

Q&As - the new PIB module

This document is not intended to be a complete guide to the PIB module of the DFSA Rulebook. It merely addresses a number of frequently asked questions. Accordingly, we recommend that you read the PIB module of the DFSA Rulebook which can be found on the DFSA website.

1. What is the scope of application of the new PIB module? Are there any changes to its application?

There are no changes in the scope of application of the new PIB module as a whole, compared to the old PIB module. All Authorised Firms covered by the old PIB module will continue to be covered by the new PIB module.

As in the past, the new PIB will not apply to Authorised Firms which are insurers, or a representative office or a credit rating agency under the DFSA regime. It should be noted that Authorised Firms licenced to carry out contracts of insurance and effecting contracts of insurance will continue to be covered by the PIN module for their capital adequacy and risk management Rules.

2. Are there any changes to the policy of waiving capital adequacy requirements for branches? If so, what are the changes? If a Firm is operating as a branch in the DIFC, is there a need to re-apply for the waiver from the new PIB Rules?

The previous policy of waiving capital adequacy requirements for branches has now been incorporated into the PIB module by way of specific rules, which obviates the need for an explicit waiver to be provided for each branch. The PIB Rules which are applicable to Authorised Firms covered by PIB and operating as branches in the DIFC are specified in PIB Rule 1.1.2 and in Application table A, which forms part of that PIB Rule.

There is no need for branches to apply for a new waiver or renew existing waivers. Going forward, applicants for an authorisation to operate a branch carrying out financial service activities covered by the PIB (refer to Q1) need not submit an application for a waiver from capital adequacy requirements.

3. How does an Authorised Firm identify the detailed Rules in PIB which are applicable to it?

The application of the specific PIB Rules in the new PIB module is based on the prudential categories under which an Authorised Firm is classified. The application of the specific Rules or sections in any chapter is indicated at the start of the respective chapter. In



addition, the application of Rules to different prudential categories of branches and domestic Firms are detailed in two tables – Tables A and B, in Rule 1.1.2 of Chapter 1 of the PIB.

4. Are there many technical terms, abbreviations and jargon used in the PIB module? Is there a glossary where the definitions for these terms are provided?

Section 1.2 of the PIB module includes a glossary which defines the relevant technical terms, abbreviations and jargon used in the PIB module and provides the definitions and meanings for them. This is in addition to the defined terms which are listed in the GLO module of the DFSA Rulebook.

5. What are the changes to the prudential category structure in the new PIB module? What are the types of Authorised Firms which will face a change in their prudential category classification?

The changes to the prudential category structure in the new PIB module are restricted to Firms previously in prudential categories 3 and 5 as referred to in the old PIB module.

Firms authorised to “Manage Restricted PSIAs” classified under category 5 in the old PIB module, will henceforth be classified in category 3C in the new PIB module. Firms authorised to “Manage an Unrestricted PSIA” will continue to be classified under category 5, as in the old PIB module.

Firms classified in category 3 in the old PIB module will be reclassified in the new PIB module as follows:

If your Firm has the following financial service on its licence, then it would be classified as -	3A	3B	3C
Dealing in Investments as Matched Principal, Dealing in Investments as Agent	√		
Providing Custody for a Fund, Acting as the Trustee of a Fund		√	
Managing Assets, Managing a Collective Investment Fund, Managing Restricted PSIAs, Providing Custody other than for a Fund and Providing Trust Services (where it is acting as trustee in respect of an express trust)			√



Authorised Firms which were classified in categories 1, 2 and 4 will continue to be classified in the same categories in the new PIB module.

6. Are there any changes to the Rules relating to operation of a trading book by an Authorised Firm?

There are no major changes to the trading book regime in the PIB module, though the PIB Rules have been enhanced to comply with international standards.

The Rules relating to operation of a trading book are applicable only to Authorised Firms in prudential categories 1, 2 and 5. If an Authorised Firm is classified in any other prudential category, then Rules relating to trading book are not applicable to that Firm.

The primary Rules relating to operation of a trading book by an Authorised Firm are specified in chapter 2 of PIB. These Rules are supplemented by more detailed Rules in App 2 of PIB, which details the DFSA's expectations of risk management systems and controls on trading book operations.

7. What are the changes to the prudential reporting requirements for Authorised Firms, in terms of mode of submission, applicable returns and frequency of their submission?

Authorised Firms will continue to follow the same procedure for submission of returns as in the past and will continue to use the EPRS to submit the prudential returns to the DFSA.

Applicable returns for Firms in different categories are listed in Tables 1 and 2 of PIB Rule A2.4.1 in App 2. The applicability of returns has not changed significantly, except for those driven by the changes in prudential category classification of some Authorised Firms as described in Q5. Specifically, Authorised Firms classified in categories 3B and 3C need not complete appendices 1 - 4 of form B10, form B70 and App 1. It should be noted that there may be some changes made to the prudential reporting forms in the EPRS, in Q1 2013.

8. Are there any changes to the overall approach towards calculation of capital requirements for different categories of Authorised Firms? If so, what categories will face such a change in the approach towards calculation of their capital requirements?

Overall approach towards calculation of capital requirements has changed in a significant manner for Firms in categories 3B, 3C and 4 of the new PIB module. For these Firms, capital requirements would be determined as the higher of:

- a. their base capital requirement; and
- b. their expenditure based capital minimum (EBCM).



These Firms need not calculate risk-based capital requirements in order to determine their capital requirements. Consequently, these Firms need not complete the prudential return forms in Apps B10 and B20, as part of their quarterly and annual prudential returns submission in the EPRS.

In addition, Firms in these categories will be required to maintain an amount which exceeds their EBCM in the form of liquid assets. The different types of liquid assets which are permitted to be held to meet this requirement are listed in PIB Rule 3.5.3.

9. Are there any changes to the base capital requirements?

There are no changes to base capital requirements applicable to different types of Authorised Firms, except Authorised Firms which are licenced to Manage Restricted PSIA's. Firms Managing Restricted PSIA's will face a base capital requirement of USD \$500,000 compared to the requirement of USD \$10 million under the old Rules.

10. What are the changes in the calculation methodology for EBCM?

There are no significant changes to the methodology for calculation of EBCM, except for minor changes in the amounts that can be deducted from annual audited expenses of an Authorised Firm.

In addition, Authorised Firms now face a more stringent process and regulatory notification requirement if they choose to recalculate their EBCM due to a material change in their expenditure or due to a change in their activities.

In such cases, Authorised Firms are required to submit their recalculation to the DFSA within 7 business days of its completion and seek approval from the DFSA for such a change. Please refer to PIB Rule 3.7.4 for more details.

11. What are the major changes to the determination of risk capital requirements?

The most prominent change to the methodology for determination of risk capital requirements is the introduction of capital requirement for operational risk and the addition of a capital conservation buffer (CCB). These changes are not relevant to Authorised Firms in categories 3B, 3C and 4 as described in response to Q8.

Capital requirement to address operational risk will henceforth be a component of total capital requirements for applicable Firms. Rules for determination of operational risk capital requirement are detailed in Chapter 6 of PIB.

The CCB is an additional capital buffer on top of the risk capital requirement. The CCB applicable to an Authorised Firm will equal 25% of the risk capital requirement of that Firm. CCB needs to be met with common equity tier 1 capital (CET1 capital).



12. What are the changes to determination of capital resources?

The new PIB module involves material changes in the composition of capital resources eligible to meet capital requirements, definition of the various elements which are permitted to make up capital requirements, eligibility criteria for inclusion of various capital elements in capital resources and applicable regulatory adjustments. The new Rules specify clearly defined and stringent eligibility criteria for inclusion in the different capital components.

In particular, Authorised Firms should review the terms of their subordinated debt issues and ensure that they are in compliance with the required eligibility criteria to ensure eligibility for inclusion of such issues in their capital resources. Please refer to section 3.15 of PIB module.

Authorised Firms should also review the terms of issue of different capital elements and ensure that they meet the eligibility criteria defined in the new Rules so that such capital elements can be included in their capital resources.

The Rules defining the different categories of eligible capital resources which can be used to meet the capital requirements of an Authorised Firm and calculation of capital resources are specified in part 4 of Chapter 3 of PIB.

According to the Rules in part 4 of chapter 3 of PIB, an Authorised Firm's capital resources can be composed of tier 1 (T1) capital and tier 2 (T2) capital. T1 capital can be composed of CET1 capital (Common Equity Tier 1 capital) and additional tier 1 (AT1) capital. The calculation methodology for capital resources is set out in a helpful table in Rule 3.11.2.

The various capital elements which are permitted to be included in each of the capital components, the eligibility criteria for inclusion of such capital elements, any regulatory adjustments which are required to be made to the amount of capital elements and any deductions which are required to be made to specific capital elements are detailed in the sections 3.12 to 3.17 of the PIB module.

13. Practically, what are the implications for Firms in categories 3B, 3C and 4 due to the new PIB?

The practical implications can be described by looking at a couple of examples.

Example 1: AF1 is a Category 3C Firm, with an EBCM of USD \$400,000. What are the key requirements and obligations it faces under the new PIB?

Because AF1 is a Category 3C Firm, its base capital requirement (BCR) is USD \$500,000 – Rule 3.6.2.

Given that its EBCM is USD \$400,000, its capital requirement is determined as USD \$500,000; the higher of BCR and EBCM – Rule 3.5.2.



An Authorised Firm must have CET1 capital to the extent that it exceeds its relevant BCR. This means AF1 must have at least USD \$500,000 of CET1 capital at all times – Rule 3.6.3.

Practically, this means that AF1 needs to fund its balance sheet with common equity, share premium and retained earnings to the extent of USD \$500,000. The eligibility criteria for CET1 capital are specified in Section 3.13 of PIB. This amount has to be reflected in the liabilities side of AF1's balance sheet as common equity, share premium and retained earnings as well as any other eligible capital element.

Apart from the above, AF1 also needs to maintain, at all times, its EBCM amount in the form of liquid assets, which are defined in Rule 3.5.3. This requirement has to be met by ensuring that at least USD \$400,000 of its assets are liquid assets, as defined in Rule 3.5.3. In order to meet this requirement, AF1 can maintain USD \$400,000 in the form of bank deposits, demand deposits with tenor of 1 year or less, deposited with a bank which as a short-term credit rating of A1 or P1 or equivalent.

This example will also hold good for an Authorised Firm in category 3B, except for the fact that firms category 3B face a BCR of USD 4 million.

Example 2: AF2 is a Category 4 Firm, with an EBCM of USD \$300,000. What are the key requirements and obligations it faces under the new PIB?

Because AF2 is a Category 4 Firm, its BCR is USD \$10,000 – Rule 3.6.2.

Given that its EBCM is USD \$300,000, its capital requirement is determined as USD \$300,000; the higher of BCR and EBCM – Rule 3.5.2.

An Authorised Firm must have CET1 capital to the extent that it exceeds its relevant BCR. This requires AF2 to have at least USD \$10,000 of CET1 capital at all times – Rule 3.6.3.

AF2 is required to have capital resources as defined in Rule PIB Rule 3.11.1 to meet its capital requirement of USD 300,000. AF2 can use either AT1 capital or T2 capital to meet the excess of its EBCM requirement over and above its BCR, which amounts to USD 290,000. AF2 does not face any limits in the share of either AT1 or T2 capital used to meet this requirement of USD 290,000.

AF2 also needs to maintain, at all times, its EBCM amount in the form of liquid assets, which are defined in Rule 3.5.3. This requirement has to be met by ensuring that at least USD \$300,000 of its assets are liquid assets, as defined in Rule 3.5.3. In order to meet this requirement, AF2 can maintain USD \$300,000 in the form of bank deposits, demand deposits with tenor of 1 year or less, deposited with a bank which as a short-term credit rating of A1 or P1 or equivalent.

14. What are the limits on use of different types of capital resources components?

The limits on use of different capital components – CET1 capital, AT1 capital and T2 capital are defined in Rule 3.2.7. These limits are applicable only for Authorised Firms in



categories 1, 2, 3A and 5. These Rules specify the limits as a percentage of risk capital requirement or the EBCM, as applicable to an Authorised Firm in those categories.

The limits are that T2 capital can be used only to a maximum of 20% of risk capital requirement or 20% of EBCM and AT1 capital can be used only up to a maximum of 20% of risk capital or EBCM requirement.

In cases where the capital requirement is determined by the BCR, the entire capital requirement has to be met by CET1 capital according to Rule 3.6.3.

In addition, the CCB requirement wherever applicable, must be met only with CET1 capital at all times. This is not applicable to Firms in categories 3B, 3C and 4.

15. What are the major changes to the Rules in respect of credit risk management?

The most critical change is the change in methodology to calculate the credit risk capital requirement, which has been updated to meet Basel III's standardised approach methodology. The other Rules relating to aspects including the credit risk management systems and controls as well as counterparty credit risk have been updated.

These Rules located in Chapter 4 are not applicable to Firms in categories 3B, 3C and 4.

16. What are the changes to the Rules relating to market risk management and related capital charges?

There are very few changes to the Rules in chapter 5 of PIB which deal with market risk. These Rules are applicable only to Firms in categories 1, 2, 3A and 5. Rules and guidance relating to various aspects of market risk management systems and controls have been updated and enhanced. Additional guidance on areas relating to prudent valuation, incremental risk charge models, criteria for approval of internal models have been included in the new PIB in App 5 of the PIB module.

17. What are the operational risk Rules applicable to Firms in categories 3B, 3C and 4?

All the Rules in Chapter 6 of the PIB module which deal with operational risk are applicable to Authorised Firms in categories 3B, 3C and 4 except for the Rules relating to determination and maintenance of capital to support operational risk exposures in their business. These Rules impose obligations to implement and maintain an operational risk policy, procedures, adequate systems and controls to manage operational risk. The Rules require an Authorised Firm to have an operational risk management framework which includes systems for risk identification and assessment, monitoring & reporting, controls and mitigation approaches.



In addition, the Rules include specific obligations on Authorised Firms in relation to their IT systems, information security, outsourcing risk as well as business continuity and recovery.

In particular, the Firms in categories 3B, 3C and 4 are required to take out and maintain adequate professional indemnity insurance (PII) cover for their activities, except for Firms which are authorised to arrange custody.

Please refer to Section 6.12 of the PIB module for detailed Rules on PII requirements.

18. What is the amount of PII cover for an Authorised Firm in categories 3C, 3B and 4?

The Rules do not prescribe any specific amount of PII cover for Firms in these categories. According to PIB Rule 6.12.2, an Authorised Firm in these categories, must maintain PII cover to the extent, which is appropriate to its nature, size, volume of business, complexity of operations and risk profile.

In addition, the Rules also require the Authorised Firm to submit to the DFSA, a copy of the PII cover policy covering the next 12 months and also notify the DFSA if there are any material changes in the terms of the PII cover from the previous year.

19. The PIB module now includes a chapter on interest rate risk in the non-trading (banking) book. What is the scope of application of this chapter and what are the new requirements from this chapter?

Chapter 7 of the new PIB module deals with interest rate risk in the non-trading book also referred to as banking book in the Basel framework. This chapter is applicable only to Authorised Firms in categories 1 and 2, both on a solo basis and on a financial group basis. For the purpose of clarity, this chapter is not applicable to Authorised Firms classified in categories 3A, 3B, 3C, 4 and 5.

The main features of this chapter are Rules introducing requirements to carry out regular stress testing of a bank's balance sheet to measure its exposure to interest rate risk in its banking activities and Rules requiring adequate systems and controls for managing that risk.

20. What is scope of application of group risk Rules under the new PIB?

In the new PIB module, group risk Rules are located in Chapter 8. The scope of application of group risk Rules aimed at addressing risks arising out of a Firm's participation in a financial group is limited to Authorised Firms in categories 1, 2 and 5 (sections 8.2 – 8.4). However, Section 8.5 of PIB includes Rules applicable to All Authorised Firms in all categories. Please refer to Question # 22 for details on Section 8.5.

The group risk Rules are relevant only to Authorised Firms which are part of a financial group as defined in the PIB and GLO modules.



If your Firm is part of a group of entities, please refer to the definition of Financial Group in order to determine whether your Firm is part of a Financial Group. If so, then the Financial Group risk Rules, including the Financial Group capital adequacy Rules apply to your Firm.

21. What are the changes in Rules defining Financial Group capital adequacy requirements?

According to Rule 8.3.3 in the new PIB, Financial Group capital requirement can be calculated only using the accounting consolidation method. This method requires the application of the relevant PIB Rules on the consolidated financial statements of the group to determine its capital requirement. The option of using the aggregation method, which adds up the capital requirements for individual entities in the group has been removed.

22. What are the newly introduced restrictions on ownership of complex financial institutions by Authorised Firms in categories 3A, 3B, 3C or 4?

Authorised Firms in these categories cannot be a Parent – as defined in DFSA regulations – of an Authorised Firm which would be classified in categories 1, 2, or 5 (Section 8.5 of PIB). The exception to this restriction would be a case in which an Authorised Firm in categories 3A, 3B or 4 is a Subsidiary (as defined in DFSA Rules) of a regulated bank or a regulated insurer or a regulated Islamic bank. Please refer to Section 8.5 of PIB module for details.

23. What are the changes to the Rules relating to management of liquidity risk?

The changes to the liquidity Rules located in chapter 9 of the new PIB are insignificant. The scope of application of this chapter continues to be the same as in the old PIB module. As described in the consultation paper, the DFSA aims to implement the Basel III liquidity regulations following an observation period, which is consistent with the implementation timelines prescribed by the Basel Committee.

24. What are the requirements relating to internal risk assessment as applicable to Firms in categories 3A, 3B or 3C?

Authorised Firms in these categories are required to establish and maintain an internal risk assessment process (IRAP) which will facilitate it to identify, measure, aggregate and monitor the risks faced by the Firm. The IRAP is required to be used by the relevant Authorised Firm to make an internal assessment of all risks to which it is exposed on an annual basis. The outcome of this assessment must be documented, reviewed and approved by the board of the relevant Authorised Firm before it is submitted to the DFSA.



The DFSA intends to issue more guidance to the Firms on what it expects from the Firms as part of the IRAP assessment, which may include possibly a suggested template for the IRAP assessment report.

25. What are the requirements relating to internal risk assessment as applicable to Firms in categories 1, 2 or 5?

Authorised Firms in these categories are required to complete the IRAP as described in the previous response. In addition, they are also expected to establish and maintain an internal capital adequacy assessment process (ICAAP). These Firms are also required to complete an ICAAP assessment on an annual basis which is subject to appropriate governance and approved by their governing body. The resulting ICAAP assessment report must be submitted to the DFSA for review and evaluation.

The ICAAP assessment should use the results of the IRAP assessment. In light of the risk profile identified in the IRAP assessment, the Authorised Firm should assess the adequacy of the capital required to support that risk profile. If IRAP identifies material levels of risks which have not been adequately addressed in the methodology to calculate regulatory capital requirements as described in PIB Rules, the Firm must estimate the amount of additional capital required to support those risks.

The total amount of such additional capital required to support such risks should be informed to the DFSA as part of the ICAAP assessment report. As part of their supervisory review and evaluation of the ICAAP report, the DFSA supervisors will assess whether all the additional risks have been properly identified and measured and whether the additional capital requirement estimated by the Firm is adequate to cover those additional risks.

Depending on the outcome of this supervisory evaluation, the DFSA will determine whether there is a need to impose an additional capital requirement, in addition to the regulatory capital requirement calculated in accordance to Rules in Chapter 3 of PIB.

Under the new PIB regime, the DFSA is empowered to set a higher capital requirement exceeding the regulatory capital requirement, called the Individual capital requirement (ICR) for any Authorised Firm in the categories 1, 2 or 5. Such ICR will be determined based on the ICAAP results and the supervisory review of the ICAAP results.

26. What is the scope of application of the disclosure requirements specified in chapter 11 of the new PIB?

The disclosure requirements prescribed in Chapter 11 and in App 11 of the new PIB are applicable only to Authorised Firms in categories 1, 2 or 5 of the new PIB.

27. What are the additional measures the DFSA intends to take to facilitate smooth implementation of the new PIB?

The DFSA intends to provide information sessions to Authorised Firms on the various new regulatory requirements as well as various changes to the Rules in the old PIB in Q1 2013.





Apart from this Q&A document, the DFSA also intends to host outreach sessions and targeted workshops to communicate with targeted categories of Firms on the key requirements and practical considerations involved with the new PIB. The DFSA intends to host a session for Firms in categories 3B, 3C and 4 while hosting a separate session for Firms in categories 1, 2, 3A and 5. This is intended to focus the outreach sessions on the relevant aspects of the new PIB module.

Should you have any questions at all, please ensure that you contact your DFSA Supervisor.



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