CREDIT RISK MANAGEMENT MODULE

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CM-A.1 Purpose

CM-A.1.1 The purpose of this Module is to provide the Central Bank of Bahrain's (the CBB's) Directive concerning requirements relevant to the key elements of a sound credit risk management system which it expects Islamic bank licensees to observe. +

CM-A.1.2 This Module must be read in conjunction with other parts of the Rulebook, mainly:

(a) High-level Controls;
(b) Capital Adequacy;
(c) Liquidity Risk;
(d) Operational Risk;
(e) Profit Rate Risk in the Banking Book;
(f) Reputational Risk;
(g) Stress Testing; and
(h) Internal Capital Adequacy Assessment Process ('ICAAP').

Legal Basis

CM-A.1.3 **This Module contains the CBB's Directive (as amended from time-to-time) relating to credit risk management in Islamic bank licensees, and is issued under the powers available to the CBB under Article 38 of the of the Central Bank of Bahrain and Financial Institutions Law (Decree No. 64 of 2006) ("CBB Law"). This Module is applicable to all Islamic bank licensees. Branches of foreign bank licensees shall comply with the requirements in this Module unless stated otherwise under relevant paragraphs of the Module.**

CM-A.1.4 For an explanation of the CBB's rule-making powers and different regulatory instruments, see Section UG-1.1.

CM-A.2 Module History

CM-A.2.1 This Module was first issued in July 2004. Changes made subsequently to this Module are annotated with the calendar quarter date in which the change was made as detailed in the table below. Chapter UG 3 provides further details on Rulebook maintenance and version control.

Summary of Changes

Module Ref.	Change Date	Description of Changes
CM-2.2	1/10/05	Role of Internal audit becomes a rule
CM-7.4	1/10/05	Clarification re non-compliant facilities
CM-A.1	10/2007	New Rule CA-A.1.4 introduced, categorising this Module as a Directive.
CM-7	10/2007	New Requirement to follow the "Code of best Practice on Consumer Credit and Charging
CM-1.2	10/2007	Membership of CRB
CM-4.2	10/2007	Clarification of definition of exposure
CM-8	10/2007	Re-organised the Chapter.
CM-4.4 & 6.1	04/2008	New Limits for significant shareholders and guidance on write-offs
CM-7.6	04/2008	New Insurance Refund and prepayment requirements
CM-4.6	10/2009	New reporting arrangements for exposures of connected counterparties.
CM-A.1.3	01/2011	Clarified legal basis.
CM-4	01/2011	Changes made to incorporate CP-5 and large exposures requirements.
CM-A.2.4	04/2011	Corrected cross reference in line with new limits introduced in January 2011.
CM-4.2.1(c), CM-4.5.1	04/2011	Corrected cross reference.
CM	07/2011	Various minor amendments to clarify Rules and have consistent language.
CM-4.4.10	07/2011	Amended the definition of connected counterparties.
CM-7.5.3	10/2011	Clarified reference to APR.
CM-7.5.9 and CM-7.5.10	10/2011	Corrected elements of APR formula.
CM-7.5.12	10/2011	Deleted Paragraph as it does not reflect current practice on residual interest.
CM-4.4.1E	01/2012	Amended definition of qualifying holdings
CM-4.5	01/2012	Clarified and amended the Rules on temporary exposures.
CM-4.9.3	01/2012	Clarified the Rule on future increases in qualifying holdings.
CM-7.4.9	01/2012	Changed Rule to Guidance.
CM-4.5.2E and CM-4.5.2F	04/2012	Clarified Rule on temporary exposures.
CM-A.2.9	07/2012	Updated reference to Bahrain Association of Banks.
CM-4.4.7	07/2012	Clarified the definition of 'controlling interest'.
CM-4.4.8A	07/2011	CBB prior approval required for excess over limits to connected counterparties.
CM-4.4.10	07/2012	Minor corrections.
CM-4.9.3	07/2012	Amendment made to be in line with updated definition of qualifying holdings.

CM-A.2 Module History

CM-A.2.2 (continued)

Summary of Changes

Module Ref.	Change Date	Description of Changes
CM-7.5.4	07/2012	Minor typo corrected.
CM-7.5	10/2012	This Section was deleted and requirements are now included in Section BC-4.2.
CM-A.2.11	01/2013	Clarified Rule related to the write-off of a credit facility.
CM-4.4.13A	07/2013	Clarified Rule on the amount that must be deducted from the capital base where exposure exceeds the limit stipulated.
CM-7.6.2	07/2013	Clarified the type of mortgages on which the CBB imposes a ceiling on early repayment fees and/or charges.
CM-1.2.4	10/2013	Amended to reflect the expanded scope of activities of the Credit Reference Bureau and the membership requirements.
CM-7.4.4	10/2013	Updated reference to Eskan Bank to reflect new name.
CM-1.2.4	01/2014	Clarified Rule to apply to credit facilities to residents in Bahrain.
CM-A.2, CM-4 and CM-8.1.19	04/2014	Added cross references and corrected terminology to link to Glossary items.
CM-5.1.1A	04/2014	Clarified Rules on staff loans.
CM-7.2.4	04/2014	Reference updated for the code of best practice on consumer credit and charging.
CM-4.9.2A	07/2014	Added a guidance Paragraph to clarify the treatment of investments in commercial entities which are otherwise not connected to the bank.
CM-A.2 and CM-4	01/2015	Corrected to be aligned with updated requirements under module CA.
CM-4.4.2	01/2015	Added reference to transactions subject to the regulation on close-out netting under a market contract.
CM-4.4.1B	01/2015	Corrected cross reference.
CM-4.4.1E	04/2015	Deleted cross reference as not applicable.
CM-4.4.13	04/2015	Clarified that RIAs are excluded.
CM-4.4.5, CM-4.5.2B, CM-4.5.9 and CM-4.9.10	04/2015	Corrected reference to consolidated Total Capital to be in line with Module CA.
CM-4.6.1	04/2015	Added reference to Appendix BR-19 for reporting the financial details of each large exposure.
CM-4.9.3	04/2015	Clarified language on the treatment of significant investments over the thresholds outlined in Paragraph CA-2.4.25.
CM-4.6.1, CM-4.6.1A and CM-4.6.1B	07/2015	Clarified the reporting requirements of exposures.
CM-6.1	10/2015	Amended Rules on write-offs.
CM-4.4.1E	10/2016	Amended definition of 'Major investments'.
CM-4.9	10/2016	Amended 'Acquisitions' to be 'Investments'
CM-4.9.3	10/2016	Amended Major Investments approval
CM-4.9.4	10/2016	Changed 'major acquisition' to 'major investment'.
CM-4.9.5	10/2016	Changed 'significant investment' to 'major investment'
CM-4.9.6	10/2016	Moved to new section CM-4.10
CM-4.9.7	10/2016	Moved to new section CM-4.10
CM-4.9.8	10/2016	Moved to new section CM-4.10
CM-4.9.10	10/2016	Changed 'acquisitions' to 'major investments'.
CM-4.10	10/2016	New Section – 'Limits on Significant Investments'
CM-6.1	10/2016	Amended the 'Write-offs' Section
CM-7.4.5	10/2016	Amendments to clarify the Rule
CM-A.2.2A CM-4.4.3A	01/2017	Added a new requirement on Large Exposures.
CM-4.4.6A CM-4.4.10B	01/2017	Added Paragraphs on closely related counterparties and connected counterparties.

CM-A.2 Module History (Continued)

Summary of Changes

Module Ref.	Change Date	Description of Changes
CM-3.6	07/2017	Added new Section on 'Country and Transfer Risks'.
CM-7.6.2	04/2018	Deleted Paragraph on "Early Repayment Fees/Charges".
Full Module CM	**09/2018**	**Restructured to incorporate various qualitative standards and better align with BCBS and IFSB.**

Evolution of the Module

CM-A.3.3 Prior to the development of this Rulebook, the CBB had issued various circulars representing regulations covering different aspects of <u>credit risk</u> management. These circulars and their evolution into this Module are listed below:

Circular Ref.	Date of Issue	Module Ref.	Circular Subject
BC/3/98	21 Feb 1998	CM-B.2	Basel Committee on Banking Supervision Framework for the Evaluation of Internal Controls Systems
BC/117/95 (part	1 Feb 1995	CM-1 – CM-3	Risk Management
OG/127/01	18 Mar 2001	CM-2	Developing a Sound Credit Culture
OGD/27/88	9 Feb 1988	CM-3.4	Provisions Against Country Debt
PIRI Pack	- - - - -	CM-4	Prudential Information Returns for Islamic Financial Institutions
EDBC/178/96	5 Oct 1996	CM-5	Islamic Facilities
OG/45/88	13 Mar 1988	CM-6.1	Write-Off – Credit Facility
OG/50/92 (partial)	4 Mar 1992	CM-07.1 – CM-7.2	Consumer Finance
PIRI Pack	- - - - -	CM-8	Prudential Regulations for Islamic Financial Institutions
EDBC/105/96	26 June 1996	CM-8.3	Mudaraba Contracts – Minimum Terms and Conditions
BC/4/99	17 Mar 1999	CM-9.1	Annual Accounts for the Year Ending 31 December 1999

Effective Date

CM-A.2.3 **The contents of this Module are effective from the date of release of the Module or the changes to the Module unless specified otherwise.**

CM-1.1 Overview

CM-1.1.1 Credit risk is the likelihood that a counterparty of the bank will not meet its obligations in accordance with the agreed terms. The magnitude of the credit risk depends on the likelihood of default by the counterparty, and on the potential value of the bank's contracts with the customer at the time of default. Credit risk largely arises in assets shown on the balance sheet, but it can also show-up off the balance sheet in a variety of contingent obligations.

CM-1.1.2 The effective management of credit risk is a critical component of a comprehensive approach to risk management and is essential to the long-term success of any banking organisation.

CM-1.1.3 The lack of continuous credit supervision and effective internal controls, or the failure to identify abuse and fraud are also sources of risk. The overall financing policy of the bank should be monitored by a Credit Committee, composed of officers with adequate seniority and experience.

CM-1.1.4 Although specific credit risk management practices may differ among banks depending upon the nature and complexity of their credit activities, a comprehensive credit risk management program shall specifically address the following areas (i) establishing an appropriate credit risk environment; (ii) operating under a sound credit granting process; (iii) maintaining an appropriate credit administration, measurement and monitoring process; and (iv) ensuring adequate controls over credit risk.. These practices should also be applied in conjunction with sound practices related to the assessment of asset quality, the adequacy of provisions and reserves, and the disclosure of credit risk.

CM-1.2 Elements of Credit Risk Management

Credit Risk Management Unit

CM-1.2.1 **Islamic bank licensees must establish a Credit Risk Management unit (CRMU) within their risk management function to identify, measure, monitor and control the credit risk inherent in the entire portfolio, as well as the risk in individual credits or transactions. The CRMU must also consider the relationship between credit risk and other risks.**

CM-1.2.2 **The CRMU must be independent of the business functions which are related to business acquisition. The CRMU must report to the chief risk officer ('CRO').**

CM-1.2.3 Effective credit risk management is imperative to maximise the bank's risk-adjusted rate of return by maintaining credit risk exposure within acceptable parameters.

The Role of the Board of Directors

CM-1.2.4 **The Board of Directors of Islamic bank licensee is responsible for approving and regularly reviewing, at least annually, its credit risk management strategy, credit risk appetite and limits framework, and the significant policies and procedures for identifying, measuring, evaluating, monitoring, reporting and mitigating credit risk, consistent with the approved risk appetite approved by the Board. Amendments made to the policies and procedures must also be approved by the Board.**

CM-1.2.5 A risk appetite statement is a written articulation of the aggregated level and types of risk exposures that the bank will accept, or avoid, in order to achieve its business objectives.

CM-1.2.6 **The Board must ensure that the credit risk strategy and policies cover all activities of the Islamic bank licensee in which it incurs credit risk. The Board must also determine that the bank's capital level is adequate for the risks assumed throughout the entire organisation or group.**

CM-1.2.7 **The credit risk strategy must include a statement of the bank's willingness to grant credit based on exposure type (commercial, consumer, real estate etc.), economic sector, geographical location, product, currency, maturity and anticipated profitability. This might also include the identification of target markets and the overall characteristics that the Islamic bank licensee would want to achieve in its credit portfolio (including levels of diversification and concentration tolerances).**

CM-1.2 Elements of Credit Risk Management

CM-1.2.8 **The Board must ensure that the credit risk appetite framework delineates the delegated powers, lines of responsibility and accountability over credit risk management decisions, and must clearly define authorised instruments, hedging strategies and risk-taking opportunities.**

CM-1.2.9 **The Board must assess whether the Islamic bank licensee is operating within the boundaries of the credit risk strategy, credit risk appetite and limits framework as per the policy approved by the Board.**

CM-1.2.10 **The Board must approve the structure in which the bank will organise its credit-granting functions, including independent review of the credit granting process, credit management unit and the overall portfolio.**

CM-1.2.11 **The Board must ensure that it receives adequate management information report, and exception reports to meet its oversight requirements and provide the right level and type of information to set and monitor adherence to the bank's risk tolerance/appetite. The Board must regularly evaluate whether it is receiving the right balance of detail and quantitative versus qualitative information.**

CM-1.2.12 For branches of foreign bank licensees, where no Board/Audit Committee exists, all references to the Board/Audit Committee should be interpreted as the Group Chief Risk Officer or equivalent person who has direct access or reports to the Board or Audit Committee of the parent bank.

The Role of the Senior Management

CM-1.2.13 **Senior management of the Islamic bank licensee is responsible for implementing the credit risk strategy and policies in accordance with the bank's credit risk appetite framework approved by the Board. This includes ensuring that the Islamic bank licensee's credit-granting activities conform to the established strategy, written procedures are developed and implemented, and credit approval and review responsibilities are clearly and properly assigned. Senior management must also ensure that there is a periodic independent internal assessment of the bank's credit-granting and management functions.**

CM-1.2.14 Senior management is also a key recipient of risk reports and are responsible for determining the bank's own risk reporting requirements. Senior management should ensure that it is receiving relevant information that will enable it to fulfil its management mandate relative to the bank and the risks to which it is exposed.

CM-1.2 Elements of Credit Risk Management (Continued)

CM-1.2.15 Senior management must determine that the staff involved in any credit relationship, whether established or new, basic or complex, have the necessary knowledge, skill sets, experience and are fully capable of ensuring the relationship meets the highest standards and in compliance with the bank's policies and procedures.

CM-1.2.16 Senior management must ensure that risk monitoring systems are in place for effectively undertaking the activities of credit risk management.

Effectiveness of Internal Control System

CM-1.2.17 An effective internal control system for credit risk assessment and measurement is essential to enable senior management to carry out its duties. An effective internal control system must include:

(a) Measures to comply with applicable laws, regulations and internal policies and procedures;
(b) Measures to provide oversight of the integrity of information used and reasonably ensure that the allowances reflected in the bank's financial statements, and its supervisory reports are prepared in accordance with the applicable accounting framework and relevant supervisory guidance;
(c) Well-defined credit risk assessment and measurement processes that are independent from (while taking appropriate account of) the financing function and include:
   (i) An effective credit risk rating system that is consistently applied, accurately grades differing credit risk characteristics, identifies changes in credit risk on a timely basis, and prompts appropriate action;
   (ii) An effective process which ensures that all relevant/ reasonable and supportable information, including forward-looking information, is appropriately considered in assessing and measuring expected credit loss ('ECL'). This includes maintaining appropriate reports, details of reviews performed and identification and descriptions of the roles and responsibilities of the personnel involved;
   (iii) An assessment policy that ensures ECL measurement occurs not just at the individual financing exposure level, but also when necessary to appropriately measure ECL at the collective portfolio level by grouping exposures based on identified shared credit risk characteristics;

(iv) An effective model validation process to ensure that the credit risk assessment and measurement models are able to generate accurate, consistent and unbiased predictive estimates on an ongoing basis. This includes establishing policies and procedures which set out the accountability and reporting structure of the model validation process, internal standards for assessing and approving changes to the models and reporting of the outcome of the model validation;

(v) Clear formal communication and coordination among the bank's credit risk staff, financial reporting staff, senior management, the Board and others who are involved in the credit risk assessment and measurement process for an ECL accounting framework, as applicable (e.g. evidenced by written policies and procedures, management reports and committee minutes); and

(d) An internal audit function that independently evaluates the effectiveness of the bank's credit risk management framework, and in particular, assessment and measurement systems, models and processes, including the credit risk rating system. Refer to Section HC-6.5.

Credit Risk Strategy

CM-1.2.18

Islamic bank licensees must develop a credit risk strategy that establishes the objectives guiding the bank's credit-granting activities and adopt the necessary policies and procedures for conducting such activities.

CM-1.2.19

The credit risk strategy must give recognition to the goals of credit quality, earnings and growth. Islamic bank licensees, regardless of their size, is in business to be profitable and, consequently, must determine the acceptable risk/reward trade-off for its activities, factoring in the cost of capital.

CM-1.2 Elements of Credit Risk Management (Continued)

CM-1.2.20 **The credit risk strategy of Islamic bank licensee must provide continuity in approach. As a result, the strategy will need to take into account the cyclical aspects of any economy and the resulting shifts in the composition and quality of the overall credit portfolio. Although the strategy must be periodically assessed and amended, it must be viable in the long-run and through various economic cycles.**

CM-1.2.21 **The credit risk strategy must be designed and implemented within the context of internal and external factors, such as the bank's market position, trade area, staff capabilities and technology.**

CM-1.2.22 **Islamic bank licensee must have a clearly defined credit risk appetite framework which is implemented through comprehensive policies and procedures for limiting and controlling credit risk. Islamic bank licensees must establish credit limits at the level of individual obligors and counterparties, and groups of connected parties that aggregate in a comparable and meaningful manner different types of exposures, both on and off balance sheet.**

CM-1.2.23 **Islamic bank licensee's credit limits must recognise and reflect the risks associated with the near-term liquidation of positions in the event of counterparty default. Potential future exposures must be calculated over multiple time horizons. Limits must also factor-in any unsecured exposure in a liquidation scenarios.**

CM-1.2.24 **Islamic bank licensees must consider the results of stress testing in the overall limit setting and monitoring process. Such stress testing must take into consideration economic cycles, profit rates, and other market movements and liquidity conditions.**

Credit Risk Policy and Procedures

CM-1.2.25 A properly documented credit risk policy is an essential element of and, prerequisite for, the credit risk management process. Consistent with the Board's objectives, it assists bank management in the maintenance of proper credit standards and the avoidance of unnecessary risks.

CM-1.2.26 **Senior management, based on the approved credit risk strategy, must develop a credit risk policy for identifying, measuring, monitoring and controlling credit risk. The policy must address credit risk in all of the Islamic bank licensee's activities, and at both the individual credit and portfolio levels**

CM-1.2 Elements of Credit Risk Management (Continued)

CM-1.2.27 Explicit guidelines in the credit risk policy provide the basis for effective credit risk management. A sound credit risk policy must consider which types of credit products and obligors the bank is looking for, and the underwriting standards the bank will utilize.

CM-1.2.28 Islamic bank licensee's credit risk policy must address all credit and credit risk related activities throughout the credit lifecycle covering matters of significance including, but not limited to:

(a) Objectives of credit monitoring;
(b) Organisation and reporting structure of the CRMU;
(c) Designated markets and products;
(d) Establishment of a credit limit framework;
(e) Guidelines for assessment of concentration;
(f) Credit granting criteria and authorisation procedures for the advancement of credit, including exceptions to set criteria and policy limits;
(g) Credit risk analysis, credit risk reviews and credit risk ratings;
(h) Financing to related party and connected parties;
(i) Establishment of credit committees;
(j) Establishment of desirable pricing levels and criteria;
(k) Problem credit identification, remediation and administration; and
(l) Policies and procedures on write-offs and recoveries.

CM-1.2.29 The credit risk policy and procedures must be reviewed annually to ensure that, once established, they remain flexible enough to be current and enable the bank to:

(a) Maintain sound credit-granting standards;
(b) Monitor and control credit risk;
(c) Properly evaluate new business opportunities; and
(d) Identify and administer problem credits.

CM-1.2 Elements of Credit Risk Management (Continued)

Credit Granting Criteria

CM-1.2.30 **Islamic bank licensees must operate within sound, well-defined credit-granting criteria. These criteria must include a clear indication of the bank's target market and a thorough understanding of the obligor or counterparty, as well as the purpose and structure of the credit and its source of repayment. In addition, the criteria must set out who is eligible for credit and for how much, what types of credit are available, and under what terms and conditions the credit must be granted.**

CM-1.2.31 **The limits framework must ensure that the granting of credit exceeding certain predetermined levels receives prompt management attention. An appropriate limit system must assist management in initiating discussion about opportunities and risks, in controlling credit risk exposures and monitoring actual risk taking against predetermined credit risk tolerances.**

CM-1.2.32 **Islamic bank licensees must receive sufficient information to enable a comprehensive assessment of the true risk profile of the obligor or counterparty. Depending on the type of credit exposure and the nature of the credit relationship to date, the factors to be considered and documented in approving credits must include:**

(a) The purpose of the credit and sources of repayment;
(b) The current risk profile (including the nature and aggregate amounts of risks) of the obligor or counterparty and collateral and its sensitivity to economic and market developments;
(c) The obligor's repayment history and current capacity to repay, based on historical financial trends and future cash flow projections, under various scenarios;
(d) For commercial credits, the obligor's business expertise and the status of the obligor's economic sector and its position within that sector;
(e) The proposed terms and conditions of the credit, including covenants designed to limit changes in the future risk profile of the obligor;
(f) The legal structure of the entity to which credit is granted and any associated implications; and
(g) Where applicable, the adequacy and enforceability of collateral or guarantees, including under various scenarios.

CM-1.2 Elements of Credit Risk Management (Continued)

CM-1.2.33 Islamic bank licensees need to understand to whom they are granting credit. As such, prior to entering into any new credit relationship, the bank must become familiar with the obligor or counterparty and be confident that they are dealing with an individual or organisation of sound repute and creditworthiness. In particular, strict policies must be in place to avoid association with individuals involved in fraudulent activities and other crimes.

CM-1.2.34 Islamic bank licensees must perform their due diligence at the solo entity level of the bank to which there is a credit exposure. In evaluating the repayment capacity of the solo entity, banks can take into account the support of the group and the potential for it to be adversely impacted by problems in the group.

CM-1.2.35 In considering potential credit, Islamic bank licensees must recognise the necessity of establishing provisions for identified and expected losses, and holding adequate capital to absorb unexpected losses. The bank must factor these considerations into credit-granting decisions, as well as into the overall portfolio risk management process.

CM-1.2.36 Where actual or potential conflicts of interest exist within the Islamic bank licensee, internal confidentiality arrangements (e.g. 'Chinese walls') must be established to ensure that there is no hindrance to the bank in obtaining all relevant information from the obligor.

CM-1.2.37 In order to maintain a sound credit portfolio, Islamic bank licensee must have an established formal transaction evaluation and approval process for the granting of credit. Approvals must be made in accordance with the bank's written guidelines and granted by the appropriate level of management. There must be a clear audit trail documenting that the approval process was complied with and identifying the individual(s) and/or committee(s) providing input, as well as making the credit decision. Islamic bank licensees must invest in adequate credit decision making tools and resources so that they are able to make sound credit decisions consistent with their credit risk strategy and meet competitive time, pricing and structuring pressures.

CM-1.2.38 Each credit proposal must be subject to careful analysis by an experienced credit analyst with expertise commensurate with the size and complexity of the transaction. An effective evaluation process establishes minimum requirements for the information on which the analysis is to be based.

CM-1.2 Elements of Credit Risk Management (Continued)

CM-1.2.39 Islamic bank licensees must have in place a board approved policy regarding the information and documentation needed to approve new credits, renew existing credits and/or change the terms and conditions of previously approved credits. The information received will be the basis for any internal evaluation or rating assigned to the credit, and its accuracy and adequacy is critical to management making appropriate judgments about the acceptability of the credit.

CM-1.2.40 Credit risk officers must have the experience, knowledge and background to exercise prudent judgment in assessing, approving and managing credit risks. The bank's credit-granting approval process must establish accountability for decisions taken and designate who has the absolute authority to approve credits or changes in credit terms.

CM-1.2.41 All extensions of credit must be made on an arm's-length basis. In particular, credits to connected counterparties must be authorised only under exceptional circumstances. Such credits must be monitored with particular care and other appropriate steps taken to control or mitigate the risks of non-arm's length financing.

CM-1.2.42 Transactions with related parties must be subject to the approval of the Board of Directors (excluding Board members with conflicts of interest).

Credit Reference Requirements

CM-1.2.43 Islamic bank licensees which provide credit facilities to natural and legal persons in Bahrain must become members of the Bahrain Credit Reference Bureau ('BCRB'). All enquiries for new or additional credit facilities in Bahrain must be submitted to the BCRB.

CM-1.2.44 All BCRB members must abide by the agreed Code of Practice of the BCRB (see Appendix CM-3). Any such breaches will be subject to enforcement action by the CBB.

CM-1.2 Elements of Credit Risk Management (Continued)

Credit measurement methodologies

CM-1.2.45 Islamic bank licensees must have methodologies that enable them to quantify the risk involved in exposures to individual obligors or counterparties. Islamic bank licensees must also be able to analyse credit risk at the product and portfolio level, in order to identify any particular sensitivities or concentrations. The measurement of credit risk must take account of:

(a) The specific nature of the credit (financing, Shari'a compliant hedging contracts, facility, etc.) and its contractual and financial conditions (maturity, reference rate, etc.);
(b) The exposure profile until maturity in relation to potential market movements;
(c) The existence of collateral or guarantees; and
(d) The potential for default based on the internal risk rating.

The analysis of credit risk data must be undertaken at an appropriate frequency, with the results reviewed against relevant limits.

CM-1.2.46 Islamic bank licensees must use measurement techniques that are appropriate to the complexity and level of the risks involved in their activities, based on robust data and subject to periodic validation.

CM-1.2.47 Islamic bank licensees must monitor actual exposures against established limits. It is important that banks have an MIS in place to ensure that exposures approaching risk limits are brought to the attention of senior management. All exposures must be included in a risk limit measurement system. Islamic bank licensee's information system must be able to aggregate credit exposures to individual obligors and counterparties and report on exceptions to credit risk limits in a meaningful and timely basis.

CM-1.2 Elements of Credit Risk Management (Continued)

CM-1.2.48 Islamic bank licensees must take into consideration, potential future changes in economic conditions when assessing individual credits and their credit portfolios, and must assess their credit risk exposures under stressful conditions.

CM-1.2.49 An important element of sound credit risk management involves discussing what could potentially go wrong with individual credits and within the various credit portfolios, and factoring this information into the analysis of the adequacy of capital and provisions. The supervisory guidance on accounting for expected credit losses has been provided in Section CM-1.4.

Credit Rating

CM-1.2.50 Islamic bank licensees must have in place a board approved policy to develop, review and implement an internal risk rating system. Such a system must be able to assign a credit risk rating to obligors that accurately reflects the obligors' risk profile and likelihood of loss. Islamic bank licensees must also assign risk ratings in a consistent manner to enable the bank to classify obligors by risk ratings and have a clearer understanding of the overall risk profile of its portfolio. The bank's credit risk policy must define the various risk grades of its rating system. Criteria for assigning risk grades and the circumstances under which deviations from the criteria are permitted must be set. The credit risk policy must also define the roles of different parties involved in the rating process.

CM-1.2.51 The credit risk rating process must appropriately group credit exposures on the basis of shared credit risk characteristics.

CM-1.2.52 Islamic bank licensees credit exposures must be grouped according to shared credit risk characteristics, so that changes in the level of credit risk respond to the impact of changing conditions on a common range of credit risk drivers. This includes considering the effect on the group's credit risk in response to changes in forward-looking information, including macroeconomic factors. The basis of grouping must be reviewed to ensure that exposures within the group remain homogeneous in terms of their response to credit risk drivers. Grouping, implemented upon initial recognition based on similar credit risk characteristics, will not necessarily be adequate, given that the relevant characteristics and their impact on the level of credit risk for the group may change over time.

CM-1.2 Elements of Credit Risk Management (Continued)

CM-1.2.53 Islamic bank licensees must validate their risk rating system and ascertain its applicability to their portfolio prior to implementation. An external independent party, other than the external auditor, with the necessary expertise in model validation must conduct the validation every three years and upon development of the model and when there are changes to the portfolio or model parameters. Banks that use a judgmental rating system must ensure that each rating is unique, well-defined and distinct from other ratings in the rating scale. The relevant risk factors and weights employed in the rating methodology must be appropriate for the risk profile of the obligors in different market segments, such as corporations, small and medium-sized enterprises ('SMEs'), and financial institutions.

CM-1.2.54 Risk ratings must be assigned at the inception of financing and updated at least on an annual basis. However, Islamic bank licensees must review ratings as and when adverse events occur. Risk ratings assigned to various obligors must be reviewed by bank personnel that are independent of personnel involved in financing origination. As part of its portfolio monitoring, the bank must generate reports on credit exposures by risk rating. Trend and migration analysis between risk ratings must also be conducted to detect changes in the credit quality of the portfolio. The bank may establish target limits for risk grades to highlight concentration in particular rating bands. The bank must note that analysis of the portfolio by risk ratings is meaningful only when the bank's rating system is able to consistently assign similar ratings to obligors with similar risk profiles.

Credit Reviews and Monitoring

CM-1.2.55 After the credit facility has been granted, its performance must be monitored at regular intervals. This includes an appropriate periodic review of financial statements, a reassessment of collateral and update of appraisals, and attentive monitoring of conditions in the obligor's industry. Credit supervision constitutes the first line of detection of difficulties and provides the bank with an opportunity to address problems before losses are sustained.

CM-1.2.56 Islamic bank licensees must perform regular credit reviews. The purpose of a credit review is to verify that credits are granted in accordance with the bank's credit risk policy and to provide an independent judgment of asset quality. Islamic bank licensees must conduct credit reviews with updated information on the obligor's financial and business conditions, as well as the conduct of the account. Exceptions noted must be evaluated for impact on the obligor's creditworthiness.

CM-1.2 Elements of Credit Risk Management (Continued)

CM-1.2.57 Credit reviews must also be conducted on a consolidated group basis to factor in the business connections among connected entities in a borrowing group. The performance of the underlying assets in the case of securitisation exposures must also be included in the credit reviews.

CM-1.2.58 Credit reviews must be performed and documented at least once a year. More frequent reviews must be conducted for Stage 2 and 3 accounts (See Paragraph CM-1.4.11). Procedures must also be instituted to ensure that reviews are conducted at the appropriate times. A process to approve deferment of credit reviews must also be put in place. For consumer financing, annual credit reviews of individual obligors are only needed if significant and a portfolio analysis does not identify credit risk related issues or problems. However, it must monitor and report credit exceptions and deterioration.

Credit Administration

CM-1.2.59 Islamic bank licensees must have in place a system for the ongoing administration of their various credit risk-bearing portfolios.

CM-1.2.60 In developing their credit administration areas, Islamic bank licensees must ensure:

(a) The efficiency and effectiveness of credit administration operations, including monitoring documentation, contractual requirements, legal covenants, collateral etc.;
(b) The accuracy and timeliness of information provided to management information systems ('MIS');
(c) Adequate segregation of duties;
(d) The adequacy of controls over all 'back office' procedures; and
(e) Compliance with prescribed policy and procedures, as well as applicable laws and regulations.

CM-1.2.61 For the various components of credit administration to function appropriately, senior management must understand and demonstrate that it recognises the importance of this element of monitoring and controlling credit risk.

CM-1.2 Elements of Credit Risk Management (Continued)

CM-1.2.62 **The credit files must include all information necessary to ascertain the current financial condition of the obligor or counterparty, as well as sufficient information to track the decisions made and the history of the credit. For example, the credit files must include current financial statements, financial analyses and internal rating documentation, internal memoranda, reference letters and appraisals. The credit review function must determine that the credit files are complete and that all credit approvals and other necessary documents have been obtained.**

CM-1.2.63 **Islamic bank licensees must develop and implement comprehensive procedures and information systems to monitor the condition of individual credits and single obligors across the bank's various portfolios. These procedures need to define criteria for identifying and reporting potential problem credits and other transactions to ensure that they are subject to more frequent monitoring, as well as possible corrective action, classification and/or provisioning.**

Credit risk stress testing

CM-1.2.64 **Stress testing must involve identifying possible events or future changes in economic and other conditions that could have unfavourable effects on the Islamic bank licensee's credit exposures and assessing the bank's ability to withstand such changes. Three areas that the bank could usefully examine are: (i) economic or industry downturns; (ii) market risk events; and (iii) liquidity conditions. Stress testing can range from relatively simple alterations in assumptions about one or more financial, structural or economic variables, to the use of highly sophisticated financial models.**

CM-1.2.65 Stress tests are to be performed by adjusting the parameters and then recalculating credit losses, for example:

(a) Unfavourable changes (increases/decreases, depending on portfolio composition) in the underlying **profit rates** by a certain number of basis points; and

(b) Unfavourable changes (increases/decreases, depending on portfolio composition) in crucial exchange rates by a certain percentage.

CM-1.2 Elements of Credit Risk Management (Continued)

CM-1.2.66 In undertaking credit risk stress tests, banks should consider counterparty-based and credit facility-based risk factors and scenarios that help estimate credit losses after modeling a change in PD and/or LGD/EAD. Stress testing programmes should consider:

(a) The inclusion of the bank's individual credit portfolio composition and compile a list of the credit products in use;
(b) Identify the decisive risk factors for each individual credit product and develop a basis for prioritising the factors by relevance and to group those risk factors which influence each other strongly under normal conditions or in crisis situations for the development of stress tests;
(c) Analyse the prevailing social, economic, and political conditions and filter as many potential crisis situations as possible ;
(d) Use of in-house as well as external expertise, as appropriate, and ensure that the stress tests attain the necessary level acceptance.

CM-1.2.67 The approaches towards modeling stress tests include considering the following elements considered individually and on a combined basis as appropriate and with varying severity:

(a) Downgrading all obligors by one rating class
(b) Increasing default probabilities by a certain percentage
(c) Increasing LGD by a certain percentage
(d) Increasing EAD by a certain percentage for variable credit products (justification: customers are likely to utilize credit lines more heavily in crisis situations, for example)
(e) Assumption of negative credit spread developments (e.g. parallel shifts in term structures of **profit rates**) for Sukuk
(f) Modeling of input factors (e.g. balance sheet indicators).

CM-1.2.68 Additionally, the impact of macroeconomic risk factors such as fluctuations in profit rates and/or exchange rates etc. on the following illustrative general conditions may be considered:

(a) Stress tests for specific industries or regions;
(b) Downgrading all obligors in one or more crisis-affected industries; and
(c) Downgrading all obligors in one or more crisis-affected regions.

CM-1.2.69 If the bank uses risk models (such as credit portfolio models or credit pricing models), it is necessary to perform stress tests which show whether the assumptions underlying the risk models will also be fulfilled in crisis situations. Only then will the models be able to provide the appropriate guidance in crisis situations.

CM-1.2 Elements of Credit Risk Management (Continued)

CM-1.2.70 Islamic bank licensees should also examine political risk factors when significant parts of the credit portfolio consist of obligors from politically unstable countries. Due to the complex interrelationships involved, however, developing plausible stress tests for political risk factors involves far more effort than designing tests for macroeconomic risk factors. It is, therefore, advisable to call in specialists to develop stress tests for political risk factors in order to assess the relevant effects on financial and macroeconomic conditions.

CM-1.2.71 **The output of the stress tests must be reviewed periodically by senior management and appropriate action taken in cases where the results exceed agreed tolerances. The output must also be incorporated into the process for assigning and updating policy and limits.**

CM-1.2.72 **Islamic bank licensees must attempt to identify the types of situations, such as economic downturns, both in the whole economy or in particular sectors, higher than expected levels of delinquencies and defaults, or the combinations of credit and market events that could produce substantial losses or liquidity problems.**

Collateral Requirements

CM-1.2.73 **When the credit decision is based on collateral value, independent and timely appraisals of the collateral by a third party valuation expert must be obligatory, including provision for sufficient security margins.**

CM-1.2.74 **Islamic bank licensees can utilise transaction structure, collateral and guarantees to help mitigate risks (both identified and inherent) in individual credits, but transactions must be entered into primarily on the strength of the obligor's repayment capacity. Collateral cannot be a substitute for a comprehensive assessment of the obligor or counterparty, nor can it compensate for insufficient information. It must be recognised that any credit enforcement actions (e.g. foreclosure proceedings) can eliminate the profit margin on the transaction. In addition, Islamic bank licensee need to be mindful that the value of collateral may well be impaired by the factors that have led to the diminished recoverability of the credit. Islamic bank licensees must have a policy covering the acceptability of various forms of collateral, procedures for the ongoing valuation of such collateral, and a process to ensure that collateral is, and continues to be, enforceable and realisable. With regard to guarantees, Islamic bank licensees must evaluate the level of coverage being provided in relation to the credit-quality and legal capacity of the guarantor. Banks must be careful when making assumptions about implied support from third parties, such as the government.**

CM-1.2 Elements of Credit Risk Management (Continued)

CM-1.2.75 **The value of collateral must be updated at least annually, to account for changes in market conditions. For example, where the collateral is property or shares, a bank must undertake more frequent valuations in adverse market conditions. If the facility is backed by an inventory or goods purportedly on the obligor's premises, appropriate inspections must be conducted to verify the existence and valuation of the collateral.**

CM-1.2.76 **Since provisions are dependent on the recoverable value of collateral it holds, Islamic bank licensees must obtain appropriate valuations of collateral. The bank must have a reliable and timely collateral valuation system. The valuation system must include factors such as the legal enforceability of claims on collateral, ease of realisation of collateral, effects of currency and maturity mismatches, and be based on current market conditions.**

Definition of Default / Impairment

CM-1.2.77 **Default for the purpose of the Rulebook and impairment in the context of credit risk exposure of an obligor as per Financial Accounting Standard (FAS) 30 is considered to have occurred with regard to a particular obligor when either or both of the two following events have taken place:**

(a) The bank considers that the obligor is unlikely to pay its credit obligations in full (i.e. principal, profit, fees or any other amount), without taking actions such as realising security (if held).

(b) **The obligor is past due for 90 days or more on any credit obligation to the bank. In case of overdrafts, the customer will be considered as being past due once an advised limit has been breached or the customer has been advised of a limit smaller than the current outstanding amount.**

For the purpose of (b), banks must take into account number of days the obligation was past due prior to a previous restructuring. For example, if a obligor restructured his dues on 1 July 2019 when his financing facility was past due for 70 days and, then he fails to pay the instalment falling due on 31 July, under the restructured terms, the obligor should be considered as 101 days past due on that day.

CM-1.2.78 The elements to be taken as indications of unlikeliness to pay must include, but not be limited to, the following:

(a) The bank puts the profit on the credit obligation on non-accrual status;
(b) The bank makes a charge-off or account-specific provision resulting from a significant perceived decline in credit quality subsequent to the bank taking on the exposure;
(c) The bank sells the credit obligation at a material credit-related economic loss;
(d) The bank consents to a distressed restructuring of the credit obligation where this is likely to result in a diminished financial obligation caused by the material forgiveness, or postponement, of repayment instalments;
(e) The bank has filed for the obligor's bankruptcy or a similar order in respect of the obligor's credit obligation to the bank; or
(f) The obligor has sought or has been placed in bankruptcy or similar protection where this would avoid, or delay, repayment of the credit obligation to the bank.

Identification of Non-performing Exposures

CM-1.2.79 Non-performing exposures must always be categorised for the whole exposure, including when non-performance relates to only a part of the exposure, for instance, unpaid profit. For off-balance sheet exposures, such as credit commitments or financial guarantees, the whole exposure is the entire uncancellable nominal amount. All non-performing exposures will be classified as Stage 3 for the purpose of ECL calculations under CM-1.4.

CM-1.2.80 The following exposures are considered as non-performing:

(a) All exposures that are 'defaulted' or "impaired" under Paragraph CM-1.2.77, where applicable;
(b) All exposures that have experienced a downward adjustment to their valuation due to deterioration of their creditworthiness and classified as Stage 3 according to the applicable accounting framework;
(c) The purchase or origination of a financial asset at a deep discount that reflects an incurred loss to the lender(s); and
(d) All other exposures that are not defaulted or impaired but nevertheless:
    (i) Relate to a counterparty that has other exposures that are past due for 90 days or more; and

CM-1.2 Elements of Credit Risk Management (Continued)

(ii) Where there is evidence that full repayment based on the contractual terms, original or, when applicable, modified (e.g. repayment of principal and profit) is unlikely without the bank's realisation of collateral, whether or not the exposure is current and regardless of the number of days the exposure is past due.

CM-1.2.81 Collateralisation or received guarantees must have no direct influence on the categorization of an exposure as non-performing. However, Islamic bank licensees may consider the collateral when assessing a obligor's economic incentive (both positive and negative) to repay under the unlikeliness to repay criteria. Any recourse by the bank must not be considered in this judgment. The collateralisation or guarantee status does not influence the past-due status, including the counting of past-due days and the determination of the exposure as non-performing, once the overdue days threshold have been met. When the relevant criteria are met, an exposure must be categorised as non-performing even if the collateral value exceeds the amount of the past-due exposure.

CM-1.2.82 The classification of an exposure as non-performing must be applied as follows:

(a) When an exposure to a non-retail counterparty is categorised as non-performing, all exposures to that counterparty must be categorised as non-performing (i.e. cross-default across obligor);
(b) In the case of exposures to a retail counterparty, the definition of default may be applied at the level of a particular facility rather than at the level of the obligor. This would be appropriate when the bank considers the risk of each product and source of repayments having different characteristics for each transaction. In the case of a retail counterparty with more than one exposure from the bank, it must consider the non-performing or performing status of the other exposures when deciding about the status of a given exposure; and
(c) In the case of exposures to a group, non-performing status can be applied at the counterparty level. This assumes that the bank has a separate credit review and rating assigned for each counterparty within the group. At the same time, the bank must consider the non-performing or performing status of the other group entities when deciding about the status of any of the group entities.

Re-categorisation of Non-performing Exposures as Performing

CM-1.2.83 An exposure ceases to be non-performing and can be re-categorised as performing when all the following criteria are met simultaneously:

(a) The counterparty does not have any exposures that are past due for 90 days or more (see also Paragraph CM-1.2.77);

(b) Repayments have been made when due over a continuous repayment period of at least:
   (i) Six months or six instalments, whichever is longer, for retail facilities; or
   (ii) Twelve months or two instalments, whichever is longer, for all other facilities.

   In cases where a non-retail non-performing exposure has been restructured and the revised terms allow for longer repayment intervals, re-categorisation can be made after a 12-month period provided at least two instalments have been paid under the revised terms. However, if the payments are not clearly reflective of improvement in the counterparty's financial position, a longer re-payment history or higher number of instalments must be assessed by the bank before re-categorisation of the exposure to a 'performing' status;

(c) The counterparty's financial situation has improved so that the full repayment of the exposure is likely, according to the original or, when applicable, modified conditions. This must usually require a credit review process that evaluates the obligor's current capacity to repay, clarity on the source of cash flow available for Sukuk repayments, improvements in the level of indebtedness and compliance with various debt covenants imposed by the bank. Repayments through liquidation or enforcement of collateral is generally not considered as an improvement in the financial health of the obligor; and

(d) The exposure is not considered to be in 'default' or 'impaired' according to the applicable accounting framework.

CM-1.2 Elements of Credit Risk Management (Continued)

CM-1.2.84

Islamic bank licensee must clearly articulate and document policies in respect of the counting of days past due, in particular in respect of the re-ageing of the facilities and the granting of extensions, deferrals, renewals and rewrites to existing accounts. At a minimum, the re-ageing policy must include:

(a) Approval authorities and reporting requirements;
(b) Minimum age of a facility before it is eligible for re-ageing;
(c) Delinquency levels of facilities that are eligible for re-ageing;
(d) Maximum number of re-ageing allowed per facility; and
(e) A reassessment of the obligor's capacity to repay.

CM-1.2.85

The following situations will not lead to the re-categorisation of a non-performing exposure as performing:

(a) Partial write-off of an existing non-performing exposure, (i.e. when the bank writes-off part of a non-performing exposure that it deems to be uncollectible);
(b) Repossession of collateral on a non-performing exposure, until the collateral is actually disposed of and the bank realises the proceeds (when the exposure is kept on-balance sheet, it is deemed non-performing); or
(c) Extension or granting of forbearance measures to an exposure that is already identified as non-performing subject to the relevant exit criteria for non-performing exposures.

The re-categorisation of a non-performing exposure as performing must be made on the same level (i.e. obligor or transaction approach) as when the exposure was originally categorised as non-performing.

CM-1.2 Elements of Credit Risk Management (Continued)

NPA Strategy and Policy

CM-1.2.86 **Islamic bank licensees must develop a non-performing financing ('NPAs') strategy which outlines the approach they would take to deal with NPAs. Additionally, the banks' credit risk policy must clearly set out how the bank will manage NPAs. Responsibility for such credit must be assigned to a specialised workout section.**

CM-1.2.87 Understanding the full context of the operating environment, both internally and externally, is fundamental to developing a realistic NPA strategy.

CM-1.2.88 **To formulate and execute a fit-for-purpose NPA strategy, Islamic bank licensees must complete an assessment of the following elements as a minimum:**
(a) The internal capabilities to effectively manage, i.e. maximise recoveries, and reduce NPAs over a defined time horizon;
(b) The external conditions and operating environment; and
(c) The capital implications of the NPA strategy.

CM-1.2.89 **Islamic bank licensees must fully understand and examine:**
(a) Scale and drivers of the NPA problem:
- **(i) The size and evolution of its NPA portfolios on an appropriate level of granularity, which requires appropriate portfolio classification as outlined in Section 1.4;**
- **(ii) The drivers of NPA in-flows and out-flows, by portfolio where relevant; and**
- **(iii) Other potential correlations and causations.**

(b) Outcomes of NPA actions taken in the past:
- **(i) Types and nature of actions implemented, including forbearance measures; and**
- **(ii) The success of the implementation of those activities and related drivers, including the effectiveness of forbearance treatments.**

CM-1.2 Elements of Credit Risk Management (Continued)

(c) Operational capacities (processes, tools, data quality, IT/automation, staff/expertise, decision-making, internal policies, and any other relevant areas for the implementation of the strategy) for the different process steps involved, including, but not limited to:
   (i) Early warning and detection/recognition of NPAs;
   (ii) Forbearance;
   (iii) Provisioning;
   (iv) Collateral valuations;
   (v) Recovery/legal process/foreclosure;
   (vi) Management of foreclosed assets (if relevant); and
   (vii) Reporting and monitoring of NPAs and effectiveness of NPA workout solutions.

Capital Implications of the NPA Strategy

CM-1.2.90 Capital levels and their projected trends are important inputs towards determining the scope of NPA reduction actions available to banks. Islamic bank licensees must be able to dynamically model the capital implications of the different elements to their NPA strategy, ideally under different economic scenarios. Those implications must also be considered in conjunction with the risk appetite framework as well as the internal capital adequacy assessment process ('ICAAP').

CM-1.2.91 Where capital buffers are slim and profitability low, Islamic bank licensees must include suitable actions in their capital planning, which will enable a sustainable clean-up of NPAs from the balance sheet.

Developing the NPA Strategy

CM-1.2.92 Islamic bank licensees must have in place a board approved policy on NPA strategy, including operational plan, which must be reviewed annually.

CM-1.2.93 An NPA strategy must encompass, at a minimum, time-bound quantitative NPA targets supported by a corresponding comprehensive operational plan. It must be based on an assessment and an analysis of NPA strategy implementation options.

CM-1.2 Elements of Credit Risk Management (Continued)

CM-1.2.94 Islamic bank licensees must ensure that their NPA strategy includes not just a single strategic option, but rather combinations of strategies/options to best achieve their objectives over the short, medium and long-term, and explore which options are advantageous for different portfolios or segments.

CM-1.2.95 Islamic bank licensees must also identify medium and long-term strategy options for NPA reductions.

CM-1.2.96 Islamic bank licensees must include, at a minimum, clearly defined quantitative targets in their NPA strategy (where relevant, including foreclosed assets), which must be approved by senior management. The combination of these targets must lead to a concrete reduction, gross and net (of provisions), of NPA exposures, at least in the medium-term. While expectations about changes in macroeconomic conditions can play a role in determining target levels (if based on solid external forecasts), they must not be the sole driver for the established NPA reduction targets. Targets must be established at least along the following dimensions:

(a) By time horizons, i.e. short-term (indicative 1 year), medium-term (indicative 3 years) and possibly long-term;

(b) By main portfolios (e.g. retail mortgage, retail consumer, retail small businesses and professionals, small and medium corporate, large corporate, and commercial real estate); and

(c) By implementation option chosen to drive the projected reduction, e.g. cash recoveries from hold strategy, collateral repossessions, and recoveries from legal proceedings, revenues from sale of NPAs or write-offs.

Operational Plan for NPA

CM-1.2.97 The operational plan must clearly define how the bank will operationally implement its NPA strategy over a time horizon of at least 1 to 3 years (depending on the type of operational measures required).

CM-1.2.98 The NPA operational plan must contain, at a minimum:
(a) Clear time-bound objectives and goals;
(b) Activities to be delivered on a segmented portfolio basis;
(c) Governance arrangements including responsibilities and reporting mechanisms for defined activities and outcomes;
(d) Quality standards to ensure successful outcomes;
(e) Staffing and resource requirements;
(f) Required technical infrastructure enhancement plan;
(g) Granular and consolidated budget requirements for the implementation of the NPA strategy; and
(h) Interaction and communication plan with internal and external stakeholders (e.g. for sales, servicing, efficiency initiatives etc.).

CM-1.2.99 The operational plan must put a specific focus on internal factors that could present impediments to a successful delivery of the NPA strategy.

Implementing the NPA Operational Plan

CM-1.2.100 The implementation of the NPA operational plan must rely on suitable policies and procedures, clear ownership and suitable governance structures (including escalation procedures). Any deviations from the plan must be highlighted and reported to the management in a timely manner with appropriate remediation actions put in place.

Embedding the NPA Strategy

CM-1.2.101 Islamic bank licensees must clearly define and document the roles, responsibilities and formal reporting lines for the implementation of the NPA strategy, including the NPA operational plan.

CM-1.2.102 The NPA strategy must be fully embedded in the risk control framework. In that context, special attention must be paid to:
(a) ICAAP: All relevant components of the NPA strategy must be fully aligned with, and integrated into, the ICAAP. High NPA banks must prepare the quantitative and qualitative assessment of NPA developments under base and stressed conditions, including the impact on capital planning;

CM-1.2 Elements of Credit Risk Management (Continued)

(b) Risk appetite framework: The risk appetite framework and NPA strategy are closely interlinked. In this regard, there must be clearly-defined RAF metrics and limits approved by the Board of Directors which are in alignment with the core elements and targets forming part of the NPA Strategy; and

(c) Recovery plan: Where NPA-related indicator levels and actions form part of the recovery plan, banks must ensure they are in alignment with the NPA strategy targets and operational plan.

CM-1.2.103 A strong level of monitoring and oversight by risk management function in respect of the formulation and implementation of the NPA strategy (including the NPA operational plan) must also be ensured.

CM-1.2.104 Islamic bank licensees must write-off financing which are deemed to be uncollectable in a timely manner.

Credit Risk Reporting and Management Information Systems ('MIS')

CM-1.2.105 Islamic bank licensees must have an effective MIS that captures all on and off-balance sheet credit exposures.

CM-1.2.106 The MIS in place must enable management to identify any concentrations of risk within the credit portfolio.

CM-1.2.107 The MIS must comprehensively cover reporting of NPA, including but not limited to the following:

(a) NPA related KPIs and performance against the KPIs;
(b) Forbearance activity levels;
(c) Early warning indicators;
(d) Liquidation, foreclosure, provisions for impairment and write offs; and
(e) Risk adjusted returns and capital implications.

CM-1.2.108 The MIS must be able to aggregate all such credit exposures to a single obligor and also aggregate exposures to groups of accounts under common ownership or control. This data must be aggregated in an accurate and timely manner, and monitored as part of the bank's credit risk management process. The MIS must provide the Board and senior management with timely and forward-looking information on credit risk management to support them in identifying emerging concerns on credit risk as well as in managing credit stress events.

CM-1.2 Elements of Credit Risk Management (Continued)

The MIS must be fit for the purpose of supporting the bank's day-to-day monitoring of compliance with established policies, procedures and limits.

CM-1.2.109 Risk management reports must be accurate and precise to ensure that Islamic bank licensees' Board and senior management can rely, with confidence, on the aggregated information to make critical decisions about risk.

CM-1.2.110 To ensure the accuracy of the reports, Islamic bank licensees must maintain, at a minimum, the following:

(a) Defined requirements and processes to reconcile reports to risk data;
(b) Automated and manual edit and reasonableness checks, including an inventory of the validation rules that are applied to quantitative information. The inventory must include explanations of the conventions used to describe any mathematical or logical relationships that must be verified through these validations or checks; and
(c) Integrated procedures for identifying, reporting and explaining data errors or weaknesses in data integrity via exceptions reports.

CM-1.2.111 Risk management reports to the Board and senior management must provide a forward-looking assessment of risk and must not just rely on current and past data. The reports must contain forecasts or scenarios for key market variables and the effects on the bank, so as to inform the Board and senior management of the likely trajectory of the bank's capital and risk profile in the future.

CM-1.2.112 Islamic bank licensees must develop an inventory and classification of risk data items which includes a reference to the concepts used to elaborate the reports.

CM-1.2.113 The credit risk reports must be clear and useful. Reports must reflect an appropriate balance between detailed data, qualitative discussion, explanation and recommended conclusions. Interpretation and explanations of the data, including observed trends, must be clear.

CM-1.2 Elements of Credit Risk Management (Continued)

CM-1.2.114 Islamic bank licensees must confirm, periodically with recipients that the information aggregated and reported is relevant and appropriate, in terms of both amount and quality, to the governance and decision-making process.

CM-1.2.115 Islamic bank licensees must assess, periodically, the purpose of each report, adequacy of the scope of the information in the reporting and MIS and set requirements for how quickly the reports need to be produced in both normal and stress/crisis situations. The bank must routinely test its ability to produce accurate reports within established timeframes, particularly in stress/crisis situations.

Independent assessments

CM-1.2.116 Islamic bank licensees must establish a system of independent, ongoing assessments of the bank's credit risk management processes by external consultants (other than the bank's external auditors), at least every 3 years. The results of such reviews must be communicated directly to the Audit or Board Risk Committee and to the Board of Directors.

CM-1.2.117 Internal audits of the credit risk processes must be conducted on a periodic basis to determine that credit activities are in compliance with the bank's credit risk policy and procedures, that credits are authorised within the guidelines established by the bank's Board of Directors, that the existence, quality and value of individual credits are accurately being reported to senior management, etc. These audits must also be used to identify areas of weakness in the credit risk management process, policy and procedures as well as any exceptions to policy, procedures and limits.

CM-1.3 Name-financing

CM-1.3.1 In many banks there is a tendency to indulge in 'name-financing' without any credit analysis or understanding of the concerned counterparty's ability to repay. The CBB prohibits banks from engaging in such activities in order to minimise their credit risk and reputational risk.

CM-1.4 Classification and Provisioning

CM-1.4.1 The objective of this section is to set out the requirements and supervisory guidance on the assessment and measurement of expected credit losses and allowances (together referred to as 'ECL'). The supervisory guidance is intended to supplement the guidance under the applicable accounting framework and, where relevant, ensure consistency in application of definitions and other areas of estimates and judgment that are expected to be common across the banking sector. The term 'allowances' includes allowances/provisions on financing, credit commitments, financial guarantees and similar contracts.

CM-1.4.2 In applying these instructions, banks shall make sure that consistent accounting policies are applied at group level including subsidiaries and branches outside Bahrain. If the supervisory and accounting standards applied at the bank's outside branches or subsidiaries (such as NPA norms) are in conflict with these instructions, the bank should notify CBB accordingly.

Governance

CM-1.4.3 **Islamic bank licensees' Board of Directors (or equivalent) and senior management are responsible for ensuring that the bank has appropriate credit risk practices, including an effective system of internal control, to consistently determine adequate allowances in accordance with the bank's stated policies and procedures, the applicable accounting framework and relevant supervisory guidance.**

CM-1.4.4 **Islamic bank licensees must adopt, document and adhere to sound policies, procedures and controls for assessing and measuring credit risk impairment allowances on all financing exposures. The measurement of allowances must build upon those robust methodologies and result in the appropriate and timely recognition of expected credit losses in accordance with the applicable accounting framework.**

CM-1.4 Classification and Provisioning (Continued)

CM-1.4.5 **Islamic bank licensees must have in place, a detailed and clear policy statement pertaining to ECL provisioning. The policy statement must be approved by the Board of Directors and submitted to the CBB for its review, including at the time of any changes made periodically. The policy statement must be comprehensive and must include, but not be limited to, the following components:**

(a) Definition of default (including consideration of cross defaults and restructured/renegotiated/rescheduled facilities in such assessment);
(b) Portfolio segmentation, detailing the level at which probability of default ('PD') and loss-given-default ('LGD') will be measured;
(c) For collectively evaluated exposures, a description of the basis for creating groups of portfolios of exposures with shared credit risk characteristics;
(d) Qualitative and quantitative staging criteria, including criteria for qualifying as low credit risk assets and triggers for both forward and backward transition between Stages 1 to 3 (CM-1.4.11);
(e) Source of internal data sets, minimum period of internal data repository and when external data sets will be used as reliable proxies for use in assessment of required impairment allowances;
(f) Identify and document the ECL assessment and measurement methods (such as a loss rate method, PD/LGD modelling methods, prepayment and cure rate models or any another method) to be applied to each exposure, segment or portfolio;
(g) Methodology for conversion from through-the-cycle ('TTC') to point-in-time (PIT) PDs and variables considered for making forward-looking adjustments to PIT PDs, including use of macroeconomic factors;
(h) Determine the extent to which the value of collateral and other credit risk mitigants will be used for LGD calculations (including the use of liquidation haircuts and, where available, forecasting of collateral values);
(i) Policy for specific cash shortfall assessment for Stage 3 accounts (NPA provisions);

CM-1.4 Classification and Provisioning (Continued)

(j) Document the methods and frequency used to validate models for ECL measurement (e.g. back tests, quantitative and qualitative validation tests). Models, input data and systems used to develop PD, LGD and other components of ECL must be subject to internal and external validation as required under CM-1.2.53; and

(k) Include a process for evaluating the appropriateness of significant inputs and assumptions in the ECL assessment and measurement method chosen. It is expected that the basis for inputs and assumptions used in the estimation process will generally be consistent from period-to-period. Where basis of use of inputs and assumptions change, the rationale must be documented.

CM-1.4.6 **Islamic bank licensees must have the necessary tools to ensure a robust estimate and timely recognition of ECL. Information on historical loss experience or the impact of current conditions may not fully reflect the credit risk in financing exposures. In this context, the bank must use its experienced credit judgment to thoroughly incorporate the expected impact of all reasonable and supportable forward-looking information, including macroeconomic factors, on its estimate of ECL. The bank's use of its experienced credit judgment must be documented in the bank's credit risk methodology and subject to appropriate oversight.**

CM-1.4.7 Applying the concepts of ECL could vary for each bank depending on its underwriting criteria, loss history, terms of collateral and a number of other variables, both entity-specific and external. Reasonable and supportable information will not present itself, but would rather require management to determine what is relevant and practical, without undue costs or efforts, to actively gather, analyse and process to make required credit risk assessments to support the ECL process. Banks will need to adopt an appropriate risk assessment methodology which is commensurate with the size, complexity, structure, economic significance and risk profile of their portfolio. This means that, in general, the larger and more complex a portfolio or institution, the more its risk infrastructure should capture relevant and reliable information and trends that would support the development of a sophisticated approach to determine a risk based ECL. Conversely, for smaller and simpler portfolios or institutions, a less sophisticated approach may be adopted to align with the risk management infrastructure and processes within the bank.

CM-1.4.8 Regardless of the size of the bank or prominence of the portfolio, the approach adopted by the bank should comply with the specific requirements of this section and applicable accounting standards. It is not necessary that every bank or every portfolio within the bank would apply the same level of sophistication. However, banks will need to periodically assess whether their approach continues to be appropriate and relevant in light of changing circumstances with the aim of improving its level of estimation over time.

CM-1.4 Classification and Provisioning (Continued)

Measurement Requirements

CM-1.4.9 The credit impairment assessment under IFRS 9 is based on an expected loss approach, i.e. it is not necessary for a loss event to occur before an ECL is recognised. As a result, all financial assets are generally expected to attract an ECL. For the purpose of Section CM 1.4, any direct credit exposures to the government of Bahrain (or exposures explicitly guaranteed by the government of Bahrain) are exempted from the application of the expected credit loss model.

CM-1.4.10 IFRS 9 requires a three-stage approach to recognise and measure ECL at each reporting date, which is based on changes observed in credit quality of financial assets since origination. The standards prescribe two measures of ECL to be carried by banks:

(a) Twelve-month ECL: The expected credit losses that result from default events that are possible within 12 months after the reporting date. It is not the expected cash shortfalls over the 12-month period, but the entire credit loss on an asset weighted by the probability that the loss will occur in the next 12 months; and

(b) Life-time ECL: The expected credit losses that result from all possible default events over the life of the financial instrument.

CM-1.4.11 The below staging classification must represent migration in credit quality and dictates the level of ECL to be recognised. The following must be followed:

Staging	Description	ECL measure
Stage 1	Performing assets with no significant deterioration in credit risk since origination or with very low credit risk.	12-month ECL
Stage 2	Performing assets that have exhibited significant increase in credit risk since origination.	Life-time ECL
Stage 3	Non-performing assets, that are considered credit impaired.	Life-time ECL

CM-1.4 Classification and Provisioning (Continued)

CM-1.4.12 The staging classification should normally apply to the entire balance of an outstanding facility because, if a problem exists with one credit, it normally applies to the whole facility and not just the payment or individual credit, which may be overdue. This is a conservative approach, which will alert bank management and the Board to the full extent of a potential problem.

Retail Exposures

CM-1.4.13 **With reference to Sub-Paragraph CM-1.2.82 (b), a default by a obligor on one retail obligation may not require the bank to however, treat all other obligations to the bank as defaulted and non-performing. In these cases, Islamic bank licensees must carefully consider the categorisation and staging status of other exposures to the same counterparty (i.e. cross-product default). For example, if a customer has a retail personal financing and an auto financing with the bank, a default on the personal financing must be considered when assessing the stage classification of the auto financing.**

Restructured Accounts, Forbearance and Modifications

CM-1.4.14 **Islamic bank licensees must report restructured accounts to the CBB on a quarterly basis. For the purpose of ECL calculations, all non-NPA accounts restructured due to credit related issues must be classified as Stage 2 for at least 12 months until the satisfactory performance of the account, under revised terms, and the counterparty has resolved its financial difficulty.**

CM-1.4.15 Restructurings or forbearance occurs when a counterparty is experiencing financial difficulty in meeting its financial commitment and the bank grants a concession that it would not otherwise consider due to credit related issues.

CM-1.4.16 The following list provides examples of possible indicators of financial difficulty. In particular, financial difficulty can be identified even in the absence of arrears on an exposure:

(a) A counterparty is currently past due on any of its material exposures.

(b) A counterparty is not currently past due, but it is probable that the counterparty will be past due on any of its material exposures in the foreseeable future without the concession, for instance, when there has been a pattern of delinquency in payments on its material exposures.

(c) A counterparty's outstanding securities have been delisted, are in the process of being delisted, or are under threat of being delisted from an exchange due to noncompliance with the listing requirements or for financial reasons.

CM-1.4 Classification and Provisioning (Continued)

(d) On the basis of actual performance, estimates and projections that encompass the counterparty's current capabilities, the bank forecasts that all the counterparty's committed/available cash flows will be insufficient to service all of its financing (both profit and principal) in accordance with the contractual terms of the existing agreement for the foreseeable future.
(e) A counterparty's existing exposures are categorised as exposures that have already evidenced difficulty in the counterparty's ability to repay in accordance with the supervisory categorisation scheme in force or the credit categorisation scheme within the bank's internal credit rating system.
(f) A counterparty is in non-performing status or would be categorised as nonperforming without the concessions.
(g) The counterparty cannot obtain funds from sources other than the existing banks at an effective profit rate equal to the current market rate for similar financing or for a non-troubled counterparty.

CM-1.4.17 Concessions are special contractual terms and conditions that a lender would not extend or consider under normal market conditions.

CM-1.4.18 Banks should distinguish between restructured financing and rescheduled financing where no concessions have been granted to a performing customer in response to changes in market conditions provided that at the time of rescheduling the financing have been serviced normally; the ability of the obligor to service is not in doubt and where there is reasonable assurance that the obligor will be able to service all future principal and profit payments on the financing in accordance with the revised repayment terms.

Regulatory Treatment of Accounting Provisions

CM-1.4.19 **The regulatory concepts of collective provisions ('CP') and specific provisions ('SP') are important elements in linking the capital and accounting frameworks. The banks must adopt the following approach to the three stages of IFRS 9 provisioning:**

(a) Stage 1: Allocate to CP if held against future, presently unidentified losses and, therefore, freely available to meet losses that subsequently materialise.
(b) Stage 2: Allocate to CP as not credit-impaired at present.
(c) Stage 3: Credit impaired and incurred losses and considered SP for regulatory purposes although, in some cases, these may be calculated using a collective approach.

CM-1.4 Classification and Provisioning (Continued)

CM-1.4.20 **Islamic bank licensees must disclose in their public disclosures their policies and definitions that are integral to the estimation of ECL. Quantitative and qualitative disclosures, taken together, must communicate to users the main assumptions/inputs used to develop ECL estimates.**

CM-1.5 Provisioning Policies of Branches of Foreign Bank Licensees

CM-1.5.1 **Specific provisions for impaired assets (i.e. Stage 3 accounts) and, where applicable, collective provisions (i.e. Stage 1 and Stage 2) representing ECL on performing exposures of branches of foreign bank licensees must be maintained in the books of the Bahrain branch.**

CM-1.5.2 **If a branch of a foreign bank licensee which is a wholesale bank license is not able to meet the requirement in Paragraph CM-1.5.1, the branch's head office must advise the CBB, on an annual basis and in writing, whether an equivalent or higher amount of specific and collective provisions related to the exposures of its Bahrain branch is being maintained by the head office. In all cases, the branch must maintain and make available all underlying details of such provision calculations at the request of its external auditors and the CBB. The provisions maintained at the head office in relation to exposures of the branch must be disclosed in the financial statements of the branch submitted to the CBB.**

CM-1.5.3 In addition, the CBB may contact the bank's home supervisor, on a regular or ad hoc basis in order to obtain information about the adequacy of the provisioning for such assets or may require the bank to provide additional comfort or assurance, example, through external auditors, that such provisions are indeed set aside properly.

CM-1.6 Provisions Against Sovereign Debt

CM-1.6.1 The CBB has consistently encouraged banks to maintain adequate provisions against credits for countries with current or potential debt servicing difficulties.

CM-1.6.2 With regard to 'sovereign debt', it is particularly important that the size of the provisions made should be based on the identification and objective assessment of the nature and extent of difficulties being experienced by particular countries and reflect, as near as possible, any deterioration in the prospects for recovering debts. With these objectives in mind, the Sovereign Debt Provisioning Matrix (see Appendix CM-1) contains a list of measurements which have been designed to help identify those obligors and countries with payment difficulties and to decide what would constitute adequate provisions.

CM-1.6.3 **Islamic bank licensees must continue to apply the Sovereign Debt Provisioning Matrix (see Appendix CM-1) as a benchmark for estimating future recoverable cash receipts. However, if a lower provisioning amount is determined, i.e. lower than the amount identified through the matrix, and the bank intends to book the lower amount, then a meeting must be arranged with the CBB to discuss the issues before booking these provisions.**

CM-1.6.4 It is emphasized that this Section and the Sovereign Debt Provisioning Matrix (see Appendix CM-1) are merely a general framework for assessing degrees of provisions. They should not be regarded as an exhaustive or definitive framework. Nevertheless, the CBB does intend to include the results of banks' calculations in its discussions with the banks, and to establish that adequate provisions are being made.

CM-1.7 Country and Transfer Risks

CM-1.7.1 With effect from 30th June 2018, Islamic bank licensees must set out their policy on country and transfer risks, including the criteria on downgrading a country exposure from Stage 1 to Stages 2 or 3, and related provisioning requirements, in a policy statement which must be approved by the CBB.

CM-1.7.2 In the case of exposure to obligors, Islamic bank licensees must examine any associated country and transfer risks keeping in view factors, such as domicile of the counterparty, the legal structure of the counterparty, the existence of special purpose vehicles, conduits and or other related factors that may affect the transferability of proceeds of repayment.

CM-1.7.3 For the purpose of Paragraph CM-1.7.1, Islamic bank licensees may consider the sovereign risk matrix factors, stipulated in Appendix CM-1 (Sovereign Debt Provision Matrix), and any other factors.

CM-1.7.4 Branches of foreign bank licensees must satisfy the CBB that equivalent arrangements are in place at the parent entity level, otherwise a policy would be required in line with Paragraph CM-1.7.1.

CM-2.1 Overview

CM-2.1.1 The CBB's directives on large exposures for banks in Bahrain are issued as part of the CBB's measures to encourage banks to mitigate risk concentrations and to design the banks' large exposure framework so that the maximum possible loss the bank could incur, if a single counterparty or group of connected counterparties were to suddenly fail, would not endanger the bank's survival as a going concern.

CM-2.1.2 **The contents of this Chapter apply in full to all Bahraini Islamic bank licensees both on a consolidated basis and on a solo basis (refer to Paragraph CA-B.1.2 of CA Module).**

CM-2.1.3 **The application of the large exposures framework at the consolidated level implies that the bank must consider all exposures to third parties across the relevant regulatory consolidation group and compare the aggregate of those exposures with the group's consolidated total capital.**

CM-2.1.4 **Bahraini Islamic bank licensees, through the PIR forms (see Module CA), must notify the CBB of the subsidiaries to be consolidated for regulatory reporting purposes.**

CM-2.2 Exposures Undertaken by Overseas Islamic Bank Licensees

CM-2.2.1 The CBB may, if circumstances so require and on a case-by-case basis, apply the full or part of the requirements of this Chapter to branches of foreign bank licensees.

CM-2.3 Measure of Exposure

CM-2.3.1

For the purpose of the banking book and trading book, the measure of exposure net of specific provisions, reflects the maximum loss that will arise should a counterparty fail, or the loss that may arise due to exposures relating to concentration per product, asset classes, collateral, segments, country, region, currencies, market, etc. In certain cases (particularly Shari'a compliant hedging instruments), the measure of an exposure may be larger than that used in published financial statements. Consistent with this, an exposure encompasses the amount at risk arising from the bank's:

(a) Claims on a counterparty, including actual and potential claims which would arise from the drawing down in full of undrawn advised facilities (whether revocable/irrevocable, conditional or unconditional) which the bank has committed itself to provide, and claims which the bank has committed itself to purchase or guarantee/underwrite. In the case of undrawn facilities (including overdrafts), the advised limit must be included in the measure of exposure (after deduction of any provisions). In the case of financing, the net outstanding balance to be repaid, as shown in the books of the bank, must be included in the measure of exposure after deduction of any provisions. These claims would include, but are not limited to:
   - (i) Financing and other credit facilities (including overdrafts) whether or not drawn;
   - (ii) Exposures arising through lease agreements;
   - (iii) Margin held with exchanges or counterparties;
   - (iv) Claims under Shari'a compliant hedging contracts such as futures, forwards, options, swaps and similar contracts on profit rates, foreign currencies, equities, securities, commodities or indexes;
   - (v) Claims arising in the course of settlement of securities transactions;
   - (vi) Receivables, such as fees or commissions;
   - (vii) Claims arising in the case of forward sales and purchases of financial instruments in the trading or banking books;
   - (viii) Amounts outstanding under sale and repurchase agreements, forward asset purchase agreements, buyback agreements, stock borrowing/financing or similar transactions;
   - (ix) Sukuk s, bills or other non-equity financial instruments; and
   - (x) Underwriting exposures for Sukuk , bills, or other non-equity financial instruments.

CM-2.3 Measure of Exposure (Continued)

(b) Contingent liabilities arising in the normal course of business, and those contingent liabilities which would arise from the drawing-down in full of undrawn advised facilities (whether revocable or irrevocable, conditional or unconditional) which the bank has committed itself to provide. In the case of an undrawn overdraft, letter of credit ('L/C') or similar facility, the advised limit must be included in the measure of exposure. Such liabilities may include:

- (i) Direct credit substitutes (including guarantees, standby letters of credit, bills accepted but not held by the reporting bank, and endorsements creating payable obligations);
- (ii) Claims sold with recourse (i.e. where the credit risk remains with the reporting bank);
- (iii) Transaction-related contingents not having the character of direct credit substitutes (e.g. performance Sukuk , bid Sukuk , transaction-related L/Cs etc.);
- (iv) Undrawn documentary letters of credit issued or confirmed;
- (v) Credit Shari'a compliant hedging instruments sold (where the bank is providing credit protection); and
- (vi) Asset value guarantees (where the bank provides protection on exit price or realisable value of a non-financial asset).

(c) Any other assets or transactions whose value depends wholly or mainly on a counterparty performing its obligations, or whose value depends upon that counterparty's financial soundness, but which do not represent a claim on the counterparty. Such assets or transactions include:

- (i) Equities and other capital instruments;
- (ii) Equity warrants, options, or equity Shari'a compliant hedging instruments where the reporting bank is obtaining credit protection; and
- (iii) Underwriting or purchase commitments for equities.

(d) Investments in transactions (i.e. index positions, securitisations, hedge funds or investment funds) must be calculated by applying the same rules as for similar instruments in the banking book (see Paragraph CM-2.3.29 to CM-2.3.44). The amount invested in a particular structure may be assigned to the structure itself, defined as a distinct counterparty to the counterparties corresponding to the underlying assets, or to the unknown client.

CM-2.3 Measure of Exposure (Continued)

CM-2.3.2

Where the bank has a legally enforceable netting arrangement in place for financing and deposits, it may calculate the exposure values for large exposures in accordance with Section CA-4.4.

Eligible Credit risk Mitigation ('CRM') Techniques

CM-2.3.3

Eligible credit risk mitigation techniques for large exposures are those that meet the minimum requirements and eligibility criteria for the recognition of unfunded credit protection and financial collateral that qualify under Chapter CA-4.

CM-2.3.4

Collaterals represented in the form of receivables, commercial and residential real estate are not eligible to reduce exposure values for large exposures purposes.

CM-2.3.5

Bahraini Islamic bank licensee must recognise an eligible CRM technique in the calculation of an exposure whenever it has used this technique to calculate the risk-based capital requirements under Chapter CA-4, and provided it meets the conditions for recognition under the large exposures framework.

CM-2.3.6

In accordance with Paragraph CA-4.6.3, hedges with maturity mismatches are recognised only when their original maturities are equal to or greater than 1 year and the residual maturity of a hedge is not less than 3 months.

CM-2.3.7

If there is a maturity mismatch in respect of credit risk mitigants (collateral, on balance sheet netting, guarantees and credit Shari'a compliant hedging instruments) recognised under Paragraph CA-4.6.3, the adjustment of the credit protection for the purpose of calculating large exposures must be calculated according to the CA-4.6.4.

CM-2.3.8

Bahraini Islamic bank licensee must reduce the value of the exposure to the original counterparty by the amount of eligible CRM technique recognised under Chapter CA-4. The recognised amount is:

(a) The value of the protected portion in the case of unfunded credit protection;

(b) The value of the portion of the claim collateralised by the market value of the recognised financial collateral when the bank uses the simple approach under Section CA-4.2; and

(c) The value of the collateral adjusted after applying the required haircuts, in the case of financial collateral when the bank applies the comprehensive approach (see Section CA-4.3).

CM-2.3 Measure of Exposure (Continued)

CM-2.3.9 The exposure value for instruments that give rise to counterparty credit risk and are not securities financing transactions, must be the exposure at default according to the standardised approach for counterparty credit risk (SA-CCR) (see Appendix CA-2).

CM-2.3.10 Off-balance sheet items must be converted into credit exposure equivalents through the use of credit conversion factors ('CCFs') by applying the CCFs set-out in Section CA-3.3, with a floor of 10 percent.

CM-2.3.11 Instruments such as swaps, futures, forwards and credit Shari'a compliant hedging instruments must be converted into positions following Section CA-3.3. These instruments are decomposed into their individual legs. Only transaction representing exposures in the scope of the large exposures framework need be considered.

CM-2.3.12 For credit Shari'a compliant hedging instruments that represent sold protection, the exposure to the referenced name must be the amount due in cases where the referenced name triggers the instrument, minus the absolute value of the credit protection. For credit-linked notes, the protection seller needs to consider positions both in the bond of the note issuer and in the underlying referenced by the note.

CM-2.3.13 The measures of exposure values of options for this Chapter differ from the exposure value used for purposes of Chapter CA-4. The exposure value must be based on the change(s) in option prices that would result from a default of the respective underlying instrument. The exposure value for a simple long call option is its market value and for a short put option is the strike price of the option minus its market value. In cases involving short-call or long-put options, a default of the underlying would lead to a profit (i.e. a negative exposure) instead of a loss, resulting in an exposure of the option's market value in the former case and equal the strike price of the option minus its market value in the latter case. The resulting positions will, in all cases, be aggregated with those from other exposures. After aggregation, negative net exposures must be set to zero.

CM-2.3.14 In case of syndicated facilities initially underwritten by the bank, the nominal amount would include only the bank's share of the syndication and any amounts, for which binding commitments from other financial institutions are not available or have not been sold down. Where a binding commitment is available, that amount would be excluded in calculation of the large exposures. See Section CM-2.6 for exemptions.

CM-2.3 Measure of Exposure (Continued)

Offsetting Long and Short Positions in the Trading Book

CM-2.3.15 **Bahraini Islamic bank licensee's exposure arising from securities' trading operations is calculated as its net long position in a particular security (a short position in one security issue may not be offset against a long position in another issue made by the same issuer). The bank's 'net long position' in a security refers to its commitment to buy that security together with its current holdings of the same security, less its commitment to sell these securities.**

CM-2.3.16 **Positions in the same issue may only be offset for the purpose of calculating large exposure. Issues are defined as the same if the issuer, coupon, currency and maturity are identical.**

CM-2.3.17 **Positions in different issues from the same counterparty may be offset only when the short position is junior to the long position, or if the positions are of the same seniority.**

CM-2.3.18 **When the result of the offsetting is a net short position with a single counterparty, this net exposure need not be considered as an exposure for the purpose of this Chapter.**

CM-2.3.19 In order to determine the relative seniority of positions, securities may be allocated into broad buckets of degrees of seniority (for example, 'equity', 'subordinated debt' and 'senior debt').

CM-2.3.20 **For positions hedged by credit Shari'a compliant hedging instruments, the hedge may be recognised provided the underlying of the hedged and the position hedged fulfil the provision of Paragraph CM-2.3.17.**

CM-2.3.21 **When the credit protection takes the form of a Credit Default Swaps ('CDS') and either the CDS provider or the referenced entity is not a financial entity, the amount to be assigned to the credit protection provider is not the amount by which the exposure to the original counterparty is reduced but, instead, the counterparty credit risk exposure calculated in accordance with Appendix CA-2.**

CM-2.3 Measure of Exposure (Continued)

CM-2.3.22 Bahraini Islamic bank licensee must add any exposure to any single counterparty arising in the trading book, to any other exposures to that counterparty that lie in the banking book, to calculate its total exposure to that counterparty.

CM-2.3.23 Netting across the banking and the trading books is not permitted.

Covered Sukuk s

CM-2.3.24 Covered Sukuk are subject by law to special public supervision designed to protect bond-holders. Proceeds deriving from the issue of these Sukuk must be invested in conformity with the law in assets which, during the whole period of the validity of the Sukuk , are capable of covering claims attached to the Sukuk and which, in the event of the failure of the issuer, would be used on a priority basis for the reimbursement of the principal and payment of the accrued profit.

CM-2.3.25 A covered bond satisfying the conditions set out in Paragraph CM-2.3.26, may be assigned an exposure value of no less than 20 percent of the nominal value of the bank's covered bond holding. Other covered Sukuk must be assigned an exposure equal to 100 percent of the nominal value of the bank's covered bond holding. The counterparty to which the exposure value is assigned, is the issuing bank.

CM-2.3.26 To be eligible to be assigned an exposure value of less than 100 percent, a covered bond must satisfy all the following conditions:

(a) It must meet the general definition set out in CM-2.3.24.

(b) The pool of underlying assets must exclusively consists of:

- (i) Claims on, or guaranteed by, sovereigns, their central banks, public sector entities or multilateral development banks;
- (ii) Claims secured by mortgages on residential real estate that would qualify for a 35 percent or lower risk-weight under Section CA-3.2 and have a financing-to-value ratio of 80 percent or lower;
- (iii) Claims secured by commercial real estate that would qualify for the 100 percent or lower risk-weight under Section CA-3.2 and with a financing-to-value ratio of 60 percent or lower; and/or
- (iv) Claims on, or guaranteed by banks that qualify for a 30 percent or lower risk weight. However, such assets cannot exceed 15 percent of covered bond issuances; and

CM-2.3 Measure of Exposure (Continued)

(c) The nominal value of the pool of assets assigned to the covered bond instrument(s) by its issuer must exceed its nominal outstanding value by at least 10 percent. The value of the pool of assets for this purpose does not need to be that outlined by the legislative framework. However, if the legislative framework does not stipulate a requirement of at least 10 percent, the issuing bank needs to publicly disclose on a regular basis that their cover pool meets the 10 percent requirement in practice. In addition to the primary assets listed under this Sub-paragraph, the additional collateral may include substitution assets (cash or short-term liquid and secure assets held in substitution of the primary assets to top up the cover pool for management purposes) and Shari'a compliant hedging instruments entered into for the purposes of hedging the risks arising in the covered bond program.

CM-2.3.27 In order to calculate the required maximum financing-to-value for residential real estate and commercial real estate referred to in Paragraph CM-2.3.26, the following requirements must be met:

(a) Legal Enforceability: Any claim on a collateral taken must be legally enforceable in all relevant jurisdictions, and any claim on collateral must be properly filed on a timely basis. Collateral interests must reflect a perfected lien (i.e. all legal requirements for establishing the claim have been fulfilled). In addition to this, the collateral agreement and the legal process underpinning it must be such that they provide for the bank to realise the value of the collateral within a reasonable timeframe; and

(b) Frequent Revaluation: The bank must monitor the value of the collateral on a frequent basis and, at a minimum, once a year. More frequent monitoring is suggested where the market is subject to significant changes in conditions. Statistical methods of evaluation (e.g. reference to house price indices, sampling) may be used to update estimates or to identify collateral that may have declined in value and that may need reappraisal. A qualified professional must evaluate the property when information indicates that the value of the collateral may have declined materially relative to general market prices, or when a credit event, such as a default, occurs.

CM-2.3.28 The conditions set out in Paragraph CM-2.3.26 must be satisfied at the inception of the covered bond and throughout its remaining maturity.

CM-2.3 Measure of Exposure (Continued)

Collective Investment Undertakings, Securitisation Vehicles and Other Structures

CM-2.3.29 Bahraini Islamic bank licensees must consider exposures even when a structure lies between the bank and the exposures, that is, even when the bank invests in structures through an entity which itself has exposures to assets ('underlying assets'). Bahraini Islamic bank licensees must assign the exposure amount, i.e. the amount invested in a particular structure, to specific counterparties following the approach described in Paragraphs CM-2.3.30 to CM-2.3.34. This structures include funds, securitisations and other structures with underlying assets.

CM-2.3.30 A Bahraini Islamic bank licensee may assign the exposure amount to the structure itself, defined as a distinct counterparty, if it can demonstrate that the bank's exposure amount to each underlying asset of the structure is smaller than 0.25 percent of Tier 1 (T1) capital, considering only those exposures to underlying assets that result from the investment in the structure itself, and using the exposure value calculated according to Paragraphs CM-2.3.35 and CM-2.3.36. In this case, the bank is not required to look through the structure to identify the underlying assets.

CM-2.3.31 Bahraini Islamic bank licensee must look through the structure to identify those underlying assets for which the underlying exposure value is equal to or above 0.25 percent of Tier 1 (T1) capital. In this case, the counterparty corresponding to each of the underlying assets must be identified so that these underlying exposures can be added to any other direct or indirect exposure to the same counterparty. The bank's exposure amount to the underlying assets that are below 0.25 percent of the bank's Tier 1 (T1) capital may be assigned to the structure itself (i.e. partial look-through ('LTA') is permitted).

CM-2.3.32 If a Bahraini Islamic bank licensee is unable to identify the underlying assets of a structure where the total amount of its exposure does not exceed 0.25 percent of its Tier 1 (T1) capital, the bank must:

(a) Assign the total exposure amount of its investment to the structure; or

(b) Assign this total exposure amount to the unknown client.

CM-2.3 Measure of Exposure (Continued)

CM-2.3.33 Bahraini Islamic bank licensees must aggregate all unknown exposures as if they are related to a single counterparty (the unknown client), to which the large exposure limit would apply.

CM-2.3.34 When a LTA is not required, according to Paragraph CM-2.3.30, a Bahraini Islamic bank licensee must, nevertheless, be able to demonstrate that regulatory arbitrage considerations have not influenced the decision whether to look through or not – e.g. that the bank has not circumvented the large exposure limit by investing in several individually immaterial transactions with identical underlying assets.

CM-2.3.35 If the LTA need not be applied, Bahraini Islamic bank licensee's exposure to the structure must be the nominal amount it invests in the structure.

CM-2.3.36 When the LTA is required according to Paragraph CM-2.3.31, the exposure value assigned to a counterparty is equal to the pro rata share that the bank holds in the structure multiplied by the value of the underlying asset in the structure. Thus, the bank holding a 1 percent share of a structure that invests in 20 assets each with a value of 5, must assign an exposure of 0.05 to each of the counterparties. An exposure to a counterparty must be added to any other direct or indirect exposures the bank has to that counterparty.

CM-2.3.37 When the LTA is required, according to the Paragraph CM-2.3.31, the exposure value to a counterparty is measured for each tranche within the structure, assuming a pro rata distribution of losses amongst investors in a single tranche. To compute the exposure value to the underlying asset, the bank must:

(a) First, consider the lower of the value of the tranche in which the bank invests and the nominal value of each underlying asset included in the underlying portfolio of assets; and
(b) Second, apply the pro rata share of the bank's investment in the tranche to the value determined in the first step above.

CM-2.3 Measure of Exposure (Continued)

Identification of Additional Risks

CM-2.3.38 **Islamic bank licensees must identify third parties that may constitute an additional risk factor inherent in a structure itself rather than in the underlying assets. This third party could be a risk factor for more than one structure that the bank invests in. Examples of roles played by third parties include originator, fund manager, liquidity provider and credit protection provider.**

CM-2.3.39 Islamic bank licensees should connect their investments in those structures with a common risk factor, to form a group of connected counterparties. In such cases, the manager would be regarded as a distinct counterparty so that the sum of the bank's investments in all of the funds managed by this manager would be subject to the large exposure limit, with the exposure value being the total value of the different investments. In other cases, the identity of the manager may not comprise of an additional risk factor – for example, if the legal framework governing the regulation of particular funds requires separation between the legal entity that manages the fund, and the legal entity that has custody of the fund's assets.

CM-2.3.40 In the case of structured finance products, the liquidity provider or sponsor of short-term programmes (asset-backed commercial paper – 'ABCP', or conduits and structured investment vehicles – 'SIVs') may warrant consideration as an additional risk factor (with the exposure value being the amount invested). Similarly, in synthetic deals, the protection providers (sellers of protection by means of CDS/guarantees) may be an additional source of risk and a common factor for interconnecting different structures (in this case, the exposure value would correspond to the percentage value of the underlying portfolio).

CM-2.3.41 Islamic bank licensees may add their investments in a set of structures associated with a third party that constitutes a common risk factor to other exposures (such as a financing) it has to that third party. Whether the exposures to such structures must be added to any other exposures to the third party, would again depend on a case-by-case consideration of the specific features of the structure and on the role of the third party. In the example of the fund manager, adding together the exposures may not be necessary because potentially fraudulent behaviour may not necessarily affect the repayment of a financing.

CM-2.3.42 The assessment may be different where the risk to the value of investments underlying the structures arises in the event of a third-party default. For example, in the case of a credit protection provider, the source of the additional risk for the bank investing in a structure, is the default of the credit protection provider. The bank must add the investment in the structure to the direct exposures to the credit protection provider as both exposures may crystallise into losses in the event that the protection provider defaults (ignoring the covered part of the exposures may lead to the undesirable situation of a high concentration risk exposure to issuers of collateral or providers of credit protection).

CM-2.3 Measure of Exposure (Continued)

Identification of Additional Risks

CM-2.3.43 It is conceivable that the bank may consider multiple third parties to be potential drivers of additional risk. In this case, the bank should assign the exposure resulting from the investment in the relevant structures to each of the third parties.

CM-2.3.44 The requirement set out in Paragraph CM-2.3.35 to recognise a structural risk inherent in the structure instead of the risk stemming from the underlying exposures is independent of whatever the general assessment of additional risks concludes.

Exposures to Central Counterparties

CM-2.3.45 **Exposures to qualified central counterparties ('QCCPs') related to clearing activities are exempted from the requirements of this Chapter.**

CM-2.3.46 **In the case of non-QCCPs, Islamic bank licensees must measure their exposure as a sum of both the clearing exposures described in Paragraph CM-2.3.48 and the non-clearing exposures described in Paragraph CM-2.3.49, and must respect the general large exposure limit of 15 percent of Tier 1 (T1) capital.**

CM-2.3.47 **The concept of closely related counterparties referred to in CM-2.5.4 does not apply in the context of exposures to centralised counterparties ('CCPs') that are specifically related to clearing activities.**

CM-2.3 Measure of Exposure (Continued)

Identification of Additional Risks

CM-2.3.48 Bahraini Islamic bank licensees must identify exposures to a CCP related to clearing activities and sum together these exposures. Exposures related to clearing activities are listed in the table below, together with the exposure value to be used:

Trade Exposures	The exposure value of trade exposures must be calculated using the exposure measures prescribed in this Chapter for the respective type of exposures.
Segregated Initial Margin	The exposure value is 0.
Non-segregated Initial Margin	The exposure value is the nominal amount of initial margin posted.
Pre-funded Default Fund Contributions	Nominal amount of the funded contribution.
Unfunded Default Fund Contributions	The exposure value is 0.
Equity Stakes	The exposure value is the nominal amount.

CM-2.3.49 Regarding exposures subject to clearing services (the bank acting as a clearing member or being a client of a clearing member), the bank must determine the counterparty to which exposures must be assigned by applying the provisions of Module CA.

CM-2.3.50 Bahraini Islamic bank licensees must apply a risk weight of 2 percent to their trade exposure to the CCP in respect of OTC Shari'a compliant hedging instruments, exchange-traded Shari'a hedging transactions, securities financing transactions (SFTs) and long-settlement transactions, where the bank acts as a clearing member of a CCP for its own purposes. Where the clearing member offers clearing services to clients, the 2 percent risk weight also applies to the clearing member's trade exposure to the CCP that arises when the clearing member is obligated to reimburse the client for any losses suffered due to changes in the value of its transactions in the event that the CCP defaults.

CM-2.3 Measure of Exposure (Continued)

CM-2.3.51 **Other types of exposures that are not directly related to clearing services provided by the CCP, such as funding facilities, credit facilities, guarantees, etc., must be measured according to the rules set out in this Chapter as for any other type of counterparty. These exposures will be added together and be subjected to the large exposure limit.**

CM-2.4 Identity of Counterparty

CM-2.4.1 For the purposes of measuring exposures, the counterparty will generally be the person from whom the concerned funds are receivable (in the case of fees and commissions etc.); the obligor (customer) in the case of credit facilities; the person guaranteed; the issuer of a security in the case of a security held; or the party with whom a contract was made in the case of a Shari'a compliant hedging contracts.

CM-2.4.2 Where a third party has provided an eligible guarantee, and subject to the guaranteed bank's policy statement not stating otherwise, the guaranteed bank must recognise an exposure to the third-party guarantor, rather than the person guaranteed (see Chapter CA-4 for full conditions relating to the recognition of guarantees for regulatory purposes).

CM-2.5 Limits for Large Exposures

Definitions and Aggregate Limit on Large Exposures

CM-2.5.1 A 'large exposure' is any exposure to counterparty or a group of closely related counterparties which is greater than, or equal to, 10 percent of the reporting Bahraini Islamic bank licensee's Tier 1 capital.

CM-2.5.2 The CBB requires that any large exposure, as defined in Paragraph CM-2.5.1, must have a prior approval by the Bahraini Islamic bank licensee's Board of Directors.

Single Exposure Limit to a counterparty – 15 Percent

CM-2.5.3 A Bahraini Islamic bank licensees may not incur an exposure to an individual counterparty or group of closely related counterparties (not connected to the reporting bank) which exceeds 15 percent of the reporting bank's Tier 1 capital without the prior written approval of the CBB. Where this limit has been exceeded, the excess amount must be risk-weighted at 800 percent.

Closely related counterparties – Criteria

CM-2.5.4 In order for the bank to establish the existence of a group of closely-related counterparties, it must assess the relationship amongst counterparties by referring to the following criteria:

(a) Control relationship: One of the counterparties, directly or indirectly, has control over the other(s) based on the following:
   - (i) Where one entity owns 50% or more of the voting rights of another entity.
   - (ii) Where one entity is deemed to have control by virtue of voting agreements (e.g. control of a majority of voting rights pursuant to an agreement with other shareholders).
   - (iii) Where one entity exercises significant influence on the appointment or dismissal of an entity's board and/or senior management, such as the right to appoint or remove a majority of such persons, or the fact that a majority of such persons have been appointed solely as a result of the exercise of an individual entity's voting rights.

CM-2.5 Limits for Large Exposures (Continued)

(iv) Where one entity has significant influence on the board or senior management, e.g. an entity has the power, pursuant to a contract or otherwise, to exercise a controlling influence over the management or policies of another entity (e.g. through consent rights over key decisions).

; or

(b) Economic interdependence: If one of the counterparties were to experience financial problems, in particular funding or repayment difficulties, the other(s), as a result, would also be likely to encounter funding or repayment difficulties.

CM-2.5.5 Bahraini Islamic bank licensees are also expected to refer to criteria specified in IFRS for further qualitative guidance when determining control.

CM-2.5.6 The CBB shall exercise its discretion in applying the definition of closely related counterparties on a case-by-case basis if it finds, during its onsite or offsite supervisory review, any linkage of such counterparties.

CM-2.5 Limits for Large Exposures (Continued)

CM-2.5.7 In establishing closely related counterparty relationships based on economic interdependence (CM-2.5.4 (b)), banks should consider, at a minimum, the following qualitative criteria:

(a) Where 50 percent or more of one counterparty's gross receipts or gross expenditures (on an annual basis) is derived from transactions with the other counterparty (e.g. the owner of a residential/commercial property and the tenant who pays a significant part of the rent);

(b) Where one counterparty has fully, or partly, guaranteed the exposure of the other counterparty, or is liable by other means, and the exposure is so significant that the guarantor is likely to default if a claim occurs;

(c) Where a significant part of one counterparty's production/output is sold to another counterparty, which cannot easily be replaced by other customers;

(d) When the expected source of funds to repay each financing one counterparty makes to another is the same and the counterparty does not have another source of income from which the financing may be fully repaid;

(e) Where it is likely that the financial problems of one counterparty would cause difficulties for the other counterparties in terms of full and timely repayment of liabilities;

(f) Where the insolvency or default of one counterparty is likely to be associated with the insolvency or default of the other(s); and

(g) When two or more counterparties rely on the same source for the majority of their funding and, in the event of the common provider's default, an alternative provider cannot be found – in this case, the funding problems of one counterparty are likely to spread to another due to a one-way or two-way dependence on the same main funding source.

CM-2.5 Limits for Large Exposures (Continued)

Limit on Exposures to connected counterparties – 25 Percent Aggregate

CM-2.5.8 **Exposures to connected counterparties of Bahraini Islamic bank licensees may be justified only when undertaken for the clear commercial advantage of the bank, when negotiated and agreed on an arm's-length basis, and when included in the Large Exposures Policy statement agreed with the CBB.**

CM-2.5.9 **A Bahraini Islamic bank licensee may not exceed the individual or aggregate limits for exposures to connected counterparties shown in Paragraph CM-2.5.14, without the prior written approval of the CBB.**

CM-2.5.10 **The bank may not undertake exposures to its own external auditor. In this context, 'external auditor' refers to the firm/partnership, the partners, the directors and managers of the audit firm.**

CM-2.5.11 **For the purpose of this Module, 'connected counterparties' includes legal and natural persons connected with the Bahraini Islamic bank licensee, including, in particular; controllers of the bank (and Board members, senior management and key staff of the controller, the controller's appointed Board representatives, subsidiaries and associated companies of controllers including their Board members, senior management and key staff), approved persons of the bank, as defined by Module LR-1A, and their close family members (as defined by IFRS – IAS 24); associated companies not mentioned herein above, unconsolidated subsidiaries and members of the Shari'a Supervisory Board ('SSB'), if any.**

CM-2.5.12 Equity participations in, and credit exposures to, consolidated banking and financial subsidiaries (see CA-2.3.1(c)) need not be included in exposures to connected counterparties for the sake of the table in CM-2.5.14. Equity participations in, and credit or financing exposures to, unconsolidated subsidiaries are included in the definition of exposure in order to understand the degree of support the parent is supplying to its unconsolidated subsidiaries on a day-to-day basis.

CM-2.5.13 The CBB shall exercise its discretion in applying the definition of connected counterparties of the bank on a case-by-case basis, if it finds during its onsite or offsite supervisory review any linkage of such counterparties.

CM-2.5 Limits for Large Exposures (Continued)

CM-2.5.14 <u>Exposures</u> (both on and off-balance sheet) to all <u>connected counterparties</u> of <u>Bahraini Islamic bank licensees</u> listed below, when taken together, may not exceed 25 percent of the Tier 1 capital. Where any of these limits have been exceeded, the excess amount must be risk-weighted at 800 percent.

Connected Counterparties	Individual Limit	Aggregate Limit
<u>Controllers</u> and their close family members as defined in IFRS, and board members, senior management and key staff of the <u>controller</u>, the <u>controller</u>'s appointed board representatives, <u>subsidiaries</u> and associated companies of <u>controllers</u> including their board members, senior management and key staff)	0%	0%
<u>Approved persons</u> (and their close family members as defined in IFRS)	10%	25%
Associated companies, other connected <u>counterparties</u> not mentioned above, and unconsolidated subsidiaries	15%	
Total (including senior management and others)		25%

CM-2.5 Limits for Large Exposures (Continued)

Deductions from Total Capital

CM-2.5.15 The CBB will closely examine all exposures to 'connected counterparties' and will deduct them from the bank's consolidated total capital if they are, in the CBB's opinion, of the nature of a capital investment, or provision of long-term working capital, or are made on particularly concessionary terms.

CM-2.5.16 **Reciprocal cross-holdings of capital between the bank and its controllers (see GR-5) which artificially inflate the capital of licensee concerned are not permitted. Any cross-holdings that occur, due to acquisitions or takeovers, must be deducted from the concerned bank's total capital (see also CA-2).**

CM-2.5.17 Any other form of financing to connected counterparties outside the scope of the above will be dealt with by the CBB on a case-by-case basis.

CM-2.5.18 **Bahraini Islamic bank licensees must perform valuations of collaterals covering large exposures to ensure that collaterals are, and continue to be, enforceable and realisable at least on an annual basis.**

CM-2.6 Exempt Exposures

Exempt Exposures to Parties not Connected to the Bank

CM-2.6.1 **Certain types of exposure are exempt from the 15 percent exposure limit set out in CM-2.5.3, but prior notification of commitment to such exposures must be made to the CBB and then retrospectively on a quarterly basis, using the Form PIR provided in Appendix BR-5.**

CM-2.6.2 **These exemptions fall into the following categories and are subject, in each case, to the policy statement as agreed with the CBB:**

(a) Intraday interbank exposures;

(b) Exposures to GCC governments and their public sector entities that do not operate on a commercial basis;

(c) Exposures secured by cash or GCC government securities or guarantees;

(d) Exposures to central governments who are members of the Organisation for Economic Cooperation and Development ('OECD') or exposures secured by OECD central government securities/guarantees;

(e) Specific connected short-term exposures agreed with and approved in advance by the CBB, in particular those arising from a group Treasury function (see Paragraph CM-2.6.7);

(f) Pre-notified exposures which are covered by a guarantee from the bank's parent (see Paragraphs CM-2.6.9 to CM-2.6.12); and

(g) Sukuk or other securities issued or exposure to / exposure guaranteed by the Islamic Development Bank or any of its subsidiaries.

CM-2.6.3 Where two or more entities that are outside the scope of sovereign exemption are controlled by or economically dependent on an entity that falls within the scope of the sovereign exemption referred to in paragraph CM-2.6.2, and are closely related, those entities need not be deemed to constitute a group of closely related counterparties pursuant to paragraph CM-2.5.4.

CM-2.6.4 **If a Bahraini Islamic bank licensee has an exposure to any entity noted in Paragraph CM-2.6.2 which is hedged by a credit Shari'a compliant hedging contracts, the bank will have to recognise an exposure to the counterparty providing the credit protection, as prescribed in Paragraphs CM-2.4.2 and CM-2.3.20, notwithstanding the fact that the original exposure is exempted.**

CM-2.6 Exempt Exposures (Continued)

Exempt Exposures to <u>Connected Counterparties</u>

CM-2.6.5 **Exposures to subsidiaries which are always fully consolidated on a line-by-line basis for all supervisory purposes are exempt from the limits in this Module on a consolidated basis, however banks must observe the CBB's solo capital adequacy requirements in Module CA.**

CM-2.6.6 **Exposures to unconsolidated subsidiaries (normally non-financial and outside the scope of regulatory consolidation) are not exempt from the limits in this Module and are included under the limits for exposures to associates, related parties and unconsolidated subsidiaries (See Paragraph CM-2.5.14).**

CM-2.6.7 **<u>Bahraini Islamic bank licensees</u> may apply to the CBB to take on a treasury role on behalf of the group as a whole (provided that the group is subject to consolidated supervision by its home supervisor). The CBB's policy regarding the taking on of a treasury role includes exposures arising from a central risk management function. Such exposures must be approved by the CBB before they may be exempted.**

CM-2.6.8 In the above scenario (Paragraph CM-2.6.7), for example, exposures of more than 15% of Tier 1 Capital to a parent bank from a subsidiary bank may be permitted where they constitute short term financing of excess liquid funds.

Exposures Undertaken by a Subsidiary Bank

CM-2.6.9 **Where exposures undertaken by a Bahrain subsidiary of an overseas bank are guaranteed by its parent bank, the Bahrain subsidiary bank may be deemed to have an exposure to its parent bank.**

CM-2.6.10 **Under the terms of this Module (see Paragraph CM-2.6.2(f)), such indirect exposures to a parent bank may be exempted from the limits on large exposures if the CBB is satisfied that:**

(a) Such exposures have been pre-notified to the CBB for the CBB's approval and are entered into within the terms of a policy agreed by the parent bank;

(b) There are guarantees in place from the parent bank to protect the subsidiary should the exposure become impaired or require to be written off; and

(c) In the case of banks, which are the Bahrain subsidiaries of overseas banks, the supervisory authority of the parent bank has approved the exposures that can be undertaken by the Bahrain subsidiary.

CM-2.6 Exempt Exposures (Continued)

CM-2.6.11 **In the case of a Bahrain incorporated bank's subsidiary in Bahrain, in order for an exposure exceeding 15% of Tier 1 Capital to be acceptable in the subsidiary, the Bahrain parent bank must at all times have the capacity to take on the exposure to the third party, without itself exceeding the limit of 15% of its own Tier 1 Capital. Also, the total exposure of the banking group to the customer must be within 15% of the parent bank's consolidated Tier 1 Capital.**

CM-2.6.12 The CBB will need to be satisfied that adequate control systems are in place to ensure that risks taken in the group as a whole are properly monitored and controlled.

CM-2.7 Reporting of Exposures

CM-2.7.1 **Islamic bank licensees are required to report their 25 largest exposures to banks, as well as their 25 largest exposures to non-banks, to the CBB on a quarterly basis using the Form PIR, provided in Appendix BR-5.**

CM-2.7.2 **Islamic bank licensees must report the financial details of each large exposure, as defined under Paragraph CM-2.5.1, in Appendix BR-19, as required under Paragraph BR-3.1.10.**

CM-2.7.3 **Bahraini Islamic bank licensees must report all their exposures to connected counterparties on a monthly basis using the form provided in Appendix BR-11, as required under Paragraph BR-4.3.4.**

CM-2.7.4 **Banks are required to adopt policies and set internal limits, which will not lead to the exposure limit(s) referred to above being exceeded as a matter of course.**

CM-2.7.5 For some banks, the CBB may determine it prudent to set lower large exposure limits than the ones given in this Module.

CM-2.7.6 **Should any bank incur, or may incur an exposure to an individual counterparty (other than an exempt exposure) which results in, or may result in, it exceeding any of the limits set out above, this must be reported immediately to the CBB for its consideration. Where the exposure or counterparty is not exempt, action must be taken to immediately bring the exposure back within applicable limits as soon as possible.**

CM-2.8 Policy Statements

CM-2.8.1

The CBB requires each Islamic bank licensee to set out its policy and internal limits on large exposures, including limits for differing types of exposures, to individual customers, banks, corporates, countries, regions, products, asset classes, collateral, currencies, markets, commodities, connected counterparties and economic sectors, in a policy statement which must be formally approved by the Board of Directors and then submitted to the CBB for approval. Furthermore, banks must not implement significant changes to this policy without the prior approval of the Board and the CBB.

CM-2.8.2

The necessary control systems to give effect to the bank's policy on large exposures must be clearly specified and monitored by its Board.

CM-2.8.3

Bahraini Islamic bank licensees are required to implement appropriate internal systems and controls to monitor the size of their total Tier 1 capital on a daily basis to ensure that the limits detailed in this Module are not exceeded.

CM-2.9 Concentrations in Geographic, Economic and Market Sectors

CM-2.9.1 The extent to which the bank may be prudently exposed to a particular geographic, economic and market sectors will vary considerably, depending upon the characteristics and strategy of the bank, and the sector concerned.

CM-2.9.2 Concentrations should also be recognised in not just geographic and economic sectors, but also in markets (e.g. individual stock exchanges). The CBB will not apply common maximum percentages to banks' sectoral or market exposures but, instead, will continue to monitor such exposures on an individual and general basis.

CM-2.9.3 **Islamic bank licensees must specify in their policy statements, how they define geographic, economic and market sectors, and what limits apply to differing sectors.**

CM-2.9.4 **Exposures and limits for sectors must be reviewed at least quarterly by the Board of Directors.**

CM-2.9.5 **Bahraini Islamic bank licensees which have over 10 percent of their risk-adjusted assets in market risk (i.e. the trading book) must also set market risk concentration limits.**

CM-2.10 Major Investments

Prior approval for Major Investments

CM-2.10.1 **Bahraini Islamic bank licensees must obtain the CBB's prior written approval before making an investment in another commercial or financial entity (whether incorporated inside or outside of Bahrain) which falls within the definition of a major investment. Additionally, the CBB's prior approval must be obtained for any subsequent increases in the bank's ownership in excess of 5% of similar exposure. Where the increase is due to a revaluation or change in capital of the bank, a written notification outlining the percentage increase and reasons for increase must be provided to the CBB.**

CM-2.10.2 In assessing a proposed major investment, the CBB will take into account the impact of such investment on the risk profile of the bank. See Appendix CM-4 for criteria for assessment.

CM-2.10.3 **A major investment is defined as either of the following:**

(a) An investment in the capital instruments of another entity by a Bahraini Islamic bank licensee which is equivalent to or more than 10% of the Bahraini Islamic bank licensee's consolidated Tier 1 capital; or

(b) Any investment in the capital instruments of a commercial entity which is equivalent to or more than 10 percent of the issued common share capital of the issuing commercial entity.

CM-2.10.4 **Any major investments by a Bahraini Islamic bank licensee in the capital instruments of another entity must be included in the measure of an 'exposure' for the purposes of this Module, i.e. such major investments must be aggregated with all other facilities to a client for the purpose of calculating the level of 'large exposures'. Where a percentage ownership increase results in the bank exceeding the single large exposure limit, the 800 percent risk-weight rule must be applied (see CM-2.5).**

CM-2.10.5 **The CBB reserves the right to require Bahraini Islamic bank licensees to dispose of any major investments acquired without its prior approval. Where a 'major investment' is acquired without the 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 'major 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).**

CM-2.10 Major Investments (Continued)

CM-2.10.6 If the bank's close links with another entity prevent effective supervision of the bank (or bank group), the CBB may refuse or revoke a license, or require a bank to sell or otherwise dispose of entities within its corporate group, or to restructure the bank.

Limits on major investments

CM-2.10.7 **The total amount of the bank's investments in commercial entities, other than associated companies considered under CM-2.5.14, may not exceed the limits set forth below:**

Limits on major investments in commercial entities*	Individual Limit**	Aggregate Limit
Major investments by retail Islamic bank licensees		30%
Major investments by wholesale Islamic bank licensees undertaking commercial banking business	15%	40%
Major investments by wholesale Islamic bank licensees undertaking investment banking business		70%

*** Exposure for this purpose includes investment in capital instruments and any other exposure and includes any other exposure to the subject entity**

**** Limits expressed as a percentage of Total Tier 1 Capital**

CM-3.1 Reporting and Compliance

CM-3.1.1 The CBB's prior written consent must be obtained for any financing to an employee where the amount of this financing, either singly or when added to an existing financing(s) outstanding to that employee at that date, would be equal to or in excess of BD 100,000, or its equivalent in foreign currency. Islamic bank licensees must notify the CBB in writing of any senior employee who fails to discharge his repayment obligations.

CM-3.1.2 Where an Islamic bank licensees seeks the CBB's prior approval, as required under Paragraph CM-3.1.1, in its request, it must confirm that the employee financing is in-line with the bank's Board-approved policy. The request must also confirm that the bank has made an internal assessment and evaluation when reaching the decision to grant the employee financing and that all necessary internal approvals have been obtained. The bank must also obtain the necessary credit references information from the Bahrain Credit Reference Bureau.

CM-3.1.3 Islamic bank licensees must ensure that the provisions of relevant laws (including, specifically, the Bahrain Labour Law) are observed at all times in this area.

CM-4.1 Write-offs

CM-4.1.1 **<u>Bahraini Islamic bank licensees</u> must notify the CBB of any write-off of an exposure of an amount in excess of BD100,000, or its equivalent in foreign currency.**

CM-4.1.2 Such notification should be accompanied by documentary evidence showing, beyond reasonable doubt, that the <u>customer</u> does not possess the resources to fulfil the outstanding obligation.

CM-4.1.3 **<u>Bahraini Islamic bank licensees</u> must obtain the CBB's written no-objection before writing-off any of the following:**

(a) <u>Exposures</u> to, or guaranteed by, any <u>approved person</u> of the bank or any other CBB <u>licensee</u>;
(b) <u>Exposures</u> to <u>controllers</u>, subsidiaries, associates and SSB members of the bank;
(c) <u>Exposures</u> to any business entity for which the bank, or any of its <u>approved persons</u>, is a related party, such as a Board member, a shareholder owning 5 percent or more, a person assuming a managerial role, a guarantor; etc. and
(d) <u>Exposures</u> to any <u>controller</u> of another CBB <u>licensee</u> (as defined in Section GR-5.2 – Definition of Controller).

CM-4.1.4 **<u>Branches of foreign banks licensees</u> must obtain the CBB's written no-objection before writing off the exposures listed in CM-4.1.3 from (a) to (d) except for (b).**

CM-4.1.5 **<u>Islamic bank licensees</u> must notify the CBB of any applicable <u>exposures</u> outlined in Paragraph CM-4.1.3 that are classified as NPAs.**

CM-4.1.6 In order to comply with Sub-paragraphs CM-4.1.3 (a) and (d), <u>Islamic bank licensees</u> should refer to the CBB register on the CBB website, which contains a list of <u>approved persons</u> and <u>controllers</u> of all CBB <u>licensees</u>.

CM-5.1 Overview

CM-5.1.1 This Chapter sets out various requirements regarding the provision of consumer finance within the Kingdom of Bahrain, by the CBB licensees. The aim of these requirements is to encourage:

(a) Prudent financing by licensees providing consumer finance; and
(b) The transparent disclosure of the full costs and terms on which licensees offer consumer finance.

CM-5.2 The CBB's Approach to Consumer Finance

CM-5.2.1 **Bank licensees are reminded of their obligation to implement a sound internal controls framework, including an effective credit culture (as outlined in Section CM-1.2).**

CM-5.2.2 **Islamic bank licensees which offer consumer finance facilities to residents of Bahrain must follow the Code of Best Practice on Consumer Credit attached as Appendix CM-2 in Part B of the Rulebook. Failure to adhere to the Code may result in enforcement action as outlined in Module EN.**

CM-5.2.3 **Bank licensees are also reminded of their obligations to display and communicate charges and APRs clearly (as outlined in Section BC-4.3).**

CM-5.2.4 The measures presented in this Chapter should be viewed as minimum standards, rather than best practice. They are aimed at encouraging prudent financing and full, frank and fair disclosures. These measures should be read in conjunction with the 'Code of Best Practice on Consumer Credit and Charging' which was agreed jointly between the CBB and the Bahrain Association of Banks (see Appendix CM-2).

On-going Effort by the CBB

CM-5.2.5 The CBB supervisors and examiners will also focus on banks' implementation of the 'Code of Best Practice on Consumer Credit and Charging' in their on-going supervision of licensees, to monitor and encourage sound financing practices and disclosure standards.

CM-5.3 Definition of Consumer Finance

CM-5.3.1 Consumer finance is the provision of any form of credit facility to an individual excluding:

(a) Any financing secured by a first charge on residential property to an individual, where the obligor lives in, or intends to live in the property;

(b) Any credit facility secured by cash or investments, where the security provided more than covers the principal of the credit facility; and

(c) The provision of any form of credit to an individual for business purposes where the facility is to be repaid from the business activities of the obligor.

CM-5.3.2 For the purposes of the Rulebook, 'credit facility' includes personal overdraft facilities, credit cards, consumer financing or other financing facilities. 'Consumer financing' are defined as financing for a fixed period to individuals for non-business purposes.

CM-5.4 Maximum Limits

Total Repayments Ratio

CM-5.4.1 Licensees may only provide a new consumer facility (or renew, extend or otherwise modify an existing consumer facility) for an amount so that that the obligor's total monthly repayments on all their consumer finance commitments do not exceed 50 percent of their monthly gross income. This limit may only be exceeded in the circumstances described in Paragraphs CM-5.4.6 and CM-5.4.9.

CM-5.4.2 When reviewing an applicant for a consumer facility, licensees may only take into consideration regular income. A spouse's income may only be taken into consideration when the credit facility would be in joint names, so that the spouse would also be legally liable for the obligation incurred.

CM-5.4.3 Notwithstanding the above limit, licensees must review, in detail, an applicant's personal financial standing and ability to service their obligations. Where a spouse's income is being taken into consideration, their individual circumstances must also be similarly assessed. In many cases, these reviews may require consumer finance repayments to be kept significantly below 50 percent of monthly gross income.

CM-5.4.4 Licensees must enquire as to applicants' sources of income, their past credit history, their regular outgoings and other financial commitments, including potential liabilities such as guarantees. Particular attention must be paid to housing costs (such as payments to Eskan Bank). A person's regular income, net of consumer finance repayments and other financial obligations, must remain sufficient for that person to support himself and any dependents. Licensees must also take into account likely future trends in income and outgoings, and the impact this may have on the 50 percent ratio.

CM-5.4.5 When factoring in credit cards into the repayment limit in Paragraph CM-5.4.1 above, licensees must include 5 percent of the credit limits available on these facilities. If the amounts outstanding (including profit) under such facilities exceed their limit, then the full amount outstanding must be included in the repayments ratio calculation. Charge cards are not included under this definition.

CM-5.4 Maximum Limits (Continued)

CM-5.4.6

In the case of high earners – defined for these purposes as persons earning more than BHD 3,000 per month – the 50 percent limit may be relaxed, providing that the licensee has undertaken the review required in Paragraph CM-5.4.4 above and is satisfied that the obligor can comfortably support a higher facility service ratio.

CM-5.4.7

The review undertaken to satisfy requirements, as outlined in Paragraph CM-5.4.4 above, must be documented and made available to the CBB's examiners upon request. The documentation must include all relevant information used to support the decision to extend credit facilities. In the case of high earners granted a facility in excess of the 50 percent limit, the documentation must also include a written statement, signed by an appropriate member of management, explaining the justification for relaxing the limit.

Maximum Tenor Limit

CM-5.4.8

The maximum tenor for instalment consumer finance is 7 years. In the case of any restructured instalment consumer finance facilities repayable in instalments, the stated final maturity must be within 7 years from the date of the original facility. The tenor may not be extended more than twice during the period of the agreement and in any case not extended beyond the 7-year duration above.

Non-compliant Facilities

CM-5.4.9

Where a customer's monthly gross income falls (e.g. due to redundancy, disability or a similar event outside the control of the customer), the bank must identify such accounts as 'technically non-compliant'. If a customer requests an extension to the tenor of the facility due to reduced income, then the bank may increase the term to assist the customer. The bank must take account of the 50 percent limit outlined in Paragraph CM-5.4.1. Such facilities must also be identified as 'technically non-compliant'. Islamic bank licensees must report all facilities that are still considered 'technically non-compliant facilities' as of each quarter end.

CM-5.5 Refunds and Prepayments

Refund/Adjustment of Insurance Premium on Financing Prepayments and Top-Ups

CM-5.5.1 Banks/financing companies must refund/adjust proportionately the insurance premium charged on individual credit facilities when the customer either requests for a top up or prepayment of the credit facility as per the prescribed formula below:

$$\textit{Refund/Adjustment Amount} = \frac{\textit{Remaining period to Maturity} \times \textit{Premium Paid}}{\textit{Original Maturity}}$$

CM-6.1 Overview

CM-6.1.1 [This Paragraph was deleted in April 2011].

CM-6.1.2 [This Paragraph was deleted in April 2011].

CM-6.1.3 **In order to monitor and identify any asset deterioration due to the Islamic contracts, the CBB requires additional disclosures (see Module BR) on the Islamic contracts undertaken by the bank during the period.**

CM-6.1.4 Definitions, disclosure requirements and method(s) of accounting treatments for some of the Islamic contracts are outlined below.

Murabaha

CM-6.1.5 **Revenue for the purpose of Murabaha contracts must be recognised on an accrual basis.**

CM-6.1.6 For a detailed definition, disclosure requirements and method(s) of accounting treatment, refer to AAOIFI's FAS 2: Murabaha and Murabaha to the Purchase Orderer.

Mudaraba

CM-6.1.7 **Revenue on Mudaraba contracts may only be recognised to the extent it is being distributed.**

CM-6.1.8 For a detailed definition, disclosure requirements and method(s) of accounting treatment, refer to AAOIFI's FAS 3: Mudaraba Financing.

CM-6.1.9 **As part of its on-going supervision of Islamic banks, the CBB has set out the type of terms and conditions (see Appendix BC-7) which it believes Islamic banks should include, as a minimum, in such contracts.**

Musharaka

CM-6.1.10 **Under a Musharaka contract, losses are shared in proportion to the contributed capital. It is not permissible to stipulate otherwise.**

CM-6.1 Overview (continued)

CM-6.1.11 For a detailed definition, disclosure requirements and method(s) of accounting treatment, refer to AAOIFI's FAS 4: Musharaka Financing.

Salam

CM-6.1.12 **As a policy no Salam contracts must be entered into without covering the position through a Parallel Salam contract.**

CM-6.1.13 **Where the bank is not able to enter into a Parallel Salam contract it must agree a statement policy with the CBB.**

CM-6.1.14 For a detailed definition, disclosure requirements and method(s) of accounting treatment, refer to AAOIFI's FAS 7: Salam and Parallel Salam.

Istisna'a

CM-6.1.15 **As a policy no Istisna'a contracts must be entered without covering the position through a Parallel Istisna'a contract.**

CM-6.1.16 **In accordance with provisions contained in FAS 10: Istisna'a and Parallel Istisna'a, revenue and profit on such contracts must be recognised on a percentage of completion method.**

CM-6.1.17 For a detailed definition, disclosure requirements and method(s) of accounting treatment, refer to AAOIFI's FAS 10: Istisna'a and Parallel Istisna'a.

Ijarah and Ijarah Muntahia Bittamleek

CM-6.1.18 For a detailed definition, disclosure requirements and method(s) of accounting treatment, refer to AAOIFI's FAS 8: Ijarah and Ijarah Muntahia Bittamleek.

Facilities Transferred to Qard Hassan

CM-6.1.19 **The CBB's approval must be obtained before any transfer of any <u>exposures</u> to Qard Hassan if the amount is more than BD 100,000 or its equivalent in foreign currency (see Paragraph BR-5.2.6).**

CM-6.1.20 **The requirement stated in Paragraph CM-6.1.19 above applies to both on-balance sheet and restricted investment account related <u>exposures</u>.**

Appendix CM-4
CBB Illustrative Criteria for Assessment of Major Investments by Bahraini Islamic Bank Licensees

In assessing any proposed major investments mentioned above, the CBB will take into account the following points:

(a) The amount of the proposed major investment relative to the existing consolidated total capital of the bank;
(b) Existing capital adequacy ratios on a consolidated basis and forecast ratios after the major investment has gone ahead;
(c) The adequacy of information flows from the investee company to the concerned bank;
(d) Experience, and fit and proper matters relating to the senior personnel associated with the proposed major investment;
(e) Risks associated with the proposed major investment;
(f) Disclosure and exchange of (supervisory) information (in the case of a foreign major investment);
(g) Adequacy of host supervision (in the case of a foreign major investment);
(h) Current investments and concentrations in exposures of the concerned bank.
(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;
(j) The extent of holdings by any other shareholders (holding 5 percent or more of the capital of the concerned entity) or controllers of the concerned entity;
(k) Whether the proposed activities are in line with the memorandum and articles of association ('MOA' and 'AOA') of the bank;
(l) The accounting treatment of the proposed major investment;
(m) Whether the major investment relates to a closely-linked party, connected party, or controller in any way;
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 'major investment' is 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 major investment) and how the major investment is to be funded (e.g. by the issuance of new capital or sale of other investments).