

**Consultation on Proposed Amendments to the Credit Risk Management Module (CM) for Locally Incorporated Banks – Major Acquisitions**  
**Industry Comments and Feedback**  
**Conventional Banks**  
**January 2016**

Specific Comments:			
Reference to the draft Directive:	Comments	REF	CBB's Response
<p>CM-5.10.3 All <u>Bahraini conventional bank licensees</u> must obtain the CBB's approval prior written approval before to making a "significant investment" "major acquisition or investment" (as described in CM-5.5.1E) in another commercial entity (whether incorporated inside or outside of Bahrain).</p>	<p><u>A bank:</u></p> <p>1. Suggested to add a definition of "Major acquisition or investment" to the glossary section.</p> <p>2. CBB's prior written approval to be taken before making major acquisition of investment  <u>Clarification needed from CBB :</u></p> <p>a) Presume there is no aggregate limit for such exposures (previous qualifying holding stipulation required to the aggregate to be restricted to 60% of Capital Base).</p> <p>b) Presume that 800% risk weight rule will not apply to such exposures, once approval is obtained from CBB.</p>	<p>SP-1</p>	<p>1. The Paragraph will be read as follows:</p> <p>CM-5.10.3 All <u>Bahraini conventional bank licensees</u> must obtain the CBB's approval prior written approval before to making a "significant major investment" (as described in CM-5.5.1E) in another commercial entity (whether incorporated inside or outside of Bahrain).</p> <p>2. "Major Investments" which requires a prior written approval by the CBB will be defined in the glossary, as follows:</p> <p><u>A major investment</u> is defined as any acquisition or investment in the capital instruments of another entity by a <u>Bahraini conventional bank licensee</u> which is equivalent to or more than 10% of the Bahraini conventional bank licensee's consolidated total capital.</p> <p>B) the limits must be applied, refer to CM-5.3.3 and CM-5.11:  CM-5.5.3 The aggregate of large exposures may not exceed 800% of the bank's consolidated Total Capital (there are separate sub-limits for "significant</p>

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			investments” in Section CM-5.11), whether funded or not funded, i.e. contingent commitments.
<p><b>CM-5.10.3A All Bahraini conventional bank licensees must obtain the CBB’s prior written approval before any future increases in the bank’s ownership of any of the existing major acquisitions or investments in excess of 5% of such exposure.</b></p>	<p><b>A bank</b> requires a clarification, since ‘Major Acquisitions or Investments’ has been defined as 10% of the Bank’s Consolidated Total Capital, presume above clause means that the bank will require CBB’s approval for any exposure in excess of 5% of the Bank’s Consolidated Total Capital.</p>	SP-2	<p>The paragraph will be read as follows:</p> <p><b>CM-5.10.3A All Bahraini Conventional bank licensees must obtain the CBB’s prior written approval before any future increases in the bank’s ownership of any of the existing major investments in excess of 5% of such exposure.</b></p> <p>The prior approval is required once a bank has Major Acquisition or Investment” as per CM.5.1.1E (i.e. 10% of the issued common share capital of the Bahraini conventional bank licensee’s consolidated total capital). Any increment above the 10% which constitute 5% of such exposure needs the CBB prior written approval.</p>
	<p><b>A bank</b> noted that the CBB requires Bahraini banks to obtain CBB’s prior written approval before any future increase in the Bank’s ownership of such investments in excess of 5% such exposure. We believe this 5% should be with reference to the Bank’s capital and not such exposure as otherwise, any small increases amounting to 5% of such</p>	SP-3	Please refer to SP-2

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	exposure would require CBB’s prior approval.		
<b>CM-5.10.3B</b> Where the percentage ownership increase is due to revaluation or change in the capital of the bank, the bank must provide a written notification to the CBB, outlining the percentage increase and the reason for such increase.	<b>A bank</b> noted that this paragraph does not define any minimum percentage above which this notification needs to be given to CBB. The revaluation keeps changing on a daily basis based on market prices and hence it is impractical to notify the CBB on a daily basis for changes.	SP-4	This rule means that in case the 5% limit (of the major investment’s <u>amount</u> ) as in CM-5.10.3A, is due to “revaluation or change in the capital of the bank”, the bank is required to notify the CBB instead of getting a prior written approval from the CBB.
<b>CM-5.10.3C</b> Where a percentage ownership increase as described in Paragraph CM-5.10.3B occurs, the 800% risk weight rule will apply as it exceeds the single large exposure limit outlined in Section CM-5.5.	<b>A bank</b> noted that this should be applicable only if the total exposure exceeds the Single large exposure limit as outlined in Section CM-5.5. In certain times increases due to 5 % of existing exposure (as defined in Paragraph CM-5.10.3A) or changes in ownership due to revaluation (as defined in Paragraph CM-5.10.3B) may not result in the single obligor limit being exceeded in which case it should be risk weighted at the applicable risk weight and not 800 %. However, if Paragraph CM-5.10.3A and Paragraph CM-5.10.3B are reworded with reference to 5 % of the Bank’s capital base, the wordings as proposed in Paragraph CM-5.10.3C are correct and hence no change is required.	SP-5	<p>1. The 800% risk weight rule is applicable when the “single large exposure limit” of 15% (as stated in CM-5.5.4)</p> <p><b>CM-5.5.4</b> A bank may not incur an <u>exposure to an individual counterparty or group of closely related counterparties (not connected to the reporting bank) which exceeds 15% of the reporting bank’s consolidated Total Capital without the prior written approval of the CBB. Where such limit has been exceeded whether with or without the prior approval of the CBB, the excess amount must be risk-weighted at 800%.</u></p> <p>2. CM-5.10.3A clearly links the 5% limit to the exposure not to the bank’s capital base.</p>

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<b>CM-5.10.3E Banks must notify the CBB of any acquisition or investment that constitutes 5% or more of the Bahraini conventional bank licensee's consolidated total capital.</b>	<u>A bank</u> requires <u>clarification from CBB</u> : a) Whether above should be reported to CBB, even though they are existing investments. b) is it one time reporting or is there any periodicity for reporting c) do future increases for these investments have to be reported even if maintained below 10%.	SP-6	a)  CM-5.10.3E was deleted from the final rules issued.
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<p><b><i>CBB Criteria for Assessment of Investments and Acquisitions by Bahraini Conventional Bank Licensees</i></b></p> <p><b>CM-5.10.10</b> In assessing any proposed <u>investments</u> or <u>acquisitions</u> mentioned above, the CBB will take into account the following points:</p> <p>(a) The amount of the proposed <u>investment</u> or <u>acquisition</u> relative to the existing consolidated Total Capital of the bank;</p> <p>(b) Existing capital adequacy ratios on a consolidated basis and forecast ratios after the <u>investment</u> or <u>acquisition</u> has gone ahead;</p> <p>(c) The adequacy of information flows from the investee company to the concerned bank;</p> <p>(d) Experience and fit and proper matters relating to the senior personnel associated with the proposed <u>investment</u> or <u>acquisition</u>;</p> <p>(e) Risks associated with the proposed <u>acquisition</u> or <u>investment</u>;</p> <p>(f) Disclosure and exchange of (supervisory) information (in the case of a foreign <u>investment</u> or <u>acquisition</u>);</p>	<p><b>A bank's</b> concern is that CM-5.10.10 is so broad that in practice gives the CBB the “excuse” to block any investment or acquisition they do not like, regardless of what the management and the Board (the governance of the licensees) thinks</p>	<p>SP-7</p>	<p>Please note that the CBB has, always, the right to reject any proposed “investment or acquisition” for reasons stated in CM-5.10.5 or any doubts related to specifications listed in CM-5.10.10, or for any other reason.</p> <p>Please refer to the below rules:</p> <p><b>CM-5.10.5</b> The CBB reserves the right to require <u>Bahraini conventional bank licensees</u> to dispose of any <u>significant major investments</u> acquired without its prior approval. Where a “<u>significant major investment</u>” is acquired without approval of the CBB, then the entire value of the holding must be deducted from the consolidated Total Capital of the concerned bank. Approval will not be given for “significant investments” in entities incorporated in jurisdictions where secrecy constraints exist or there are restrictions on the passage of information to the bank (other than customer confidentiality requirements imposed by financial regulators).</p> <p><b>CM-5.10.3D</b> Any bank wishing to acquire a “major investment” in another entity must address the points outlined in Paragraph CM-5.10.10 of this Section so that the CBB may make an informed review of the request. Banks must submit such request to the CBB and the CBB shall respond within 2 weeks from the date of receiving a complete set of all the required documents.</p>
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<p>(g) Adequacy of host supervision (in the case of a foreign <u>investment</u> or <u>acquisition</u>);</p> <p>(h) Current <u>investments</u> and concentrations in <u>exposures</u> of the concerned bank.</p> <p>(i) The compliance of the concerned bank with the CBB’s rules and regulations (e.g. reporting issues), and the adequacy of internal systems and controls;</p> <p>(j) The extent of holdings by any other shareholders (holding 5% or more of the capital of the concerned entity) or controllers of the concerned entity;</p> <p>(k) Whether the proposed activities are in line with the Memorandum &amp; Articles of Association of the bank;</p> <p>(l) The accounting treatment of the proposed <u>investment</u>;</p> <p>(m) Whether the <u>investment</u> or <u>acquisition</u> relates to a closely-linked party, connected party, or controller in any way;</p> <p>(n) The existence of secrecy laws or constraints over supervisory access to the premises, assets, books and records of the concerned entity in which a “significant investment” is</p>			
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<p>being acquired;          (o) The impact and extent of goodwill and intangibles upon the capital adequacy and balance sheet of the bank on a consolidated basis; and          (p) The bank’s existing and forecast liquidity position (as a result of the <u>acquisition</u>) and how the <u>acquisition</u> is to be funded (e.g. by the issuance of new capital or sale of other <u>investments</u>).</p>			
<p>CM-5.10.11 For “Mergers and Acquisitions” refer to Module BR “CBB Reporting Requirements”, Paragraph BR-5.2.13.</p>	<p><b>A bank</b> noted that Paragraph CM-5.10.11 refers to Paragraph BR-5.2.13 which does not exist.</p>	<p>SP-8</p>	<p>CM-5.10.11 was deleted from the final rules issued.</p>
<p><b>CM-5.11 Limits on Significant Investments</b></p>	<p><b>A bank</b> requires clarification – While the definition refers to all entities, the limits refer to commercial entities. Presume this distinction is deliberate</p>	<p>SP-9</p>	<p>Yes – Please refer to CM-5.11.4  <b>CM-5.11.4 This section refers to the treatment of investments in entities which are otherwise not connected to the concerned bank (i.e. the bank’s connection to the entity is by way of shareholding or holding of other capital instruments). If a bank is investing in a company where there is a connection by way of mutual directors or mutual parent, or some other relationship that makes the investee a ‘related party’ as defined by IFRS, then the ‘significant investment’ must be treated as an exposure to a connected counterparty and the concerned limits and rules for exposures to connected counterparties apply.</b></p>

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<p><b>CM-5.10.611.1</b> No <u>Bahraini conventional bank licensee</u> may have a <u>significant investment</u> in the capital instruments of a commercial entity where the <u>significant investment</u> amount and any other <u>exposure</u> to the subject entity is more than 15% of the concerned bank's consolidated Total Capital.</p>	<p><u>A bank</u> noted a wrong spelling of “Capital” – see the underlined word</p>	<p>SP-10</p>	<p>Noted –Corrected in the final rules issued.</p>
<p><b>CM-5.10.711.2</b> The total amount of a bank's <u>significant investments</u> in unconnected commercial entities may not exceed 60% of the concerned bank's consolidated Total Capital.</p>			
<p><b>CM-5.10.811.3</b> <del>The CBB may allow the limits in Paragraphs CM-5.10.611.1 and CM-5.11.2 above to be exceeded, provided that the concerned bank has addressed the points outlined in Paragraph CM-5.10.10 to the satisfaction of the CBB.</del> Any excesses above the limits in Paragraphs CM-5.11.1 and CM-5.11.2 must be risk-weighted at 800% according to Paragraph CA-2.4.25.</p>	<p><u>A bank</u> requires clarification – Unlike in the case of ‘Major Acquisition or Investment’, there is no mention of approval process for exceeding limits under ‘Significant Investments’. Hence, whether it can be presumed that while the individual limit of 15% &amp; aggregate limit of 60% is not to be generally exceeded, if it is exceeded, there is no specific need to seek CBB approval &amp; instead the 800% risk weight shall automatically apply.</p>	<p>SP-11</p>	<p><b>For EDBS Feedback:</b> As per the current rule, yes no need for approval and the 800% RW will be automatically triggered.</p> <p>But referring to:</p> <p><i>Single Exposure Limit to Unconnected Counterparties – 15%</i></p> <p><b>CM-5.5.4</b> A bank may not incur an <u>exposure</u> to an individual <u>counterparty</u> or group of closely related <u>counterparties</u> (not connected to the reporting bank) which exceeds 15% of the reporting bank's consolidated Total Capital without the prior written approval of the CBB. Where such</p>

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		<p>limit has been exceeded whether with or without the prior approval of the CBB, the excess amount must be risk-weighted at 800%.</p> <p>Do we want to modify CM-5.11.3 to require banks to notify? Get prior written approval? Or just prohibit any excess to the 15% and 60% limits? As currently it doesn't require banks to inform the CBB by any way, it's just to risk weight the excess.</p>
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