



**BANK NEGARA MALAYSIA**  
CENTRAL BANK OF MALAYSIA

# **Single Counterparty Exposure Limit for Islamic Banks**

BNM/RH/GL 007-22	Islamic Banking and Takaful Department	Single Counterparty Exposure Limit for Islamic Banks
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## **PART A OVERVIEW**

### **1. Introduction**

1.1. Risk concentration refers to an exposure with the potential to produce losses that are substantial enough to threaten the financial condition of an Islamic banking institution. Risk concentrations can materialise from excessive exposures to a single counterparty or group of connected counterparties, a particular instrument or a particular market segment. A risk concentration to a single counterparty may arise through direct exposures to the counterparty and indirectly through exposures to protection providers, such as guarantors and credit derivatives counterparties. The magnitude of this risk is significantly influenced by the existence of common or correlated risk factors which in times of stress can adversely affect the creditworthiness of each individual counterparty making up the concentration.

#### **Policy Objective**

1.2. The single counterparty exposure limit (SCEL) represents a non-risk adjusted back-stop measure to ensure that exposures to a single counterparty or a group of connected counterparties are within a prudent limit at all times.

#### **Scope of Policy**

1.3. This policy sets out:

- (a) Bank Negara Malaysia's (the Bank) expectations of Islamic banking institutions in managing and monitoring exposures to a single counterparty;
- (b) the prudential limit for exposures to a single counterparty;
- (c) parameters for identifying connected counterparties that constitute a single counterparty;
- (d) scope and treatment of exposures applicable to a single counterparty; and
- (e) expectations with respect to on-going compliance with the SCEL.

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## 2. Applicability

2.1. This policy is applicable to:

- (a) An Islamic bank licensed under the Islamic Banking Act 1983 (IBA); and
- (b) A banking institution licensed under the Banking and Financial Institutions Act 1989 (BAFIA) that carries on Islamic banking business under the Islamic Banking Scheme (IBS)<sup>1</sup>.

For the purpose of this policy, the institutions above are hereafter referred to as “Islamic banking institutions”.

2.2. Islamic banking institutions are required to comply with the SCEL at both the entity and consolidated level<sup>2</sup>. A banking institution participating in the IBS, must comply with the requirements at the level of the IBS, as if it were a stand-alone Islamic banking institution.

## 3. Legal provisions

3.1. This policy is issued pursuant to:

- (a) sections 27(1) and 53A of the IBA; and
- (b) sections 61 and 126 of the BAFIA 1989.

## 4. Effective date

4.1. Islamic banking institutions shall comply with the requirements in this policy with effect from 1 March 2013 in accordance with the transition arrangements provided in paragraphs 13.1 to 13.3.

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<sup>1</sup> In accordance with section 124 of the BAFIA and the *Guidelines on Skim Perbankan Islam*.

<sup>2</sup> For the definition of entity and consolidated level, refer to *Capital Adequacy Framework for Islamic Banks (Capital Components)*.

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## 5. Policies superseded

- 5.1. Policies listed in Appendix 1 are superseded. Where previous approvals or directions have been issued to individual Islamic banking institutions in relation to requirements on single counterparties, such approvals or directions shall be subject to the requirements in this policy, including the transitional arrangements, unless otherwise notified by the Bank.

## 6. Definition and Interpretation

- 6.1. For the purpose of this policy –

**Exposure** refers to all claims, commitments and contingent liabilities arising from on- and off-balance sheet transactions (in both the banking and trading books) in ringgit and foreign currency denomination (based on their ringgit-equivalent amounts), which include, but are not limited to:

- (a) outstanding financing, advances and receivables;
- (b) placements (include deposit and investment account) and margins held with counterparties;
- (c) debt and equity securities held, including exposures arising from holdings of primary market securities for distribution;
- (d) investments in collective investment schemes;
- (e) exposures arising from derivative contracts; and
- (f) exposures under off-balance sheet instruments.

**Large exposure** refers to total exposures to a single counterparty which is equal to or greater than 10% of the Islamic banking institution's total capital.

**Interbank money market transactions** refers to ringgit and foreign currency transactions in the money market with a contractual maturity of one year and

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below which include secured or unsecured borrowing and lending, and buying and selling of papers with a remaining maturity of one year and below.

***Total capital*** has the same meaning assigned to it in the *Capital Adequacy Framework for Islamic Banks (Capital Components)*.

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## **PART B POLICY REQUIREMENTS**

### **7. Risk Management Expectations**

- 7.1. The board of directors (Board) must ensure that:
- (a) the Islamic banking institution establishes and adheres at all times to the internal policies governing risk concentrations, as approved by the Board;
  - (b) the internal policies are reviewed regularly (at least annually) in order to remain current, adequate and appropriate for the Islamic banking institution at all times. Any material changes to the established policies must be approved by the Board; and
  - (c) independent<sup>3</sup> reviews are conducted regularly to verify compliance to the prudential limit and standards set by the Bank as well as the established internal policies.
- 7.2. Senior management must:
- (a) establish and implement internal policies, processes and procedures governing risk concentrations;
  - (b) clearly communicate and monitor compliance with the internal policies; and
  - (c) establish and maintain adequate systems (either automated or otherwise) that are able to identify, measure, monitor and aggregate exposures to single counterparties in a timely manner.
- 7.3. The internal policies on risk concentration must at a minimum include the following:
- (a) procedures for identifying, measuring, monitoring<sup>4</sup>, controlling and reporting single counterparty exposures of the Islamic banking institution;
  - (b) detailed internal parameters for identifying connected counterparties;

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<sup>3</sup> Independent of risk taking activities.

<sup>4</sup> Exposures are expected to be monitored on a gross basis, regardless of mitigation allowed.

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- (c) internal exposure limits<sup>4</sup> (including limits on large exposures<sup>5</sup>) that are reflective of the Islamic banking institution's risk appetite and risk bearing capacity, and also take into consideration the potential changes to the market value of the underlying exposures;
- (d) clearly defined roles and accountability for ensuring compliance and effective communication of the policies, procedures and internal limits to business lines;
- (e) measures to manage and address compliance with the SCEL, including authority and procedures for approving exceptions to the internal limits which in any case, must not exceed the SCEL; and
- (f) nature and frequency of reporting to the Board and senior management.

7.4. Although certain types of exposures and counterparties are excluded from the SCEL (as specified in paragraphs 10.1 and 10.2), these exposures are not risk-free. Islamic banking institutions should have adequate procedures and controls in place to monitor these exposures. In addition, Islamic banking institutions should also ensure that its portfolios are not overly concentrated in large exposures.

## 8. Single Counterparty Exposure Limit

- 8.1. Islamic banking institutions shall comply at all times with the SCEL whereby total exposure to a single counterparty must not exceed 25% of the Islamic banking institution's total capital.
- 8.2. A banking institution that has an exposure arising from loss-bearing fund (Restricted Investment Account, RIA)<sup>6</sup> placements made with an Islamic bank/Islamic banking operation (fund manager) must apply the look-through approach as described in Appendix 2. An Islamic bank/Islamic banking

<sup>5</sup> A large exposure is defined in paragraph 6.1.

<sup>6</sup> Subject to meeting the risk absorbent criteria in the *Guidelines on Recognition and Measurement of Profit Sharing Investment Account*.

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operation who is the fund manager in this arrangement will not be subject to the SCEL.

8.3. For the purpose of compliance with the SCEL, an exposure that is guaranteed or protected by credit derivatives shall be treated as follows:

- (a) The exposure is aggregated to the direct counterparty and the same exposure is also separately aggregated to the guarantor or protection provider. In circumstances where the counterparty and its guarantor or protection provider are connected (hence, treated as a single counterparty), the exposure should be aggregated as a single group exposure to the direct counterparty and the guarantor or protection provider.
- (b) Exposure guaranteed by either Credit Guarantee Corporation (CGC) or Danajamin need not be aggregated with other exposures to CGC or Danajamin respectively, until an event of default<sup>7</sup>. Upon the event of default, the guaranteed exposure must immediately be aggregated with other direct exposures to CGC or Danajamin (refer to illustration in Appendix 3).

## **9. Definition of a Single Counterparty**

9.1. Counterparties are regarded as connected where two or more counterparties are interlinked and present a common risk to the Islamic banking institution, such that difficulties faced by any of the counterparties may affect the funding or repayment capabilities of one or all of the counterparties.

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<sup>7</sup> The definition of the 'event of default' is in accordance with the terms of the agreement between the counterparty and CGC or Danajamin.

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9.2. Counterparties must be aggregated if:

- (a) one of the counterparties holds directly or indirectly, power of control over the other(s) through shareholding<sup>8</sup>, shared management or directorship based on criteria specified in Appendix 4; or
- (b) two or more of the counterparties are connected due to economic dependence (refer to Appendix 5) where the exposures are:
  - (i) material between the counterparties (for scenarios (a) to (e) in Appendix 5); and
  - (ii) the relationship between the counterparties is not easily substituted in the short term (for scenario (e) in Appendix 5), to the extent that failure or financial difficulties experienced by one counterparty is likely to significantly affect and impair the ability of another counterparty to honour its financial obligations.

9.3. Islamic banking institutions must have in place procedures for conducting economic dependence assessments, which shall at least cover its large exposures as defined in this policy.

9.4. Islamic banking institutions should also endeavour to conduct economic dependence assessment for all other exposures considered material to the Islamic banking institution based on the Islamic banking institution's risk tolerance, to determine the extent of exposure to a single counterparty.

9.5. Where exposures are aggregated through power of control, an Islamic banking institution may disaggregate the exposures if the following criteria are met:

- (a) The entity has sufficient financial resources of its own to obtain credit facilities and to fully service its liabilities; and
- (b) The entity is not relied upon to support the liabilities of any other counterparty in its single counterparty group out of its financial resources.

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<sup>8</sup> For avoidance of doubt, exposure to be aggregated is not limited to, nor proportional to, the formal percentage of ownership.

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9.6. Exposures to entities that are disaggregated according to paragraph 9.5 may be treated as a separate single counterparty. Islamic banking institutions must document the assessments to support such disaggregation. The documentation must be accessible to the internal control and risk management functions at all times.

9.7. Islamic banking institutions must exercise a reasonable degree of due diligence, including applying the principle of 'know your customer', in obtaining sufficient information on their customers to determine interconnectedness.

9.8. There may be situations where a counterparty is linked to more than one group of connected counterparties. Such situations may arise, where:

- (a) a counterparty is controlled by two equal partners that hold 50:50 participation and exercise joint control over the counterparty;
- (b) a counterparty that is a partner in one or more partnerships also exercises control over these partnerships;
- (c) a counterparty is dependent on a sole supplier for its business output (economic dependence) and is also solely dependent on its parent for financial assistance;
- (d) a counterparty who is the sole supplier to a group of entities.

In such situations, the exposure must be aggregated in each of the counterparty groups.

## **10. Exposures Subject to the Single Counterparty Exposure Limit**

10.1. The SCEL shall be applied to all exposures, as defined under paragraph 6.1, notwithstanding the creditworthiness of the counterparties or the quality of any underlying security, except for the following:

- (a) exposures of an overseas branch or subsidiary of an Islamic banking institution to the sovereign government or central banks in the jurisdiction where it is located, where the exposure is denominated in local currency and held to meet regulatory requirements imposed by the central bank in

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that jurisdiction;

- (b) exposures to an Islamic banking institution licensed by the Bank<sup>9</sup>, or a development financial institution<sup>10</sup>, arising from interbank money market transactions;
- (c) exposures arising from granting of intra-day facilities; and
- (d) exposures deducted in the calculation of an Islamic banking institution's Total Capital as specified in Regulatory Adjustments of the *Capital Adequacy Framework for Islamic Banks (Capital Components)* (e.g. investments in financial subsidiaries).

10.2. Exposures to, or explicitly and unconditionally guaranteed by, the Federal Government of Malaysia or the Bank<sup>11</sup> are also excluded from the computation of the SCEL.

## 11. Methods of Measuring Exposures

11.1. For the purpose of determining compliance with the SCEL, exposures to a single counterparty must be measured in accordance with the applicable Financial Reporting Standards, unless specified otherwise.

11.2. **On-balance sheet exposures** must be measured in accordance with the applicable Financial Reporting Standards<sup>12</sup>, unless otherwise specified in this policy document.

<sup>9</sup> For avoidance of doubt, this exclusion does not apply to a banking institution's exposures to another bank outside of Malaysia (e.g. a foreign bank's exposure to its parent bank overseas).

<sup>10</sup> This refers to a development financial institution that is a prescribed institution under the Development Financial Institutions Act 2002.

<sup>11</sup> For avoidance of doubt, this exclusion does not include exposures to entities established by the Federal Government of Malaysia (e.g. MOF Inc, Khazanah Nasional) or the Bank that are not guaranteed explicitly by the Federal Government of Malaysia or the Bank.

<sup>12</sup> For avoidance of doubt, the exposure amount must not be computed net of provisions.

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11.3. For **off-balance sheet exposures**, the on-balance sheet credit equivalent amount shall be the nominal principal amount multiplied by a 100% credit conversion factor (CCF), except for the following:

***Underwriting arrangements***<sup>13</sup>

- (a) A 50% CCF will be applied for obligations under an on-going underwriting agreement and revolving underwriting facilities from the commitment date until 60 days<sup>14</sup> after the issuance of the securities. Any remaining securities held after such period must be computed at their full value as an exposure to the issuer.
- (b) Where an Islamic banking institution enters into a legally binding sub-underwriting agreement without recourse, the Islamic banking institution may record the amount of exposure net of the amount underwritten by the sub-underwriters. The exposures acquired by an Islamic banking institution that is a sub-underwriter under such arrangements must apply the treatment as specified in paragraph 11.3(a).
- (c) Where there is a legally binding placement (sale) agreement with an investor between the commitment and the issuance date of the securities, Islamic banking institutions can substitute the exposure from the issuer to the investor. Where the investor (buyer) of the securities is an Islamic banking institution, the acquired exposures must be recorded by the Islamic banking institution at 100% CCF, as it constitutes a commitment to purchase.
- (d) Islamic banking institutions must ensure that assurance from legal counsel has been obtained with respect to the legal enforceability of all documentation involved in an underwriting arrangement and such documentation is subject to periodic reviews to confirm its on-going legal enforceability.

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<sup>13</sup> This does not apply to bought deals which involve an outright purchase by the banking institutions.

<sup>14</sup> This grace period will be reduced to 30 days from 1 March 2014.

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***Unconditionally cancellable facilities***

- (e) Any commitments that are unconditionally and immediately cancellable and revocable by the Islamic banking institution, or that effectively provide for automatic cancellation due to deterioration in a borrower's creditworthiness, at any time without prior notice that fulfils the criteria as specified in the *Capital Adequacy Framework for Islamic Banks (Risk-Weighted Assets)*, will be subject to 0% CCF.
- 11.4. For exposures arising from **derivative contracts**, the credit equivalent amount must be computed based on the current exposure method as specified in Appendix VI (Current Exposure Method) of the *Capital Adequacy Framework for Islamic Banks (Risk-Weighted Assets)*.
- 11.5. Islamic banking institutions may compute their exposure arising from derivative transactions with the same counterparty on a net basis, subject to satisfying the conditions and requirements on bilateral netting set out in Appendix VI (Bilateral Netting) in the *Capital Adequacy Framework for Islamic Banks (Risk-Weighted Assets)*.
- 11.6. For exposures under **repurchase agreements and sell and buy back (SBBA) agreements**, Islamic banking institutions shall compute:
- (a) an exposure to the issuer of the security pledged; and
  - (b) the net amount due from the counterparty when the value of the security pledged is higher than the financing value.
- 11.7. For exposures under **reverse repurchase agreements and reverse SBBAs**, Islamic banking institutions should compute the amount due from the counterparty, which may be off-set by the value of the security pledged if it qualifies as an eligible collateral as specified in paragraph 11.10.

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11.8. Exposures under **agency trade transactions, principal trade transactions and free deliveries** related to investment bank operations shall be measured at:

- (a) the difference between the market value and transaction value of the contracts which is due from the counterparty for agency trade and principal trade transactions; and
- (b) the transaction value of the contracts which is due from the customer for free deliveries.

Exposures to the counterparties must be aggregated after the permitted settlement date as specified in Appendix VII (Capital Treatment for Failed Trades and Non-DvP Transactions) of the *Capital Adequacy Framework for Islamic Banks (Risk-Weighted Assets)*.

11.9. For **exposures to schemes with underlying assets** (e.g. investments in collective investment schemes and securitisation transaction), the exposures must be determined in accordance with the guidance specified in Appendix 6.

### **Collateralisation**

11.10. For the purpose of compliance with the SCEL, exposures to a single counterparty may be reduced to the extent that it is secured by eligible collateral, as follows:

- (a) cash deposits<sup>15, 16</sup> (including certificates of deposit or comparable instruments issued by the Islamic banking institution)<sup>17</sup>;
- (b) gold; and
- (c) securities issued by the Federal Government of Malaysia or the Bank.

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<sup>15</sup> Cash pledged includes *`urbūn* (or earnest money held after a contract is established as collateral to guarantee contract performance) and *hamish jiddiyah* (or security deposit held as collateral) in Islamic banking contracts (for example, *Ijārah*).

<sup>16</sup> Cash funded credit linked notes issued by the banking institution against exposures in the banking book which fulfil the criteria for credit derivatives will be treated as cash collateralised transactions.

<sup>17</sup> For avoidance of doubt, non-principal protected structured investments are not recognised as eligible collateral.

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11.11. The recognition of eligible collateral specified in paragraph 11.10 is subject to the following conditions:

- (a) the collateral must be pledged for the entire life of the exposure;
- (b) the collateral must be marked-to-market and revalued at a minimum frequency of 6 months;
- (c) all documentation used must be binding on all parties and legally enforceable in all relevant jurisdictions. Islamic banking institutions are required to obtain assurance from legal counsel with respect to the legal enforceability of the documentation. All documentation shall also be subjected to periodic reviews to confirm its on-going enforceability;
- (d) the legal mechanism by which collateral is pledged or transferred must ensure that Islamic banking institutions have the right to liquidate or take legal possession of the collateral in a timely manner in the event of default, insolvency or bankruptcy of the counterparty. Islamic banking institutions must have in place clear and robust procedures to ensure that any legal conditions required for declaring the default of the counterparty and liquidating the collateral are observed and that collateral can be liquidated promptly. Islamic banking institutions must take steps to ensure legal enforceability of the collateral pledged at all times;
- (e) where collateral is held by a custodian, reasonable steps must be taken to ensure good custody and that the custodian segregates the collateral from its own assets; and
- (f) for Islamic banking exposures, collateral must be fully Shariah-compliant.

11.12. A commitment to provide collateral shall not be recognised as eligible credit risk mitigation for the purpose of determining compliance with the SCEL.

11.13. When the exposure and collateral are held in different currencies, an adjustment shall be made to the collateral to take account of possible future fluctuations in exchange rates. A haircut,  $H_{FX}$ , shall be applied, as follow:

$$Exposure = G \times (1 - H_{FX})$$

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Where:

G = Nominal amount of the collateral

H<sub>FX</sub> = 8% supervisory haircut for currency mismatch between the collateral and the underlying obligation

11.14. Recognition of a single collateral to cover multiple exposures of one or more counterparties (for example, a parent company provides a single collateral to cover the borrowings of several entities within its group) is only allowed for transactions entered into with the same Islamic banking institution and if collateral pledged is exclusive to that Islamic banking institution. In addition, Islamic banking institutions must ensure that the collateral is of sufficient value to cover the aggregate value of all the exposures and conditions specified in paragraph 11.11 are adhered to.

## **12. Compliance with the Single Counterparty Exposure Limit**

12.1. The single counterparty exposure limit must be observed at all times. Islamic banking institutions must put in place appropriate procedures and processes to facilitate on-going compliance. This should include adequate monitoring and reporting mechanisms to ensure adherence to this policy.

12.2. The Bank views any breaches to the SCEL as a serious matter. Islamic banking institutions must notify the Bank immediately of any breaches, together with an explanation on the causes of the breach and remedial actions taken or to be taken (with a proposed time frame) to bring the exposures within the SCEL. During the rationalisation period, the Islamic banking institution shall not increase its exposures to the affected counterparty (including its connected counterparties).

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### 13. Transitional Arrangements

- 13.1. The Bank recognises that Islamic banking institutions will require time to fully comply with the requirements in this policy. In particular, Islamic banking institutions will need to review and confirm existing policies, procedures and internal limits, clarify roles and accountabilities, and undertake enhancements to existing systems to identify, measure, monitor, and aggregate exposures to single counterparties. The Bank expects Islamic banking institutions to initiate these efforts from 1 March 2013 but will allow time for Islamic banking institutions to demonstrate full compliance. In this regard, Islamic banking institutions will be expected to:
- (a) Establish or confirm relevant internal policies and procedures, and identify groups of connected counterparties for all large exposures by 1 December 2013.
  - (b) Have in place systems to support aggregation and monitoring of exposures to connected counterparties by 1 September 2014.
- 13.2. All exposures as at the effective date of this policy which are in breach of the SCEL based on requirements specified herein shall be brought in compliance by 1 March 2015, subject to any specific transitioning arrangements in respect of such exposures, as may be approved by the Bank on a case-by-case basis. This allowance is also extended to exposures which are pending finalisation and whose terms have been agreed upon before 1 March 2013 and approved latest by 1 June 2013.
- 13.3. Fixed term financing with agreed repayment schedules are allowed to run to maturity notwithstanding a breach of the SCEL. This includes fixed term financing which are pending finalisation and whose terms have been agreed upon before 1 March 2013 and approved latest by 1 June 2013.

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## APPENDICES

### Appendix 1 Policies Superseded

#### List of Circulars and Guidelines Completely Superseded

1. *BNM/GP5 Guidelines on the Credit Limit to a Single Customer (SCCL)* issued in 1986.
2. *Section 61 BAFIA 1989 – SCCL* issued on 31 July 1996.
3. *BNM/GP5: Had Pinjaman Kepada Seorang Pelanggan – Pengecualian Terhadap Sekuriti Hutang Cagamas* issued on 25 August 1998.
4. *Asset Backed Securitisation (ABS) Programme: Single Customer Credit Limit (SCCL)* issued on 12 January 2004.
5. *Measure to Further Enhance Financing Capacity of Islamic Subsidiary* issued 12 January 2007
6. *Means and Purpose Test for Single Counterparty Credit Limit* issued on 1 June 2009.

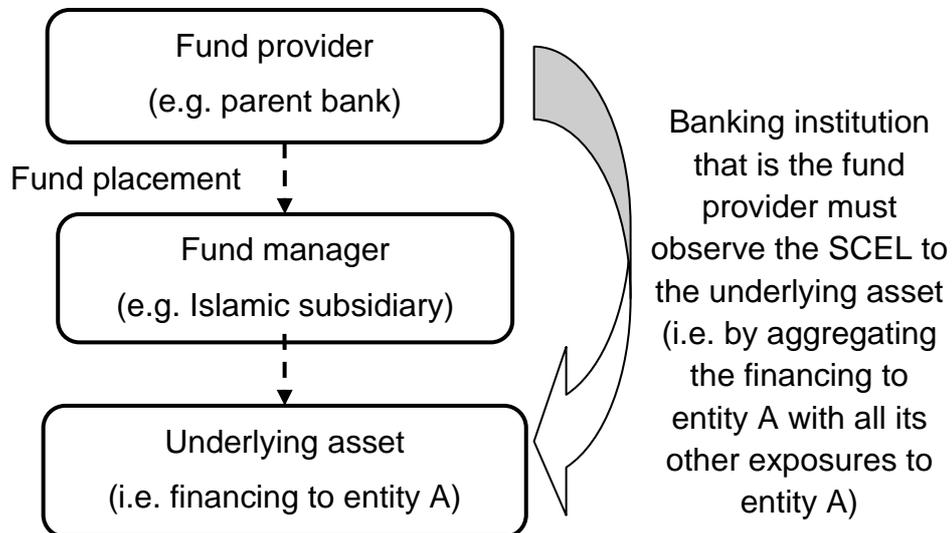
#### List of Circulars and Guidelines Partially Superseded

1. *Revised Guidelines for Investment in Private Debt Securities* issued on 18 February 1994
  - Paragraphs 4 to 8, 11 and 12.
2. *Regulatory Treatment for Interbank Transactions with Universal Brokers* issued on 5 September 2005.
  - Restriction on Single Customer Credit Limit
3. *Regulatory Treatment for Sukuk Bank Negara Malaysia – Ijarah* issued on 7 February 2006
  - Item (iv)
4. *Prudential Regulation for Investment Banks - Limits on Lending for the Purchase of Shares and Credit Limit to a Single Customer (SCCL)* issued on 5 March 2007
  - Paragraph 2 (b)
5. *Revised Regulatory Treatment for Residential Mortgage-Backed Securities* issued on 15 May 2007

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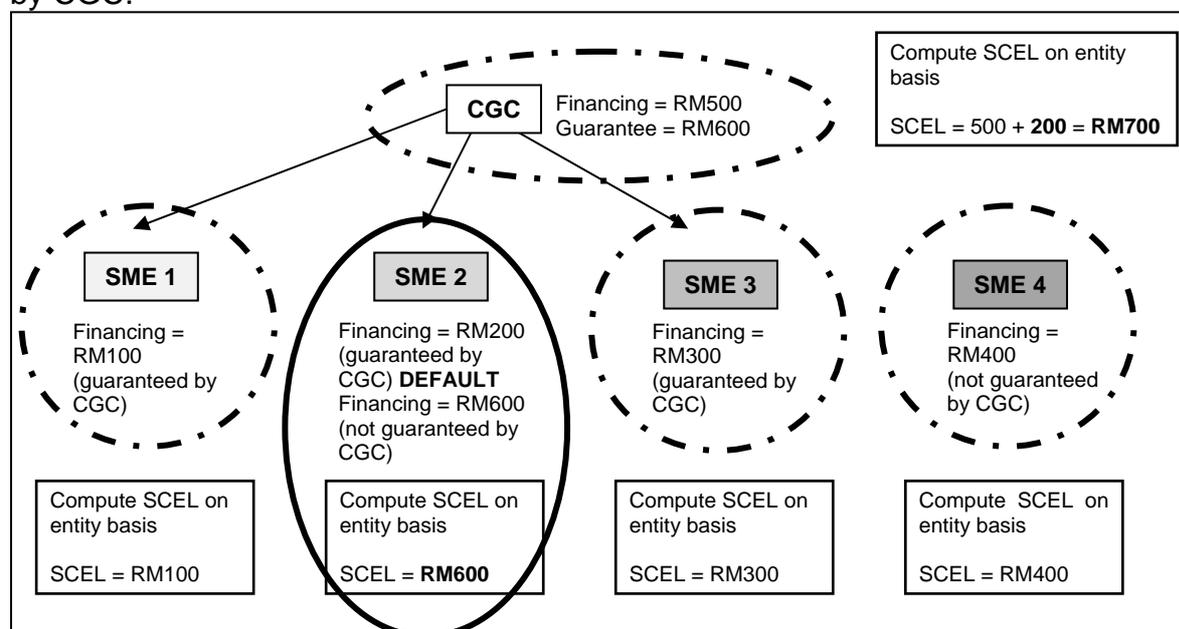
- Appendix I: Item iii
6. *Prudential Standards on Securitisation Transactions* issued on 10 March 2003 (revised on 23 October 2009)
- Chapter 8: Paragraph 8.1 (ii)

## Appendix 2 Exposures funded by Loss-bearing Funds



### Appendix 3 Exposures to and Guarantees Provided by the CGC and Danajamin

This example illustrates the computation of exposures to SMEs that are guaranteed by CGC.



An Islamic banking institution has granted the following financing:

	Counterparty	Financing Amount (RM)	Financing Amount Guaranteed by CGC (RM)	Financing Amount Aggregated for SCEL on an Entity Basis (RM)
1.	CGC	500		500
2.	SME 1	100	100	100
3.	SME 2	800	200	800
4.	SME 3	300	300	300
5.	SME 4	400		400

In the event that the financing granted to SME 2 defaults, the guarantee provided by CGC is crystallised:

	Counterparty	Financing Amount (RM)	Financing Amount Guaranteed by CGC (RM)	Financing Amount Aggregated for SCEL on an Entity Basis (RM)
1.	CGC	500 + 200		700
2.	SME 1	100	100	100
3.	SME 2	800 - 200	<del>200</del>	600
4.	SME 3	300	300	300
5.	SME 4	400		400

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#### **Appendix 4      Determination of Power of Control**

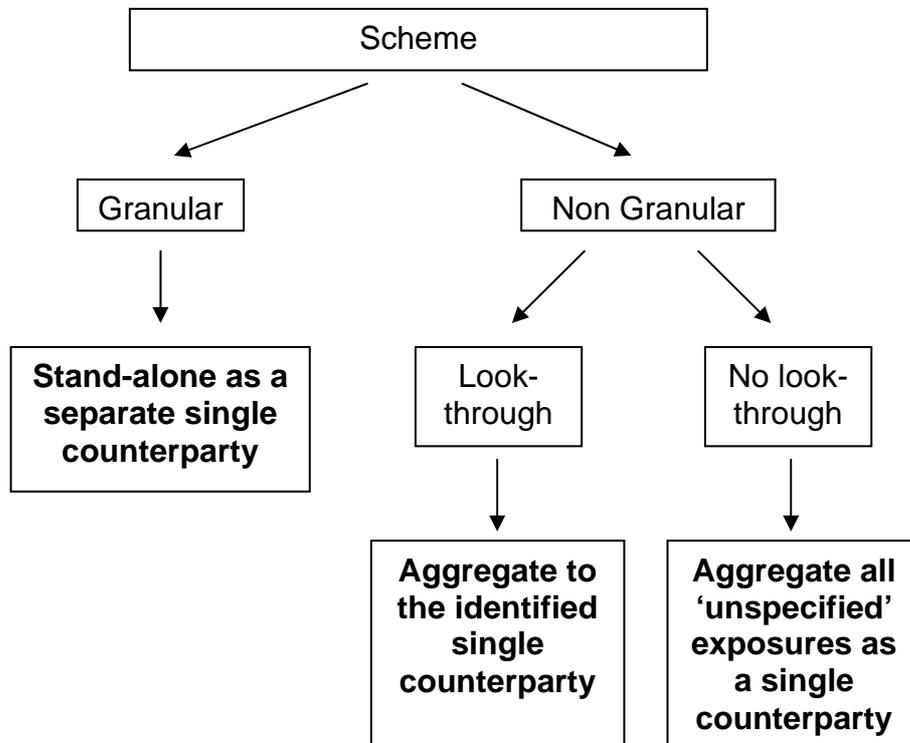
1. Power of control is deemed to exist when:
  - a) a counterparty is able to exercise power to direct the activities of the other entity so as to obtain benefits from its activities; or
  - b) a counterparty is able to exercise power to decide on crucial transactions such as the transfer of profit or loss; or
  - c) a counterparty is able to exercise power to appoint or remove the majority of directors, the members of the board of directors or equivalent governing body where control of the entity is exercised by that board or body; or
  - d) a counterparty is able to exercise power to cast the majority of votes at meetings of the board of directors, general assembly or equivalent governing body where control of the entity is exercised by that board or body; or
  - e) a counterparty is able to exercise power to co-ordinate the management of an undertaking with that of other undertakings in pursuit of a common objective, for instance, in the case where the same persons are involved in the management or board of two or more undertakings.

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## **Appendix 5      Determination of Connected Counterparties arising from Economic Dependence**

1. The presence of the following factors may be indicative of economic dependence between counterparties:
  - (a) counterparties having the same expected source of repayments;
  - (b) the existence of cross guarantees between the counterparties;
  - (c) counterparties with significant associations or relationships, for example, counterparties that share common marketing and/or branding platform;
  - (d) a counterparty and his/her spouse/child/family corporation;
  - (e) commercial interdependence between the counterparties, for example:
    - (i) exclusive relationship between a producer and a vendor; or
    - (ii) the owner of a residential/commercial property and the tenant; or
    - (iii) significant part of production/output is for one single counterparty.
  
2. Islamic banking institutions should consider other relevant aggregation criteria based on institutional experience and judgement which may be indicative of connectedness between counterparties.

## Appendix 6 Method of Measuring Exposures to Schemes with Underlying Assets



1. Islamic banking institutions must determine if the underlying assets in the scheme are **granular**. The scheme is considered granular when the largest exposure value of the underlying assets is equal to or less than 5% of the total value of the scheme, at the point of transaction. Exposures under each of such schemes may be treated as stand-alone exposures to a single counterparty.
2. If the underlying assets are **not granular**, Islamic banking institutions must apply the look-through approach and aggregate their exposures to the individual counterparty of the underlying pool of assets, subject to the ability to identify the issuers and value the assets at all times.
3. For exposures that qualify for the **look-through** approach, the exposure value must be aggregated to the issuer of each asset based on the relative size of the issuers' contribution to the scheme. For static portfolios where the

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underlying assets do not change over time, an assessment can be made once and does not need to be monitored in the future. For dynamic portfolios, monitoring must be carried out at regular intervals, at least every 6 months.

4. If the Islamic banking institution is **unable to look-through** the scheme, the exposures shall be classified as 'unspecified' exposures and aggregated with all other similar exposures arising from other schemes and regarded as a single counterparty.