FREQUENTLY ASKED QUESTIONS OF SAMA'S BASEL II IRB PRUDENTIAL RETURN PACKAGE

JANUARY 2012

SAMA IRB Prudential
Frequently Asked Questions
January 2012

Issue # 1

What is meant by Average Probability of Default (PD)? As per our understanding the Probability of Default (PD) curve is exponential and average PD is more closer to the lower bank in each range associated with the relevant rating grade.

Response

- Average Probability of Default (Ave. PD) refer to the Weighted Average Probability of Default of a group of borrowers classified in a specific rating grade. Refer to GN5 page 2 Returns Q17.11 col. 3, 4 and 5 PD range.

Issue # 2

Whether the Public Sector Entities (PSE) list provided in the Standardized Approach is also applicable to FIRB Implementation and Reporting.

Response

For the present time there are no PSE's in KSA. Refer to GN5 page 2 (Q17.11).

Issue # 2.5

Use of External Ratings associated PDs, from acceptable Rating Agencies, for Corporate Bonds, Sovereign and Banks/FIs exposures:

The above should be allowed since respective rating models and rating process, in general, are robust and calibration is based on long historical data set.

It would be substantial resource burden to develop internal rating models for such asset classes and conduct comprehensive bottom-up individual internal rating exercise.

The Agency may put conditions to this use provided:

1. KSA banks have studied in detail the chosen / acceptable Rating Agencies credit rating methodologies and have made a policy statement that they have confidence, based on their internal studies, in use of these ratings for credit and investment decisions.

Response

The Agency will amend its Guidance Document. Refer to GN5 page 2 Return Q17.11 item col. 1 and 2 under internal rating systems.

Issue # 3

Reference: GN4, Item 29 Page 7, Loss Given Default (LGD)

According to the draft rule for senior exposures that are unsecured or secured by non-recognized collateral should be assigned an LGD of 60% Vs 45% allowed by Basle i.e. it assumes recovery rate of only 40% compared with 55% recommended by Basle on the basis of their survey.
We believe the proposed LGD rate is very high and may not provide incentive for KSA banks to migrate to IRB, and put them to a competitive disadvantage.

Response: SAMA may further study this proposal.

Issue # 3.5

It should not be obligatory manage the SMEs on pooled basis i.e. it would be acceptable if risk grades and PDs are assigned at obligor level.

Response

Not applicable. SAMA expects a pooled treatment for those Small Business Enterprise which are treated as only retail exposures.

Issue # 4

Reference: GN4, Item 17 Page 4 (b), Defaulted Exposures

Please confirm our understanding that the capital charge factor (k) and RW for defaulted exposures should always equal to zero based on the interpretation of item i and ii.

Response: Yes

Issue # 4.5

Need clarification / confirmation that facility ratings are not required for FIRB implementation i.e. in view of use of Regulatory LGDs.

Response

Under FIRB, the above words "facility ratings are not required for FIRB implementation i.e. in view of use of Regulatory LGDs" are only for the corporate portfolio. However, for Retail portfolio regulatory LGDs are not permitted, and bank must develop internal models for them. Please refer to SAMA's Guidance Document GN4 page 11 item 49.

Issues # 5

Reference: GN4**,** Item 31 Page 7**,** Recognized financial collateral

SAMA allows equities as collateral only in case of exposures relating to Manager Lending Program. Please elaborate on what is "manager lending programs".

Response:

- Typographical error
- Should be Margin Lending Program. GGN 4 Guidance amended.

Issue # 6

Reference: GN4, Item 32 Page 8, Loss Given Default (LGD)

LGD needs to be corrected to 60% Vs 45% as erroneously mentioned on this page.

Response: GN4 amended.

Issue # 7

Reference: GN4, Item 71 Page 16, Other Exposures

Please define all other items that are qualified to be categorized under "Other exposures" in FIRB Approach (for e.g. Past Due Assets, other retail etc. classified as "Other Assets" under Standardized Approach but they are differently classified under FIRB due to different classification rules). We believe that we cannot use the same list that was prescribed for the Standardized Approach; please advise/confirm our understanding.

Response: Yes. GN4 Guidelines item 71 amended as attached – attachment 1.

Issue # 8

Reference: GN4, Item 72 page 17, Other Exposures

What would be the RWA for Cash and Cash in collection under FIRB?

Response: GN4 Guidelines to be amended – refer to attachment 1.

Issue # 9

Reference: GN5, Q17.11 Column 17 Page 6, Total Risk Weighted Amount

SAMA specified Column 17 (b) & (c) in Report Q17.11 whereas Specific Guidance Notes refer to (17a) and (17b) on Page 6.

Response: Yes. GN 5 Guidelines (p.6) amended as 17b and 17c.

Issue # 10

Reference: GN5, Q17.12 Item iv Page 8, Exposure after recognized Guarantees/Credit Derivatives

SAMA advised that to report the secured portion after recognized guarantee/Credit Derivative under column 9 to 11 whereas Column 9 to 11 in this report (17.12) does not represent the exposure after recognized guarantees/credit derivative. Does it imply that we have to report secured portion under Q17.11, if that's the case then please advise us where would this secured portion be reported in Q17.12 and what will be the exposure amount assigned to it.

Response: Not Applicable. Secured portion is irrelevant as capital is allocated only for the unsecured portions. Column 9 to 11 in 17.12 represents exposures net of mitigants. Consequently, it is the unsecured portion.

Issue # 11

Reference: GN5, Q17.18 page 19, Off Balance Sheet Exposures

The report does not show column 8 as referred in the Specific Guidance Notes; please clarify.

Response: Yes. The number should be column 7. GN5 amended.

Issue # 12

Reference: GN5, Q17.18 page 19, Off Balance Sheet Exposures

The sub-total for B (iv) & (v) shown in the report as 1 to 5 whereas document shows as 1-8

Response: Q17.18.2 amended; GN5 p.19 amended.

Issue # 13

Reference: GN5, Q17.20 page 20, El-EP calculation under IRB Approach

Please identify the items mentioned on Page 20 with reference to the Table columns.

Response: Yes. Additional Prudential Return Q17.20.1 incorporated as an attachment # 2.

Issue # 14

Reference: GN5, Q17.20 page 20, El-EP calculation under IRB Approach

Item (6) to (9) not clear us; we recommend that item number is mentioned in each respective column for clear identification.

Response: Yes. Additional Prudential Return Q17.20.1 incorporated as an attachment # 2.

Issue # 15

Reference: GN4 & GN5, Whole Document, Abbreviations /Acronyms

A glossary is required to explain various Terms/Abbreviations/Acronyms/Legends used throughout the document

Response: Yes. SAMA will provide. Banks to provide any specific Terms / Abbreviation to assist SAMA in this respect.

Issue # 16

Reference: GN4, Item 6 page 2, Corporate, Sovereign and Bank Exposure

As in case of FIRB value of M is 2.5 years, are there any guidelines for M for AIRB?

Response: Refer to item # 44 and 45 of GN4.

Issue # 17

Reference: GN4, Item 16 Page 4, Corporate, Sovereign and Bank Exposure (Risk weight function for derivation of Risk-weighted amount-non defaulted exposures)

Clarification is needed regarding "Capital charge factor19(k)"

Response

"k" represent Capital Requirements. "19" before "k" is a typographical error – GN4 amended.

Issue # 18

Reference: GN4, Item 48 Page 10, M under double default framework

What is meant by "Mos"? Is it a typing error or a reference to 'M' i.e. Maturity, or it means "Months"?

Response
MOS is an abbreviation for Months.

Issue # 19

Reference: GN5, Item 95 Page 24, STM Approach

Further elaboration is kindly needed

Response
Typographical error – STM approach. It should be Standardized Approach (STD Approach). GN5 amended.

Issue # 20

Reference: GN5, Q17.10, SBFE
Definition is kindly requested for Small business facilities exposure (SBFE's)? Does this include credit cards, loans and all credit granting to SMEs?

Response
Small Business facilities are those business companies and enterprises which have exposure to a bank of less than SR 5 million. This SBFE's qualify to have the same RW at 75% as of Retail Exposures under the Standardize approach. Accordingly, it includes all such exposures from such organization or entities classified as retail exposures.

Issue # 21

Reference: Q17.10 and Q17.13, Commercial Mortgages

Commercial Mortgages mentioned in item 7b Q17.10 needs to be referenced in Q17.13

Response: No. Not a retail exposure. This is already cross referenced to Q17.11

Issue # 22

2) Limitations on the permitted use of IRB Collateral types
The draft IRB rules indicate that SAMA does not recognise any IRB collateral types with the exception of those already eligible under the standardised approach being cash, bank guarantees and shares relating to margin lending programs.

Bank would welcome the opportunity to discuss the feasibility of permitting specific collateral types for situations where the loan to value is below a specific threshold or where the bank has established rights of call and liquidation over liquid securities similar to the controls used in margin lending programs.

Response

- Yes. SAMA is willing to discuss.
- A specific Working Group can be set up and it can also be discussed in the Capital Reforms Working Group.

Issue # 23

Q17.10/Q17.20 – do not specifically mention the Securitized Assets class (previously reflected in the Standardized templates). Should this asset class be disclosed separately or included under the relevant corporate/retail asset class (as specifically described in paragraph 29 of GN-4 for Purchased Receivables)?

Response

Yes. A new column entitled Securitized Assets have inserted into Prudential Return Q17.11.

Issue # 24

Q17.11 – does the description for item (17) refer to "residual" value rather than "residential" value for leasing transactions?

Response

- Typographical error
- Yes. Its Residual Value.
- Q17.11 will be accordingly amended.

Issue # 25

Q17.12 – does the weighted average maturity value in column K refer to the residual or effective maturity? If effective maturity, this will always be 2.5 in accordance with the regulations and is this what is referred to in the comment on line 29 of the report?

Response

- Weighted Average Maturity is the effective Maturity to be used for AIRB Approaches. For FIRB, Banks should use the option of using 2.5 year or the effective maturity.
- Refer to SAMA Guidance GN4 item # 45.

Issue # 26

Q17.13 – should every retail pool be individually listed or should they be combined into 'bands' of similar PD's/LGD's Given that column N requires separate disclosure of the LGD and that exposures with the same PD may have different corresponding LGD's this could result in an extensive list of unique PD/LGD combinations being reported.

Response
The Retail portfolio will have various categories of loan with similar characteristic which are to pooled together such as personal loans pool, credit card loans pool, etc. Each pool i.e. credit cards pool may have 10 risk grades, with each risk grade having a unique PD. In the same manner the personal loan pool may have 7-8 risk grades and each will have unique PD.

Issue # 27
One Bank (Bank # 4)

Q17.8, Q17.8.1 – Columns E,L, & S refer to "CCF". Given that these reports refer to Other Derivative and Credit Derivative products, should this not be labeled as 'ADD-ON'?

Response
- This refers to Q17.18.2.
- Credit equivalents are calculated as provided in the return and refer to item 95 on P.24 of GN4.

Issue # 28
For banks applying for partial use for some of its asset classes, please provide guidance on how the Q17.2 report should the completed until such time as all asset classes are transitioned to the IRB approach i.e. should this report be prepared on a consolidated basis, showing total credit risk for both standardized and IRB approaches or separately for each approach?

Response
Asset classes to the extent moved to the IRB Approaches should utilize the IRB Return Q17.10 series. Bank utilizing IRB Approach should bring forward the capital requirements from Q17.10 to Q17.2A as attachment # 3. Bank utilizing the Standardized approaches should continue to use Q17.2.

Issue # 29
Similarly, should Q17.4 to 17.6 continue to be completed for those exposures still falling under the Standardized Approach?

Response
Yes.

Issue # 30

General Guidance – Page 9 Para 44 (Effective Maturities)

General Guidance – Page 10 Para 45 (Effective Maturities)

Comments: We seek SAMA's clarification that, where individual Effective Maturities cannot be practically computed, banks will be allowed to use contractual (nominal) maturities instead.

Response

- For FIRB, Bank may use 2.5 years
- For AIRB, Banks must use the effective maturity methodology. – refer to GN4 item. In this regard, SAMA has exempted facilities to smaller domestic Saudi corporate borrowers from the explicit maturity adjustment if the reported sales i.e. turnover is less than SR 30 million. If the exemption is applied, all exposures to qualifying smaller Saudi domestic firms will be assumed to have an average maturity of 2.5 years, as under the foundation IRB approach. Please refer to GN4 page 10 item 46.

Issue # 31

General Guidance – Page 5 Para 20 (SME Corporates)

Comments: Here we note that SAMA appears to define an SME by a level of sales that is different from the SAMA 2006 guidance of SR 15 million. We ask that SAMA confirms the new formula is intended to create a different ceiling.

Response

We have charge the threshold to SR 30 million level of sales to conform with SIDF definition. Under the IRB approach for corporate credits, banks are permitted to separately distinguish exposures to SME borrowers (defined as corporate exposures where the reported sales for the consolidated group of which the firm is a part is less than SR 30 million) from those large firms. A firm-size adjustment (i.e. 0.04 x (1 – (S-5) / 45)) is made to the corporate risk weight formula for exposures to SME borrowers. S is expressed as total annual sales in millions of Saudi Riyals with values of S falling in the range of equal to or less than SR 30 million.

Correlation (R) = 0.12 x (1 – EXP (-30 x PD)) / (1 – EXP (-30)) + 0.24 x [1 – (1 – EXP (-30 x PD)) / (1-EXP (-30))] – 0.04 x (1- (S-5) / 45

Issue # 32

General Guidance – Page 6 Para 26 (Sovereign Exposures PDs)

Comments: We seek your confirmation as to whether the national discretion of using 0% RWA (based on 0% PD) for KSA and GCC sovereign exposures will continue under the IRB Approach.

Response
Yes. Also refer to GN5 (page 2, Q17.11)

Issue # 33

GN-4 Para # 20: SAMA under its Guidance Document of June 2006 has defined SME borrowers with value of Sales (S) falling in the range of equal to or less than SR 15 MM. The firm size adjustment (i.e. 0.04 x 1 – (S – 50) / 450), mentioned in the recent guidelines is based on sales of Euro 50 MM for SME, as mentioned in Basle document. The firm size adjustment formula for KSA banks should be adjusted to reflect sales of SR 15 MM.

Response
Yes, this SR 15 million has been amended to SR 30 million

Issue # 34

GN-4 Para # 31: It is noted that equities have been recognized as eligible collateral in case of exposures relating to "manager" lending program. We understand that "manager" is a typing error and has been wrongly mentioned instead of "margin" lending programs, mainly referring to collateralized share trading programs. Kindly clarify.

Response
Typographical error. This is " Margin Lending Program".

Issue # 35

The guidelines GN-5 while explaining return Q17.10 has mentioned that banks will be rolling over portfolios from standardized to IRB approach on an asset class basis. Kindly clarify our understanding that minimum level of IRB coverage (suggested at 85% of bank's RWA in SAMA Guidance Document of June 2006) is no more required, and banks can become IRB-compliant for some of the asset classes, even though the coverage may be less than 85% of total RWAs. We are of the view that flexible approach adopted for Phased Roll out to IRB compliance in the recent guidelines is more practical and prudent as modeling dynamics of 'Bank' and "Sovereign' asset classes have radically changed in recent times and it will take time for models of these asset classes to adjust to the evolving market conditions.

Response

SAMA is further deliberating on this issue and will clarify with the Banks.

Issue # 36
One Bank (Bank # 6)

As mentioned in SAMA Guidance document of June 2006 (para 3.2 pg 10), Banks using the FIRB Approach are capped to 95% of Basel-I Capital for the initial year, and 90% and 80% for each of the following year. Since banks are no longer calculating Capital under Basel-I rules, we suggest that guidelines are amended to include caps as percentages of capital under Basle-II Standardized Approach instead of Basel-I.

Response

Yes. SAMA Guidelines will be accordingly amended.

Issue # 37

GN-4 para 21: The guideline refers to risk weight functions set out in para 55 to 60. We understand that the correct reference would be risk weight functions set out in para 15 to 16.

Response

Yes. GN4 amended.

Issue # 38

GN-4 para 23: The guideline refers to criteria for the equivalent supervisory rating grade as described in para 16. We understand that the correct reference would be criteria for the equivalent supervisory rating grade as described in para 22.

Response

Yes. Accordingly, GN4 amended.

Issue # 39

GN-4: para 32: The guideline refers to foot-notes 1&2, however, no footnotes have been provided.

Response
Yes. Foot note 1 and 2 removed.