Appendix 4

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

The DFSA Rulebook

Prudential – Investment, Insurance Intermediation and Banking Module

(PIB)

7.4 Systems and controls for Non-Trading Book interest rate risk

Non-Trading Book interest rate risk policy

7.4.1 (1) An Authorised Firm must implement and maintain a policy which enables it to identify, assess, control and monitor its Non-Trading Book interest rate risk.

(2) The policy must be documented and include an appropriate interest rate risk strategy as well as an enterprise-wide interest rate risk management framework appropriate to the nature, scale and complexity of its Non-Trading Book activities. The strategy and management framework must:

(a) enable the Governing Body and senior management of the Authorised Firm to have an enterprise-wide view of interest rate risk as it applies to non-trading activities;

(b) include a system for identifying and assessing Non-Trading Book interest rate risk and its sources;

(c) include a process for the measurement and monitoring of Non-Trading Book interest rate risk, using robust and consistent methods which enable the Authorised Firm to implement the requirements set out in Rules 7.2.1 to 7.2.6; and

(d) include a system for controlling and managing Non-Trading Book interest rate risk which enables it to comply with the overall risk management standards expected of an Authorised Firm and ensure continued compliance with the Rules in PIB.

(3) An Authorised Firm must identify the Non-Trading Book interest rate risk impact of any new product, activity or service that it proposes to start and ensure that such impacts are duly addressed with adequate controls before the new product or activity is undertaken or introduced.

(4) An Authorised Firm must:

(a) ensure that its risk management systems enable it to implement the Non-Trading Book interest rate risk policy;

(b) identify, assess, mitigate, control and monitor the risk; and

(c) review and update the policy at intervals that are appropriate to the nature, scale and complexity of its activities.

Guidance

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4. Authorised Firms should measure their vulnerability to loss in stressed market conditions, including the breakdown of key assumptions, and consider those results when establishing and reviewing their policies and limits for interest rate risk. Possible stress scenarios for this exercise should include:

   a. historical scenarios such as the Asian Crisis in the late 1990s;

   b. changes in the general level of interest rates, e.g. changes in yields of 200 basis points or more in one year;

   c. changes in the relationships between key market rates (i.e. basis risk), e.g.

      i. a surge in term and savings deposit rates and benchmark rates ~~like LIBOR~~ but no change in the prime rate, and

      ii. a drop in the prime rate but no change in term and savings deposit rates and benchmark rates ~~like LIBOR~~;

   d. changes in interest rates in individual time bands to different relative levels (i.e. yield curve risk);

   e. changes in the liquidity of key financial markets or changes in the volatility of market rates; and

   f. changes in key business assumptions and parameters such as the correlation between two currencies. In particular, changes in assumptions used for illiquid instruments and instruments with uncertain contractual maturities help understanding of an Authorised Firm's risk profile.

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Responsibilities of Governing Body

7.4.3 (1) An Authorised Firm must ensure that its Governing Body is responsible for monitoring the nature and level of Non-Trading Book interest rate risk assumed by the Authorised Firm and the process used to manage that risk.

(2) Without limiting the operation of (1), the responsibilities of an Authorised Firm's Governing Body in respect of the risk include:

(a) approving the Authorised Firm's Non-Trading Book interest rate risk policy, including its strategy and management framework;

(b) establishing and maintaining a senior management structure for the management of the risk and for ensuring compliance with the Authorised Firm's risk strategy;

(c) monitoring the Authorised Firm's overall Non-Trading Book interest rate risk profile on a regular basis and being aware of any material changes in the Authorised Firm's current or prospective profile; and

(d) ensuring that Non-Trading Book interest rate risk is adequately identified, assessed, mitigated, controlled and monitored.

Guidance

1. The Governing Body of the Authorised Firm may delegate responsibility for establishing Non-Trading Book interest rate risk policies and strategies to the Asset and Liability Committee (ALCO) or an equivalent committee, which is the designated senior management committee for managing balance sheet structure and interest rate risk associated with it.

2. An Authorised Firm involved in banking activities or complex principal dealing activities should have a designated committee for design and implementation of Non-Trading Book interest rate risk management.

3. An Authorised Firm should establish and enforce operating limits and other practices that maintain Exposures within levels consistent with their internal policies and that accord with their approach to measuring the risk. In particular, Authorised Firms should set a limit on the extent to which floating rate Exposures are funded by fixed rate sources and vice versa to limit the risk. In floating rate lending, Authorised Firms should limit the extent to which they run any basis risk that may arise if lending and funding are not based on precisely the same market interest rate ~~(e.g. LIBOR)~~.