td>The combined exposures (on- and off-balance sheet)</td><td>A combined exposure of (CM-4.4.14a) & (CM-4.4.14b) above (funded by unrestricted investment accounts and bank's own funds, and restricted investment accounts) whether funded or not funded, to an individual connected counterparty may not exceed (proposed: 20%) (Current: 25%) of the reporting bank's (consolidated) capital base.</td><td>The aggregate exposures of: (CM-4.4.14a) & (CM-4.4.14b) above (whether funded from on balance sheet or restricted investment accounts) may not exceed (proposed: 50%) (Current: 60%) of the bank's (consolidated) capital base, whether funded or not funded.</td></tr>
<tr><td>Total</td><td></td><td>(Proposed: 50%)</td></tr>
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<td>combined exposure limits and these should remain at present levels.</td>
<td></td>
<td>than the 3rd party exposure limits. There should be limits on off balance sheet exposures as the bank still has a fiduciary duty to invest and could be sued in the event of negligence , particularly if the concerned exposure is to a party connected to the bank. Currently there are limits on RIA however this paper has toughened these limits.</td>
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(Current: 60%)			
	Next Step		
3. Following receipt of comments on this consultation paper, the CBB will amend and finalise Module CM. Licensees should thereafter take measures to ensure compliance with the new requirements once issued as final. Licensees which will be non-compliant with the new rules once issued will be given a six-month transitional period, effective from the issuance of this amendment to Module CM, for full compliance. Moreover, such licensees should advise the CBB of their status accordingly.	**A Bank** stated that given the current downturn, many institutions are facing delays in liquidating their investments as well as realizing the project cash inflows of many projects being executed by them. In view of this, it suggested that the CBB defer the proposed restrictive amendments to connected counterparty limits to a future date and suggested implementing the proposal once the market conditions improved. However, it expressed support for restricting additional or new facilities to connected counterparties should licensed institutions already be in excess of the limits proposed by the CBB.		**Banks which will be non-compliant with the new rules once issued will be given a transitional period for full compliance. Moreover, all banks should submit a report within one month from the issuance of this directive showing their status accordingly. This will be part of the communication letter when this amendment is issued as part of the Rulebook update.**