

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)

1.1 Application

- 1.1.1 (1) This module (PIB) applies to every Authorised Firm other than an Insurer.
- (2) The Rules in this module apply to an Authorised Firm in accordance with its Category determined under section 1.3.

Guidance

1. The effect of PIB Rule 1.1.1 is that these Rules apply to all Authorised Firms, except those carrying on Insurance Business, that is, Insurers. Those Authorised Firms that are authorised to effect or carry out Contracts of Insurance should refer to the PIN module. These Rules apply both to Domestic Firms and Authorised Firms conducting Financial Services through a branch in the DIFC. The DFSA may modify or waive the operation of certain Rules or specified parts of such Rules in appropriate circumstances. The DFSA is more likely to consider such modifications or waivers in the case of those Authorised Firms operating in the DIFC through a branch. It is unlikely, however, the DFSA will waive or modify the system and control requirements.
2. The DFSA's Rules reinforce the fitness and proprietary requirements, GEN chapter 5 — Management Systems and Principle 4 for Authorised Firms. The PIB module is set out in:
 - a. two general chapters setting overall requirements: General Requirements and Capital; and
 - b. six chapters setting specific requirements relating to the following particular risks or issues: Islamic Financial Business (including Displaced Commercial Risk), Credit Risk, Market Risk, Liquidity Risk, Group Risk and Operational Risk.
3. An Authorised Firm which is a Domestic Firm in Category 1, 2, 3 or 5 should be familiar with its obligations under chapter 6 of SUP to establish and conduct an Internal Risk Assessment Process (IRAP) and, where applicable, an Internal Capital Adequacy Assessment Process (ICAAP), and to provide documented assessments to the DFSA.
- ~~3.~~ 4. The application of each section of this module as it applies to each Category of Authorised Firm is set out in Table 4 of this chapter.

1.2 Financial resources

1.2.1 An Authorised Firm must:

- (a) have and maintain at all times financial resources of the kinds and amounts specified in, and calculated in accordance with, the Rules in this module; and
 - (b) ensure that it maintains financial resources in addition to the requirement in (a) which are adequate in relation to the nature, size and complexity of its business to ensure that there is no significant risk that liabilities cannot be met as they fall due.
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Guidance

1. For the purposes of Rule 1.2.1, the Authorised Firm's Governing Body should assess whether the minimum financial resources which are required by the DFSA as set out in PIB are adequate in relation to the Authorised Firm's specific business. Additional financial resources should be maintained by the Authorised Firm where its Governing Body has considered that the required minimum financial resources do not adequately reflect the nature and risks of the Authorised Firm's business.
2. The liabilities referred to in Rule 1.2.1 (b) include an Authorised Firm's contingent and prospective liabilities, such as liabilities arising from a change in business strategy or claims made against the Authorised Firm, but not liabilities that might arise from prospective transactions which the Authorised Firm could avoid, for example, by ceasing its operations.

2 CAPITAL

2.1 Application

- 2.1.1** (1) This chapter applies to every Authorised Firm in accordance with (2), (3) and (4) and (5).
- (2) Sections 2.2–2.8 apply to an Authorised Firm in Category 1, 2, 3, 4 or 5.
- (3) Section 2.9 also applies to an Authorised Firm which undertakes Islamic Financial Business.
- (4) Section 2.10 also applies to an Authorised Firm in Category 1, 2, 3 or 4.
- (5) Section 2.11 also applies to an Authorised Firm which is a Domestic Firm in Category 1,2, 3, or 5.

2.2 Basic requirements

- 2.2.1** An Authorised Firm must have at all times Capital Resources of at least the amount of its Capital Requirement.

Guidance

~~If the DFSA considers that a higher capital requirement may be appropriate for a particular Authorised Firm, the DFSA may impose higher requirements by the imposition of a condition on the relevant firm's licence.~~

2.3 Initial and ongoing capital requirements

2.3.1 An Authorised Firm's Capital Requirement is the highest of:

- (a) the applicable Base Capital Requirement as set out in section 2.4;
- (b) in respect of an Authorised Firm in Category 2, 3 and 4, the Expenditure Based Capital Minimum as set out in section 2.5;
- (c) 125% of the sum of the Credit Risk Capital Requirement, the Market Risk Capital Requirement and, for Authorised Firms engaging in Islamic Financial Business that Manage Profit Sharing Investment Accounts, the Displaced Commercial Risk Capital Requirement; or
- (d) the ICR imposed on the Authorised Firm under Rule 2.11.1.

Guidance

- 1. An Authorised Firm should refer to chapters 4 and 5 to determine whether it is required to calculate a Credit Risk Capital Requirement and a Market Risk Capital Requirement respectively.
- 2. The Market Risk Capital Requirement will generally not be applicable to Authorised Firms in Category 4, while the Displaced Commercial Risk Capital Requirement will only apply to Authorised Firms undertaking Islamic Business, Managing a Profit Sharing Investment Account.

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2.11 Imposition of an ICR

- 2.11.1** (1) The DFSA may at any time by written notice impose on an Authorised Firm in (2) an Individual Capital Requirement (ICR) in circumstances where the DFSA has formed the view that the firm's Capital Requirement is insufficient to address adequately all the risks.
- (2) For the purposes of (1), a Domestic Firm in Category 1, 2, 3 or 5 may be the subject of an ICR.
- (3) An Authorised Firm has a right to appeal to the Regulatory Appeals Committee in regard to any decision by the DFSA to impose an ICR on the firm.

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7 GROUP RISK

7.1 Application

- 7.1.1** (1) This chapter applies to an Authorised Firm in Category 1, 2, 3 or 5 which is a member of a Financial Group.
- (2) Section 7.2 applies to an Authorised Firm in Category 1, 2, 3, or 5 which is a member of a Group.
- (3) Section 7.5 applies to an Authorised Firm in Category 1, 2, 3 or 5 which is a Domestic Firm and a member of a Financial Group.

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7.3 Financial group capital requirements and financial group capital resources

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7.3.2 An Authorised Firm must ensure at all times that its Financial Group Capital Resources, as calculated in Rule 7.3.4, are equal to or in excess of:

- (a) its Financial Group Capital Requirement as calculated in Rule 7.3.3; or
(b) a Financial Group ICR imposed by the DFSA,

whichever is the higher.

Guidance

If an Authorised Firm breaches Rule 7.3.2, the DFSA will take into account the full circumstances of the case including any remedial steps taken by another regulator or the Authorised Firm, in determining what enforcement action, if any, it will take.

7.5 Imposition of a financial group ICR by the DFSA

- 7.5.1** (1) The DFSA may at any time by written notice impose on an Authorised Firm in (2) a Financial Group Individual Capital Requirement (Financial Group ICR) in circumstances where the DFSA has formed the view that the firm's Financial Group Capital Requirement is insufficient to address adequately all the risks.
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- (2) For the purposes of (1), a Domestic Firm in Category 1, 2, 3, or 5 which is a member of a Financial Group, may be the subject of a Financial Group ICR.
- (3) An Authorised Firm has a right to appeal to the Regulatory Appeals Committee in regard to any decision by the DFSA to impose a Financial Group ICR on the firm.

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9 DISCLOSURE REQUIREMENTS

9.1 Application

9.1.1 The disclosure requirements set out in this chapter apply to an Authorised Firm which is a Domestic Firm in Category 1 or 5.

9.1.2 (1) Where an Authorised Firm is a member of a Financial Group it must, subject to (2), ensure that the disclosures specified in App8 are made at Financial Group level.

(2) An Authorised Firm which is a subsidiary of

(a) a Regulated Financial Institution; or

(b) a Holding Company;

which is already subject to equivalent disclosure requirements, does not need to comply with these requirements.

9.2 Disclosure policy

9.2.1 An Authorised Firm must establish and maintain a formal disclosure policy that:

(a) sets out the firm's approach for determining which of the disclosures set out in App8 it will make;

(b) details the processes and procedures and its internal controls in relation to such disclosure; and

(c) is approved by the Governing Body of the firm.

9.2.2 An Authorised Firm must ensure that appropriate verification, whether internal or external, is performed in relation to any disclosure, and take all reasonable steps to ensure their accuracy and correctness.

9.2.3 To the extent that any required disclosure is substantially similar to a disclosure required of the Authorised Firm under applicable accounting standards, a disclosure under such standards shall be taken to meet the requirement for disclosure under this chapter.

9.2.4 The disclosures set out in this chapter must be made by the Authorised Firm as at the end of its financial year.

9.2.5 An Authorised Firm must make these disclosures either in its annual financial statements or another appropriate medium, provided that the annual financial statements contain clear references to the location of such disclosures.

Guidance

An Authorised Firm has discretion to determine the form of the disclosures required, and may choose to use graphical and other representations where appropriate.

Omissions

- 9.2.6** (1) An Authorised Firm may omit certain disclosures if:
- (a) the omitted item is not material, in accordance with the concept of materiality under the applicable accounting standards,
 - (b) the omitted item is proprietary in nature, and the disclosure of the relevant information to the public would undermine the Firm's competitive position or render the Firm's investments in products and systems less valuable, or
 - (c) the omitted item is confidential in nature, and the disclosure of the relevant information would violate or jeopardise confidentiality agreements with Clients or counterparties.
- (2) Where in reliance upon (1)(b) or (c) an Authorised Firm omits an item that is marked as a quantitative disclosure in App8, it must disclose general qualitative information about the subject matter of that particular requirement, together with the reasons for the omission.

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APP8 DISCLOSURES

A8.1 Disclosure Requirements

A8.1.1 Pursuant to the Rules in chapter 9, an Authorised Firm is required, where relevant, to make disclosures relating to its business, capital and risk exposures.

A8.2. General disclosure

General qualitative disclosures

A8.2.1 An Authorised Firm must describe its risk management objectives and policies, including:

- (a) strategies and processes;
- (b) the structure and organisation of the relevant risk management function;
- (c) the scope and nature of risk reporting and measurement systems; and
- (d) policies for hedging and mitigating risk and strategies and processes for monitoring the continuing effectiveness of hedges/mitigants,

in respect of each separate risk area, including but not limited to its credit, counterparty, banking book interest rate, securitisation, equity, operational, Islamic Financial Business and market risk.

Guidance

1. The DFSA encourages Authorised Firms to provide robust and informative disclosures to the market.
2. Rule A8.2.1 creates a general obligation to make qualitative risk disclosures in relation to separate risk areas. The following Rules in this App8 specify minimum qualitative and quantitative disclosures for certain risk elements.

Financial Group Disclosure

- A8.2.2** (1) An Authorised Firm must make Financial Group disclosures in both qualitative and quantitative form.
- (2) The qualitative disclosures that the Authorised Firm makes must include the following information:
- (a) the name of the Parent of the Financial Group to which chapter 9 applies;
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- (b) an outline of the method of consolidation and differences in the basis of consolidation for accounting and regulatory purposes, if any, with a brief description of the entities within the Financial Group including the entities that:

 - (i) have been excluded from the consolidation in accordance with PIB Rule 7.1.2 (2);
 - (ii) are given a deduction treatment; and
 - (iii) are neither consolidated nor deducted including where the investment is risk-weighted; and
 - (c) any restrictions, or other major impediments, on transfer of funds or regulatory capital within the Financial Group.
- (3) The quantitative disclosures that the Authorised Firm makes must include the following information:
- (a) the aggregate amount of surplus capital of insurance subsidiaries, whether deducted or subjected to an alternative method included in the capital of the Financial Group; and
 - (b) the aggregate amounts, including current book value, of the Authorised Firm's total interests in insurance entities which are risk-weighted rather than deducted from capital or subjected to an alternative group-wide method, as well as their name, their country of incorporation or residence, the proportion of ownership interest and, if different, the proportion of voting power in these entities. In addition, an Authorised Firm must indicate the quantitative impact on its Financial Group Capital Resources, using this method versus using the deduction or alternative group-wide method.

A8.3 Capital disclosure

Capital structure

- A8.3.1** (1) An Authorised Firm must make the following qualitative disclosures in relation to its capital structure:
- (a) summary information on the terms and conditions of the main features of all capital instruments, especially in the case of innovative, complex or hybrid capital instruments;
 - (b) the amount of Tier One Capital with separate disclosure of:

 - (i) paid-up share capital/common stock;
 - (ii) reserves;
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A8.4 **Risk disclosure**

A8.4.1 An Authorised Firm must make both qualitative and quantitative disclosures in relation to its risk exposures and provide an assessment of such risk exposures.

Credit risk

A8.4.2 (1) An Authorised Firm must make the following qualitative disclosures in relation to its credit risk:

- (a) definitions of past due and impaired, as defined for accounting purposes;
 - (b) description of approaches followed for specific and general provisions and statistical methods for determination of the same;
 - (c) discussion of the Authorised Firm's credit risk management policy;
 - (d) total gross credit risk exposures, plus average gross exposure over the period broken down by major types of credit exposure;
 - (e) geographic distribution of exposures, broken down in significant areas by major types of credit exposure;
 - (f) industry or counterparty type distribution of exposures, broken down by major types of credit exposure; and
 - (g) residual contractual maturity breakdown of the whole portfolio, broken down by major types of credit exposure;
 - (h) description of risks based on major industry or counterparty type, including the following:
 - (i) amount of impaired loans and if available, past due loans, provided separately;
 - (ii) specific and general provisions;
 - (iii) charges for specific provisions and charge-offs during the period;
 - (iv) amount of impaired loans and, if available, past due loans provided separately broken down by significant geographic areas including, if practical, the amounts of specific and general provisions related to each geographical area; and
 - (v) reconciliation of changes in the provisions for loan impairment.
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- (2) The quantitative disclosures that an Authorised Firm is required to make in relation to its credit risk must include information on the net exposures in each risk weight category and exposures that are deducted from capital.

Credit risk mitigation

A8.4.3 An Authorised Firm must, at a minimum, make the following qualitative disclosures in relation to its credit risk mitigation:

- (a) policies and processes for, and an indication of the extent to which the Authorised Firm makes use of, on and off-balance sheet netting;
- (b) policies and processes for collateral valuation and management;
- (c) a description of the main types of collateral taken by the Authorised Firm;
- (d) the main types of guarantor or credit derivative counterparties and their creditworthiness; and
- (e) information about market or credit risk concentrations within the mitigation taken.

General disclosure for counterparty credit risk

A8.4.4 (1) An Authorised Firm must, at a minimum, make the following general qualitative disclosures with respect to derivatives and counterparty credit risk:

- (a) discussion of methodology used to assign capital and credit limits for counterparty credit exposures;
 - (b) discussion of policies for securing collateral; and
 - (c) gross positive fair value of contracts, netting benefits, netted current credit exposure, collateral held, and net derivatives credit exposure.
- (2) An Authorised Firm must, in relation to credit derivative transactions that create exposures to counterparty credit risk (notional value), provide information that:
- (a) differentiates between use for the institution's own credit portfolio, as well as in its intermediation activities; and
 - (b) includes details of the distribution of the credit derivatives products used, broken down further by protection bought and sold within each product group.
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Market Risk

- A8.4.5** (1) The Market Risk disclosures made by an Authorised Firm will depend upon the type of internal model used by the Authorised Firm.

Disclosures for Authorised Firms not using internal models

- (2) Where an Authorised Firm is not using internal models, it must make the general qualitative disclosures for Market Risk.
- (3) In relation to the quantitative disclosures that an Authorised Firm must make in relation to Market Risk, it must provide information on the capital requirements for:
- (a) interest rate risk;
 - (b) equity risk;
 - (c) foreign exchange risk;
 - (d) commodity risk;
 - (e) options risk; and
 - (f) securities underwriting risk.

Disclosures for Authorised Firms using internal models

- (4) Where an Authorised Firm is using internal models, it must make the general qualitative disclosures for Market Risk including information on the portfolios covered by the internal models approach, as well as:
- (a) discussion on the soundness standards on which the Authorised Firm's internal capital adequacy assessment is based;
 - (b) a description of the methodologies used to achieve a capital adequacy assessment that is consistent with the soundness standards;
 - (c) information on each portfolio covered by the internal models approach:
 - (i) stating the characteristics of the models used;
 - (ii) providing a description of stress testing applied to the portfolio; and
 - (iii) providing a description of the approach used for back-testing or validating the accuracy and consistency of the internal models and modelling processes; and
 - (d) the scope of acceptance by the DFSA.
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- (5) Where an Authorised Firm is using internal models, it must make quantitative disclosures for market risk for trading portfolios, providing information on:
- (a) the high, mean and low value-at-risk values over the reporting period and period end; and
 - (b) a comparison of value-at-risk estimates with actual gains or losses experienced by the Authorised Firm, with analysis of important “outliers” in back test results.

Securitisation risk:

A8.4.6 An Authorised Firm must make the general qualitative disclosures with respect to securitisation, including a discussion of:

- (a) the Authorised Firm’s objectives in relation to securitisation activity, including the extent to which credit risk of the underlying securitised exposures has been transferred away from the Authorised Firm;
- (b) the roles played by the Authorised Firm in the securitisation process and the extent of its involvement in each of the roles;
- (c) the Authorised Firm’s accounting policies for securitisation activities;
- (d) the total outstanding exposures securitised by the Authorised Firm, broken down by exposure type; and
- (e) the current year’s securitisation activity, including the gains or losses recognised on sale by asset type.

Equity risk: disclosures for Authorised Firm’s banking book position

A8.4.7 An Authorised Firm must make the general qualitative disclosures with respect to equity risk, including:

- (a) differentiating between exposures based on their objectives, including those in respect of capital gains, strategic reasons;
 - (b) an overview of the accounting techniques and valuation methodologies used, including key assumptions and practices affecting valuation and any significant changes in these practices;
 - (c) the balance sheet value, the fair value and, for those exchange-traded, a comparison to the market price;
 - (d) the cumulative realised gains (losses) arising from sales and liquidations in the reporting period; and
 - (e) total unrealised gains or losses, and any amounts included in Tier One or Tier Two Capital Resources.
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8.5 Disclosure for Authorised Firms undertaking Islamic Financial Business

Guidance

Where an Authorised Firm conducts Islamic Financial Business it should consider the AAOIFI or IFSB standards, as appropriate, to ascertain whether there are any relevant disclosures that could be made in respect of such business. An example of such disclosure would be in respect of displaced commercial risk.
