

Appendix 1

In this Appendix underlining indicates new text and striking through indicates deleted text.



The DFSA Rulebook

Prudential – Investment, Insurance
Intermediation and
Banking Module

(PIB)

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1.2 Glossary for PIB

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1.2.1 The following terms and abbreviations bear the following meanings for the purpose of this module:

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Large Exposure	An Exposure, whether in an Authorised Firm's Non-Trading Book or Trading Book, or both, to a Counterparty or group of Closely Related Counterparties or a group of Counterparties Connected to the Authorised Firm which in aggregate equal or exceeds 10% of the Authorised Firm's Capital Resources. Has the meaning given in Rule 4.15.4.
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<u>Qualifying CCP</u>	<u>Means a CCP:</u> <u>(a) that is operated by an Authorised Person in accordance with its Licence; or</u> <u>(b) in respect of which all of the following conditions are met:</u> <u>(i) the CCP is authorised and supervised by a Financial Services Regulator in a jurisdiction other than the DIFC;</u> <u>(ii) the Financial Services Regulator has publicly stated that it applies on an ongoing basis rules and regulations that are consistent with the CPSS-IOSCO Principles for Financial Market Infrastructures; and</u> <u>(iii) the CCP satisfies the Basel Committee requirements for calculating its capital requirements for its default fund exposures.</u>

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4.13 Credit Risk mitigation

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General Requirements

4.13.1 (1) An Authorised Firm must not recognise the effects of Credit Risk mitigation unless:

- (a) all documentation relating to that mitigation is binding on all relevant parties and legally enforceable in all relevant jurisdictions; and
 - (b) the Authorised Firm complies with the Rules set out in this section, as applicable.
- (2) Where the calculation of Credit RWA already takes into account the Credit Risk mitigant, the provisions of this section do not apply.
- (3) An Authorised Firm must, where it uses a specific Credit Risk mitigation technique for the purposes of its Capital, use the same technique for Large Exposure reduction, where it is permitted and chooses to use mitigation under the requirements in chapter 4.

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4.15 Concentration Risk

Applicability and limits

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4.15.2 For the purposes of this section an Exposure that arises in the Trading Book is calculated by summing the following:

- (a) the net positive position (long positions net of short positions) for each financial instrument as set out in Rules A4.11.10 to A4.11.28;
- (b) the ~~firm's~~ Authorised Firm's net Underwriting Exposures for any Counterparty; and
- (c) any other Exposures arising from transactions, agreements and contracts that would give rise to Counterparty Credit Risk.

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Large Exposure limits

4.15.4 A Large Exposure of an Authorised Firm means a total Exposure which is ~~greater than~~ equal to or exceeds 10% of the firm's ~~Capital Resources~~ Tier 1 Capital, to any Counterparty, Connected Counterparty, group of Connected Counterparties, or group of Closely Related Counterparties, whether in the Authorised Firm's Trading Book or Non-Trading Book, or both.

4.15.5 (1) Subject to IFR Rule 5.4.15, an Authorised Firm must ensure that Exposures in its Non-Trading Book and, subject to Rule 4.15.6, Trading Book to a Counterparty or to a group of Closely Related Counterparties or to a group of Connected Counterparties, after taking into account the effect of any eligible Credit Risk mitigations, do not exceed 25% of its ~~Capital Resources~~ Tier 1 Capital, except as otherwise provided in (2) or required by the DFSA under (3).

- (2) An Authorised Firm's Exposure must not exceed 15% of its Tier 1 Capital if the Authorised Firm is a G-SIB and the Exposure is to another G-SIB, or a subsidiary of a G-SIB, in or outside the DIFC.
- (3) An Authorised Firm which is a D-SIB must, if required in writing by the DFSA, apply an Exposure limit of between 15% to 25% of its Tier 1 Capital as specified by the DFSA in the requirement, where the Exposure is to another D-SIB, or to a subsidiary of a D-SIB, in or outside the DIFC.

4.15.6 Where an Authorised Firm's Trading Book Exposure to a Counterparty or to a group of Closely Related Counterparties or to a group of Connected Counterparties, on its own or when added to any Non-Trading Book Exposure, is likely to exceed 25% of its ~~Capital Resources~~ Tier 1 Capital, the Authorised Firm must immediately give the DFSA written notice, explaining the nature of its Trading Book Exposure and seeking specific guidance from the DFSA regarding the prudential treatment of any such Exposure.

4.15.7 Subject to IFR Rule 5.4.16 an Authorised Firm must ensure that the sum of its Large Exposures does not exceed 800% of its ~~Capital Resources~~ Tier 1 Capital.

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Exclusions from the Large Exposure limits

- 4.15.8** (1) For the purposes of this section, Exposure excludes:
- (a) claims and other assets required to be deducted for the purposes of calculating an Authorised Firm's ~~Capital Resources~~ Tier 1 Capital;
 - (b) a transaction entered into by an Authorised Firm as depository or as agent that does not create any legal liability on the part of the Authorised Firm;
 - (c) claims resulting from foreign exchange transactions where an Authorised Firm has paid its side of the transaction and the countervalue remains unsettled during the 2 business days following the due payment or due delivery date. After 2 business days the claim becomes an Exposure;
 - (d) claims arising as a result of money transmission, payment services, clearing and settlement, correspondent banking or financial instruments clearing, settlement and custody services to clients, delayed receipts in funding and other Exposures arising from client activity which do not last longer than the following business day;
 - (e) in the case of the services outlined in (d) intra-day Exposures to Financial Institutions who provide these services are excluded;

- (f) claims resulting from the purchase and sale of Securities during settlement where both the Authorised Firm and the Counterparty are up to five business days overdue in settling. The five business days include the due payment or due delivery date. After five business days, the claim becomes an Exposure; and
 - (g) Exposures that are guaranteed by the Authorised Firms Parent in accordance with Rule 4.15.18.
- (2) For the purposes of this section, Exposure to a CCP which carry a 0% CCR in accordance with section 4.8 are excluded.

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Institutional exemption

- 4.15.10** (1) This Rule applies to an Authorised Firm in Category 2 and 3A.
- (2) For Exposures to a Financial Institution, or a group of Connected Counterparties one of which is a Financial Institution, the total amount of an Authorised Firm's Exposures may exceed 25% of its ~~Capital Resources~~ Tier 1 Capital, provided those institutions are Investment Grade (Credit Quality Grades 1 to 3) and subject to the following:
- (a) Exposures to any entities within the group of Connected Counterparties that are not Financial Institutions are limited to 25% of ~~Capital Resources~~ Tier 1 Capital after taking account of Credit Risk mitigation;
 - (b) the Exposures must not form part of the ~~Capital Resources~~ Tier 1 Capital of the Counterparty;
 - (c) the Counterparty Risk profile must be subject to review on at least an annual basis; and
 - (d) Exposures of this nature must not in any case exceed a maximum of US\$ 100 million or 100% of ~~Capital Resources~~ Tier 1 Capital, whichever is the lower.

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Recognition of Credit Risk mitigations

- 4.15.12** (1) For the purposes of this section, an Authorised Firm may reduce the value of its Exposures, at its discretion, by any one or more of the following:
- (a) the amount of any specific provision made, where the provision relates to the risk of a credit loss occurring on that Exposure and is not held as part of a general provision or reserve against its Credit Risks;

- (b) Netting its claims on and liabilities to a Counterparty, provided that the conditions in section 4.13 of Credit Risk mitigation are met;
 - (c) the amount of Collateral held against its Exposures, where that Collateral is of a type listed based on the FCSA and FCCA approaches and meeting the requirements under section 4.13, provided that supervisory haircuts are used for valuing that Collateral under the FCCA;
 - (d) the amount of any eligible guarantees as permitted under section 4.13.9;
 - (e) the value of a Credit Derivative, where the Credit Derivative is an instrument included in Rule 4.13.11 and the transaction meets the conditions set out in that section; and
 - (f) the effects of transactions transferring Credit Risks from the Authorised Firm to another party through securitisation, provided that the conditions in section 4.14 are met.
- (2) Where Credit Risk mitigation is used against an Exposure, an Authorised Firm must reduce the value of the original Exposure and recognise an equal Exposure to the Credit Risk mitigation provider, except where:
- (a) a credit default swap is used; and
 - (b) neither the reference entity, nor the credit default swap provider, is a Financial Institution,
- (3) For the purposes of Exposure shifting under (2), the amount subject to shifting is:
- (a) the value of the protected portion for an unfunded credit protection;
 - (b) where the FCSA is used, the market value of the collateral; and
 - (c) where the FCCA is used, the market value of the collateral adjusted by applying the standard supervisory haircuts to the FCCA.

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4.15.14 Where an Authorised Firm has availed itself of the reductions to Exposure values as set out in A4.11 the Authorised Firm must calculate the Exposure as a percentage of its ~~Capital Resources~~ Tier 1 Capital on both a gross and net basis.

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Treatment of Parental Guarantees

4.15.18 ~~An Authorised Firm may exclude an Exposure from the Concentration Risk limits set out in Rules 4.15.5 to 4.15.7 if the Authorised Firm's Parent;~~

- ~~(a) is set to increase, on the basis of a legally binding agreement, the Authorised Firm's Capital Resources, promptly and on demand, by:~~
- ~~(i) an amount that is sufficient to reverse completely the effect of any loss the Authorised Firm may sustain in connection with that Exposure; or~~
 - ~~(ii) the amount required to ensure that the Authorised Firm complies with its Capital Requirement set out in chapter 3; or~~
- ~~(b) guarantees the Exposure to a Counterparty or to a group of Closely Related Counterparties which are not Connected to the Authorised Firm only if the following conditions are met:~~
- ~~(i) the guarantee is to be provided by the Authorised Firm's Parent, or regulated member of its Group;~~
 - ~~(ii) the criteria for guarantees must be in line with the Credit Risk mitigation requirements as set out in section 4.13;~~
 - ~~(iii) the entity providing the guarantee must be a bank regulated to standards acceptable to the DFSA;~~
 - ~~(iv) the total amount of guarantees provided to the Authorised Firm must be less than 10% of the Parent (or other) Authorised Firm's Capital Resources;~~
 - ~~(v) the Parent must be rated as a Credit Quality Grade of 1 or 2 by a recognised credit rating agency;~~
 - ~~(vi) the Authorised Firm must provide confirmation from the home state Financial Services Regulator that it is satisfied that the Parent Authorised Firm has sufficient resources to provide such guarantees and has no objection to the provision of such guarantees;~~
 - ~~(vii) the Authorised Firm should provide an annual confirmation that there are no changes to the enforceability of such guarantees; and~~
 - ~~(viii) the Authorised Firm must notify the DFSA when such guarantees represent 200%, 400% and 600% of Capital Resources. The overall Large Exposure limit of 800% will apply.~~

Treatment of Parental Guarantees

4.15.18 An Authorised Firm may exclude an Exposure from the Concentration Risk limits set out in Rules 4.15.5 to 4.15.7 where:

- (a) the Authorised Firm's Parent guarantees that Exposure to a Counterparty or to a group of Closely Related Counterparties; and

- (b) the following conditions are met:
- (i) the Counterparty or group of Closely Related Counterparties are not Connected to the Authorised Firm;
 - (ii) the guarantee is to be provided by the Authorised Firm's Parent, or regulated member of its Group;
 - (iii) the criteria for guarantees must be in line with the Credit Risk mitigation requirements as set out in section 4.13;
 - (iv) the entity providing the guarantee must be a bank regulated to standards acceptable to the DFSA;
 - (v) the total amount of guarantees provided to the Authorised Firm must be less than 10% of the Parent (or other) Authorised Firm's Tier 1 Capital;
 - (vi) the Parent must be rated as a Credit Quality Grade of 1 or 2 by a recognised credit rating agency;
 - (vii) the Authorised Firm must provide confirmation from the home state Financial Services Regulator that it is satisfied that the Parent Authorised Firm has sufficient resources to provide such guarantees and has no objection to the provision of such guarantees;
 - (viii) the Authorised Firm should provide an annual confirmation that there are no changes to the enforceability of such guarantees; and
 - (ix) the Authorised Firm must notify the DFSA when such guarantees represent 200%, 400% and 600% of Tier 1 Capital and the overall Large Exposure limit must not exceed 800%.

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A4.9 Exposures to Central Counterparties (CCPs)

A4.9.1 An Authorised Firm may determine the Exposure value of a Credit Risk Exposure outstanding with a CCP in accordance with A4.9.2, provided that the CCP's Counterparty Credit Risk Exposure with all participants in its arrangements are fully collateralised on a daily basis and the CCP is a qualifying CCP.

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A4.9.8 (1) An Authorised Firm shall determine the Exposure value for clearing Exposures to non-qualifying CCPs as the amount in the table below:

<u>Type of Clearing Exposure</u>	<u>Exposure Amount</u>
<u>Segregated initial margin</u>	<u>Nil</u>
<u>Non-segregated initial margin</u>	<u>Nominal amount of initial margin posted</u>
<u>Pre-funded default fund contributions</u>	<u>Nominal amount of the funded contribution</u>
<u>Unfunded default fund contributions</u>	<u>Nil</u>
<u>Equity stakes</u>	<u>Nominal amount</u>

(2) For the purposes of (1), a “non-qualifying CCP” is a CCP that does not meet the criteria set out in the definition of a Qualifying CCP in Rule 1.2.1.

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A4.11 Concentration Risk

Exempt Exposures

A4.11.1 (1) An Authorised Firm may treat the following Exposures as exempt from the Concentration Risk limits in chapter 4 if they are to Counterparties not Connected to the Authorised Firm:

- (a) asset items or Exposures constituting claims on central governments, ~~and~~ Central Banks and Public Sector Entities (PSEs) which receive a Credit Quality Grade rating 1 or 2 in accordance with Rule 4.12.4;
- (b) asset items or Exposures constituting claims on international organisations and multi-lateral development banks (MDBs) which receive a 0% (Credit Quality Grade rating of 1) risk weight as set out at Rule 4.12.7;
- (c) asset items or Exposures carrying the explicit guarantees of either (a) or (b) where the claims on the entity providing the guarantee would receive a 0% weighting (Credit Quality Grade rating of 1);
- (d) Exposures for which the Authorised Firm has Collateral in the form of cash deposits or certificates of deposit, including certificates of deposit issued by the Authorised Firm, held by the Authorised Firm, or held by the Authorised Firm's Parent Regulated Financial Institution or a Subsidiary of the Authorised Firm, but only if:

- (i) the Authorised Firm and its Parent Regulated Financial Institution or the Subsidiary of the Authorised Firm concerned are subject to consolidated supervision; ~~and~~
 - (ii) the enforceability requirements in section 4.13 (Credit Risk mitigation) are met; and
 - ~~(e) Exposures arising from undrawn credit facilities that are classified as low risk off balance sheet items and provided that an agreement has been concluded with the client or group of Connected clients under which the facility can only be drawn only if it has been ascertained that it will not cause the limit as set out in Rule 4.15.5 to be exceeded;~~
 - ~~(f) Exposures secured by mortgages on residential property and leasing transactions under which the lessor retains full ownership of the residential property leased for as long as the lessee has not exercised his option to purchase, in all cases up to 50% of the value of the residential property concerned; and~~
 - ~~(g)(iii)~~ material holdings in Regulated Financial Institutions and other Exposures which have been deducted from an Authorised Firm's Capital Resources Tier 1 Capital as required in chapter 3.
- (2) If an Authorised Firm obtains credit protection relating to an exempt Exposure under (1)(a), the Authorised Firm must nevertheless apply the Large Exposure limits to the Exposure to the credit protection provider, notwithstanding that the original Exposure is exempt.
- (3) An Authorised Firm must report Exposures which are exempt under (1)(a), (b) and (c) to the DFSA.

Guidance:

1. In order to be applicable under (c) the guarantees must meet the requirements of section 4.13.9 in relation to Credit Risk mitigation.
2. An Authorised Firm can only treat Exposures as Collateralised provided the conditions of Rules 4.13.5 to 4.13.8 (relating to Credit Risk mitigation) are met. Item (d) also includes cash received under a credit linked note issued by the Authorised Firm and loans and deposits of a Counterparty to or with the Authorised Firm which are subject to an on balance sheet Netting agreement recognised under section 4.13 (Credit Risk mitigation).
3. The DFSA may consider a waiver for other sovereign Exposures where there is a local regulatory requirement to hold assets with a national regulatory authority. Authorised Firms will be required to apply for a waiver of the Large Exposure requirements in this regard and will be considered by the DFSA on a case by case basis.
4. The DFSA may, where it considers it appropriate, allow two or more Exposures to a sovereign not to be treated as connected or related if the sole reason for linking them is being controlled or economically dependent on the sovereign (including eligible PSEs). An eligible PSE is a PSE referred to in Rule A4.11.1(a).

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Identification of Counterparties

A4.11.4 When calculating the Exposures of an Authorised Firm, the firm Authorised Firm must include Trading Book Exposures and Non-Trading Book Exposures to:

- (a) ~~a single~~ an individual Counterparty;
- (b) group of Closely Related Counterparties;
- (c) Connected Counterparties; and,
- (d) Transactions, schemes or Funds.

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Group of Closely Related Counterparties

A4.11.5 (1) For Concentration Risk purposes, Persons are Closely Related if:

- (a) the insolvency or default of one of them is likely to be associated with the insolvency or default of the others;
- (b) it would be prudent when assessing the financial condition or creditworthiness of one to consider that of the others; ~~or~~
- (c) there is, or is likely to be, a close relationship between the financial performance of those Persons-; or
- (d) they are assessed to be economically interdependent.

(2) Persons are to be assessed as being economically interdependent for the purposes of (1)(d) where one or more of the following factors are present:

- (a) 50% or more of the annual receipts or expenditures of one is derived from transactions with the other;
- (b) a guarantee issued by one in favour of the other party is likely to result in the provider default if called;
- (c) significant output is sold to the other party and an alternative buyer is not easily found;
- (d) single source of funds to repay loans for both parties with no alternative; or
- (e) common reliance on the same funding provider that is hard to replace.

- (3) An Authorised Firm need not assess economic interdependence under (2) for a transaction where the sum of all Exposures to one individual counterparty is less than 5% of the Authorised Firm's T1 Capital.
- ~~(2)(4)~~ Persons who are Closely Related to each other are also Connected with each other.
- (5) The requirement to aggregate Exposures where Persons are Closely Related does not apply where an Authorised Firm can demonstrate to the DFSA that it is unlikely that Persons who are Closely Related will default at the same time and the DFSA has, by notice in writing, disappplied the requirement.

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Connected Counterparties

- A4.11.7** (1) For Concentration Risk purposes, and in relation to a Person, a Connected Counterparty means another Person to whom the first Person has an Exposure and who fulfils one of the following conditions:
- (a) he is Connected to the first Person;
 - (b) he is an Associate of the first Person;
 - (c) the same Persons significantly influence the Governing Body or senior management of each of them; ~~or~~
 - (d) one of those Persons has an Exposure to the other that was not incurred for the clear commercial advantage of both of them and which is not on arm's length terms; or
 - (e) one of those Persons:
 - (i) has influence over the appointment or dismissal of the Board or senior management of the other party;
 - (ii) is entitled to exercise, or controls the exercise of 50% or more of the voting rights in the other party including through voting agreements; or
 - (iii) has effective control over the other party under the criteria adopted by the International Financial Reporting Standards.
- (2) A Person is not to be treated as a Connected Counterparty under (1), where an Authorised Firm can satisfy the DFSA that effective governance and controls are in place to mitigate risks resulting from effective control of one Person by the other and the DFSA has, by notice in writing, specified that they are not to be so treated.

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Exposures to transactions, schemes or Funds

- A4.11.8** (1) Where an Authorised Firm has an Exposure to a transaction, scheme, Fund, or other Exposure to a pool of underlying Exposures, the Authorised Firm must assess the Exposure to determine whether the Exposure is to a group of Closely Related Counterparties in its economic substance.
- (2) Where the Exposure is to a group and the Authorised Firm can demonstrate that the Exposure amount to each underlying asset of the structure is less than 0.25% of its Tier 1 Capital, the Authorised Firm may assign the Exposure amount to the structure itself.
- (3) An Authorised Firm need not look through a structure for the purposes of (2) if the Authorised Firm can demonstrate that its Exposure to each asset in the structure is less than 0.25% of its Tier 1 Capital.
- (4) Where the Exposure is to a group and the Authorised Firm can demonstrate that the Exposure amount to each underlying asset of the structure is equal to or exceeds 0.25% of its Tier 1 Capital, the Authorised Firm must look through the structure and identify each underlying asset and add that Exposure to the other Exposures of the same counterparty.
- (5) If an Authorised Firm looks through the structure to identify underlying assets and one or more underlying assets cannot be identified, the Authorised Firm must aggregate and assign that Exposure to a single "unknown customer" to which the Large Exposure limits apply.
- (6) If the Exposure to the underlying assets in a structure depends on the hierarchy of loss distribution to investors in the event of the winding up of the structure, an Authorised Firm must treat its Exposure to the structure:
- (a) as the pro rata share of the firm's Exposure multiplied by the value of the underlying asset, where all investors rank equally; or
- (b) as the pro rata share of the firm's investment in the structure multiplied by the lower of the tranche value or the nominal value of the underlying assets in the structure, where the seniority differs.
- (7) An Authorised Firm must aggregate its Exposures to any additional risks inherent in the structure itself, if that would result in Exposures to the same third party.

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Connected Counterparty exemptions

A4.11.9 (1) This Rule applies to an Authorised Firm in Category 2 and 3A.

(2) An Authorised Firm may treat as exempt from the Concentration Risk limits in chapter 4 an Exposure to a Counterparty or Counterparties Connected to the Authorised Firm if all of the following conditions are met:

- (a) the Authorised Firm has given the DFSA written notice one month in advance of its intention to use the exemption and explained how it will ensure that it will still meet the Concentration Risk limits on a continuing basis when using the exemption;
- (b) the total amount of the Exposures that an Authorised Firm is treating as exempt under this Rule does not exceed 50% of the Authorised Firm's ~~Capital Resources~~ Tier 1 Capital;
- (c) the Authorised Firm makes and retains a record that identifies each Exposure it has treated in this way;
- (d) the Authorised Firm is subject to consolidated supervision;
- (e) the Counterparty is:
 - (i) an Authorised Firm which is the subject of consolidated supervision; or
 - (ii) a member of the Authorised Firm's Group which is the subject of consolidated supervision to the satisfaction of the DFSA; and
- (f) the Exposure satisfies one or more of conditions (i) to (iii):
 - (i) it is a loan made by the Authorised Firm with a maturity of one year or less in the course of the Authorised Firm carrying on a treasury role for other members of its Group;
 - (ii) it is a loan to the Parent of the Authorised Firm made in the course of a business carried on by the Authorised Firm of lending to its parent cash that is surplus to the needs of the Authorised Firm, provided that the amount of that surplus fluctuates regularly; or
 - (iii) it arises from the Authorised Firm or a Counterparty Connected to the Authorised Firm operating a central risk management function for Exposures arising from Derivatives contracts.

Measuring Exposure to Counterparties and Issuers

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- A4.11.14** (1) Subject to (2), the value of an Authorised Firm's Exposure to a Counterparty, whether in its Non-Trading Book or its Trading Book, is the amount at risk calculated in accordance with chapter 4.
- (2) For the purposes of calculating the value of an Authorised Firm's Exposure to a Counterparty under (1), the CCF factors taken into account under A4.2 are subject to a minimum floor of 10%.

Exposures to Issuers

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- A4.11.17** An Authorised Firm must calculate the value of an Exposure to the Issuer of a Security or a credit derivative used as a hedge that is held in the Authorised Firm's Trading Book by calculating the excess of the current market value of all long positions over all short positions in all the Securities or credit derivatives issued by that Issuer, based on the seniority of those Securities or credit derivatives in the liquidation of the Issuer.

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- A4.11.22** When determining its Exposure to an Issuer arising from an Option, an Authorised Firm must value the notional principal of an Option as the amount of principal underlying the Option. An Authorised Firm must, when determining its Exposure to an Issuer arising from an Option, use an Exposure value based on the level of change in the price that will result from the default of the underlying instrument.

- A4.11.23** An Authorised Firm must treat:

- (a) ~~a written put Option as a long position in the underlying instrument valued at the strike price;~~
 - (b) ~~a written call Option as a short position in the underlying instrument valued at the strike price;~~
 - (c) ~~a purchased put Option as a short position in the underlying instrument valued at the strike price; and~~
 - (d) ~~a purchased call Option as a long position in the underlying instrument equal to the book value of the Option.~~
- (1) An Authorised Firm must treat the value of:
- (a) a call Option as equal to market value; and
 - (b) a put Option as equal to the strike price minus market value.

- (2) An Authorised Firm must aggregate the resulting option Exposures to each underlying counterparty and if there is a negative net Exposure after aggregation of all option Exposures, the option Exposure must be set to nil.