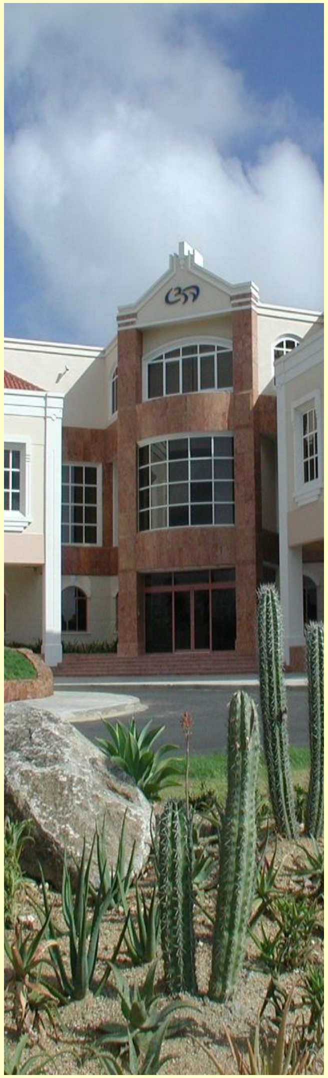


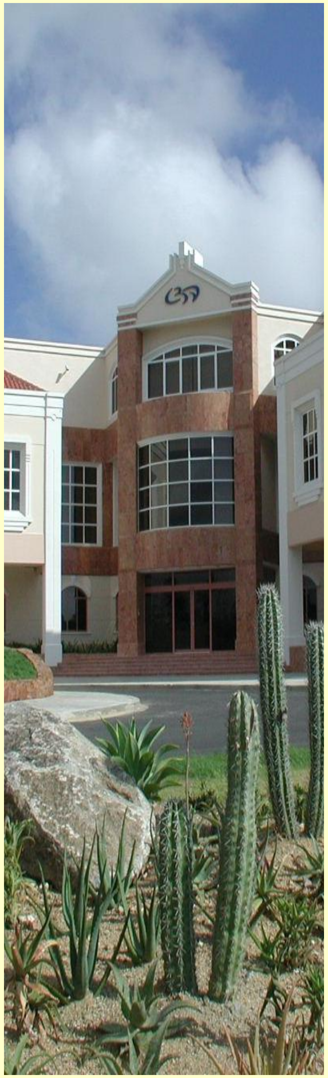
Chart of Accounts
(CoA)

K. Scholliers, Deputy Manager Prudential Supervision Department

April 16, 2014

Centrale Bank van Aruba

Content



1. Introduction New Chart of Accounts (NCoA)
2. Scope
3. General info/background Capital Adequacy (CA)
4. Overview prudential schedules related to CA
5. In-depth review of supporting schedules (SS) 1A up to and including SS 1L
6. Questions

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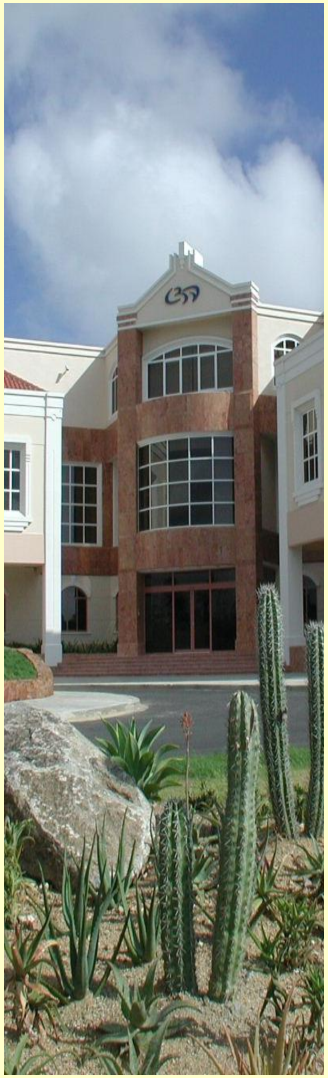
Introduction NCoA



CoA manual – Main document

⇒ Provides conceptual guidelines for the preparation of the CoA reports.

CoA manual – Attachments

⇒ Provides information on and explanation of the SSs

⇒ Contains examples on completing certain SSs

⇒ Contains a listing of the CBA’s choices made under National Discretion

⇒ Provides other relevant information with respect to the application of Basel II

⇒ Provides examples of different CoA reports.

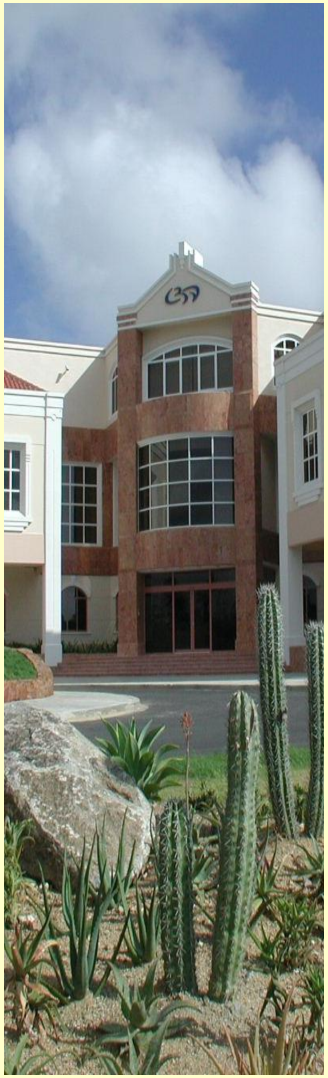
Examples document

⇒ Contains examples to illustrate the reporting of some of the CoA reports.

Tables 4.1 and 4.2 (references to IFRS)

⇒ Contain references to the applicable IFRSs for the classes, accounts and categories.

Scope



Scope of this session

⇒ Discuss in-depth solvency related schedules (see below for overview of SSs)

<u>Not covered today:</u>

⇒ SS 6A and SS 6B

⇒ Credit Risk Mitigation (CRM) Techniques (Attachment i)

⇒ Eligible instruments, compensation and guarantors for CRM

⇒ Measurement methodologies of the Basel II framework for operational risk (Attachment J)

⇒ Market risk measurement framework (Attachment K)

- **CRM, the operational risk measurement framework, the market risk measurement framework and detailed examples will be covered in a later session.**

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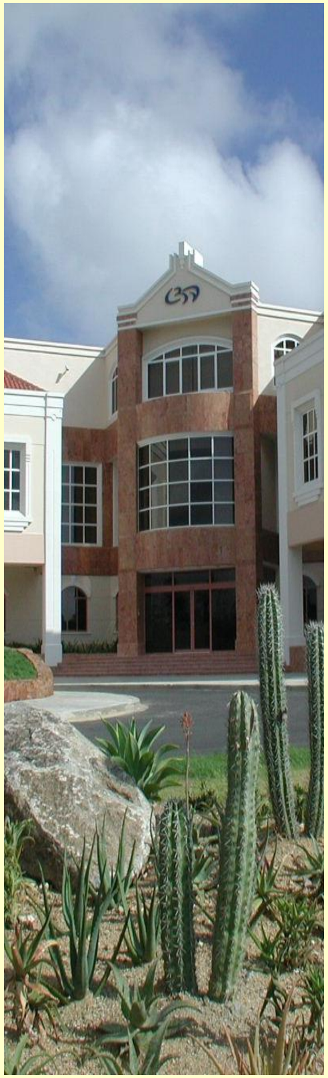
General info/background CA



The Capital Adequacy ratio (CAR) entails:

⇒ A standard for measuring CA (a qualitative element)
⇒ A minimum solvency level to be maintained (a quantitative element)

The CAR's purpose is:

⇒ To protect depositor's funds
⇒ To promote the stability and efficiency of the financial system.

The total Capital base consists of:

⇒ The core capital (Tier 1) which serves to absorb losses sustained in the ordinary course of the business operations.
⇒ Supplementary capital (Tier 2) which serves to absorb losses in the event of a liquidation of a reporting institution

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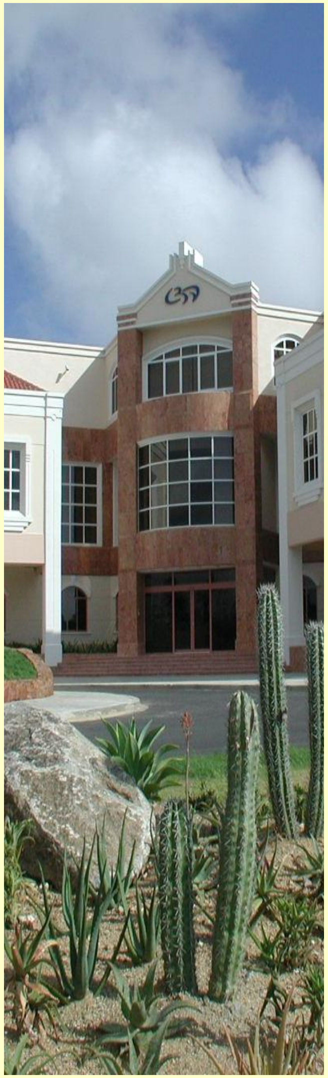
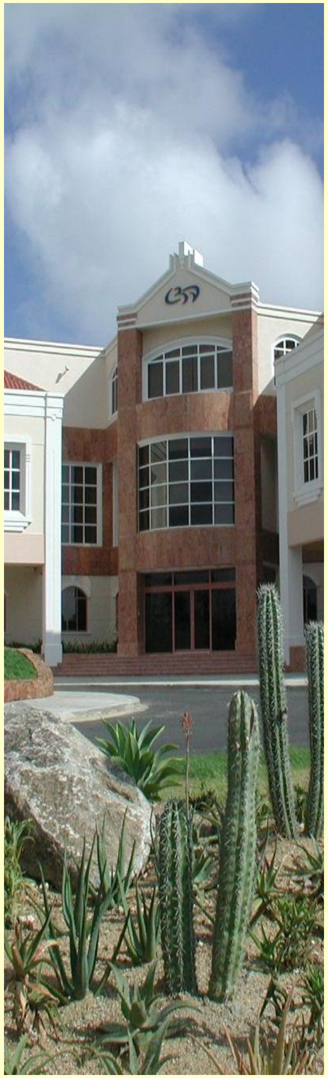
Overview CA related schedules (cont’d)



The **<u>Prudential SSs</u>** compared to current appendices- capital adequacy related:

CoA		Montly Statement	
SS 1A	Capital Adequacy Ratio (CAR)	**Appendix 7**	Risk Weighted Solvency Test
SS 1B	Capital	**Appendix 7**	Risk Weighted Solvency Test
SS 1C	RWA- Standardized Credit Risk	**Appendix 7**	Risk Weighted Solvency Test
SS 1D	RWA- Standardized Credit Risk Contingent liabilities	**Appendix 7**	Risk Weighted Solvency Test
SS 1E	RWA- Standardized Credit Risk Derivatives	**New!**	
SS 1F-1	RWA -Basic Indicator Approach Operational Risk	**New!**	
SS 1F-2	RWA -Standardized Approach Operational Risk	**New!**	
SS 1F-3	RWA -Alternativ. Standaridized Appr. Operational Ris	**New!**	
SS 1G	Market Risk Standard Method Summary	**New!**	
SS 1H-1	Market Risk Standard Method Interest Rate Risk-Specific Risk	**New!**	
SS 1H-2	Market Risk Standard Method Interest Rate Risk-General Market Risk	**New!**	
SS 1H-3	Market Risk Standard Method Interest Rate Risk-General Market Risk (Summary)	**New!**	
SS 1I-1	Market Risk Standard Method Equity Position Risk (per national market)	**New!**	
SS 1I-2	Market Risk Standard Method Equity Position Risk (Summary)	**New!**	
SS 1J	Market Risk Standard Method Foreign Exchange Risk	**Somewhat like Appendix 16**	Foreign Exchange Risk Exposure
SS 1K	Market Risk Standard Method Commodities Risk Simplified Approach	**New!**	
SS 1L	Market Risk Standard Method Options Risk Simplified Approach	**New!**	
SS 4	Due from/due to unconsolidated affiliates	**New!**	
SS 6A	Large Exposures	**Appendix 3**	Large Loans
SS 6B	Large and Other Exposures	**New!**	

Overview CA related schedules (cont'd)



Flow of capital adequacy related schedules:

RWA related
Contingent liabilities (SS 1D)
Derivative contracts (SS 1E)
Large exposures (SS 6A-6B)
Mortgages meeting qualification requirements (Subreport II-D)

Market risk capital charges
Interest rate risk (SS 1H)
Equity position risk (SS 1i)
FOREX risk (SS 1J)
Commodities risk (SS 1K/)
Options risk (SS 1L)

Capital (SS 1B)

RWA (SS 1C)

RWA Equivalent Operational risk (SS 1F-1)

RWA Equivalent Market risk (SS 1G)

CAR (SS 1A)

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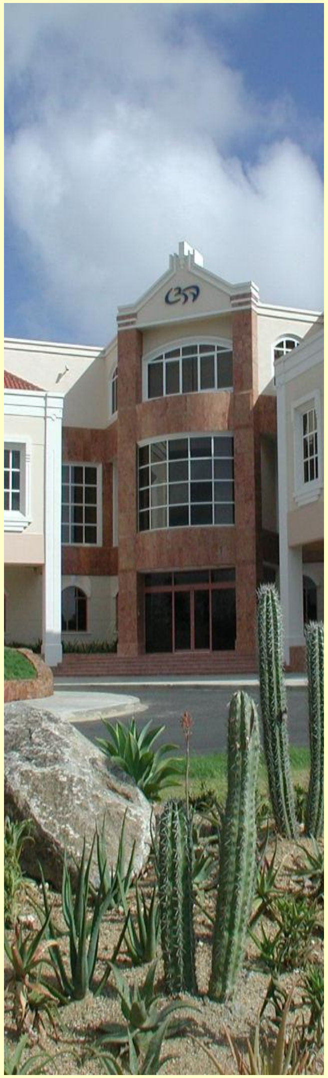
In-depth review CA-SS



SS 1A CAR

- Objective: overview of capital base and the aggregated risk weighted assets (RWA) and calculation of CAR. This SS serves to verify if minimum requirement of 14% is met.
- Frequency: reporting on a monthly consolidated basis
- SS 1A is linked to: SS 1B (Capital), SS 1C (RWA for credit risk), SS 1F-1/SS 1F-2/ SS 1F-3 (RWA for operational risk) and SS 1G (RWA for market risk)

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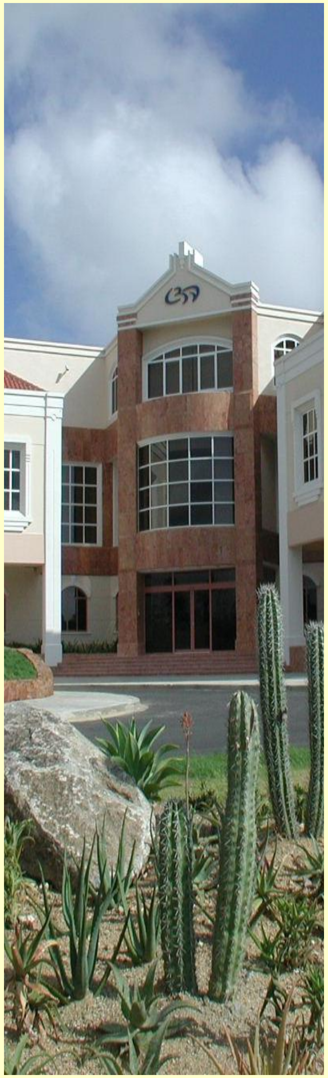
In-depth review CA-SS (cont'd)



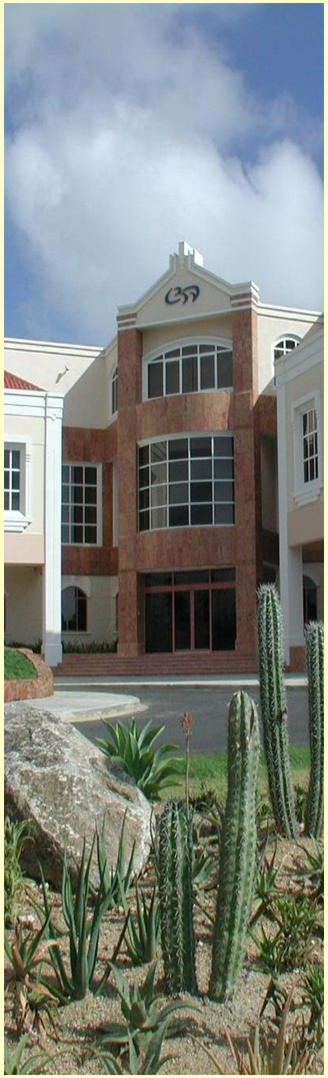
SS 1B Capital

- Objective: overview of the total capital base (or regulatory capital) => for inclusion in SS 1A

- Tier 1 components: Share capital, share premium, other reserves, retained earnings and non-controlling interests.
- Tier 1 deductions: goodwill, intangible assets, disallowed DTA and shortfall in Tier 2 must be deducted for 100% + other (50/50 of investment qualifying as significant).

- Tier 2 components: revaluation reserves, regulatory reserves, subordinated debentures and limited life redeemable shares that qualify as Tier 2.
- Tier 2 deductions: Prudential filters (line items 280-330) + other (see above).

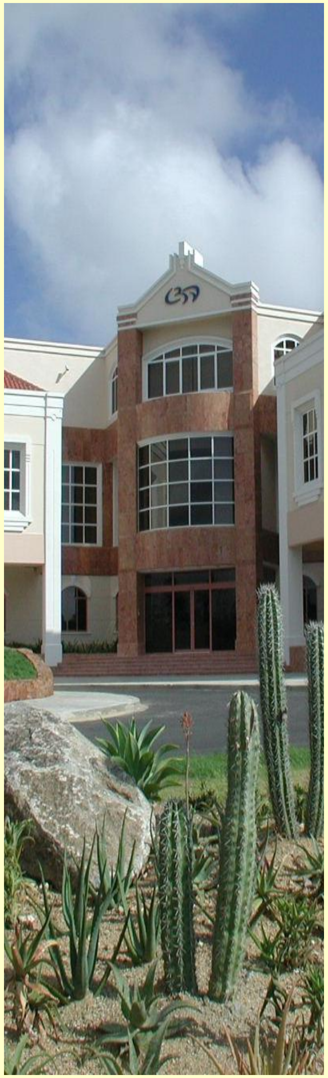
In-depth review CA-SS (cont'd)



SS 1B Capital (cont'd)

- Limitations:
  - Net Tier 1 = constitute min. 75% of required capital base
  - Net Tier 2 = limited to max. 100% of net Tier 1 capital
  - Total subordinated debentures and limited life redeemable preference shares = limited to max. 50% of net Tier 1 capital.

In-depth review CA-SS (cont'd)



<u>SS 1C: Risk-weighted assets (RWA) standardized credit risk</u>

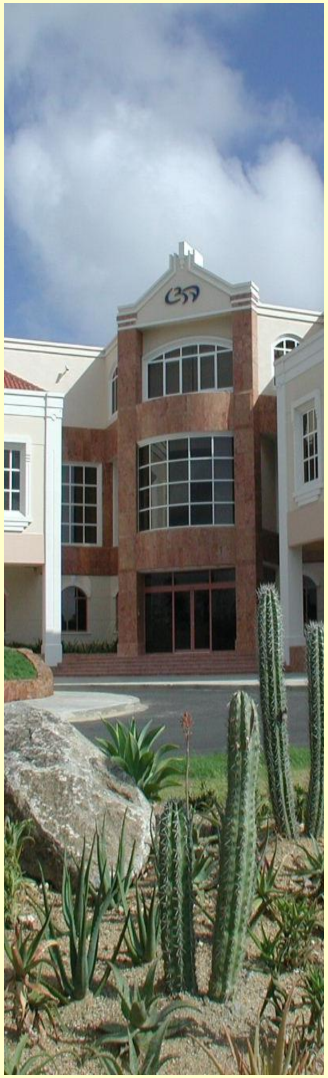
- <u>Objective:</u> overview of reporting institution's <u>total RWA</u> relating to credit risk contained in its balance sheet (incl. contingent liabilities and derivatives) under the standard approach. => for inclusion in SS 1A.

- <u>SS 1C is linked to:</u> SS 1D and SS 1E

- <u>Credit Risk</u> = risk that the borrower or counterparty will fail to meet its obligations in accordance with agreed terms.

$\Rightarrow$ Basel I already required to hold regulatory capital against credit risk.

In-depth review CA-SS (cont'd)



<u>SS 1C: Risk-weighted assets (RWA) standardized credit risk (cont'd)</u>

- <u>CR should be measured using:</u>

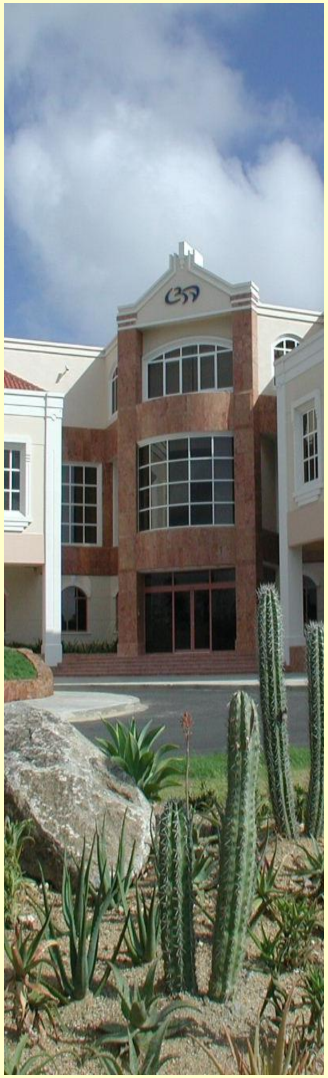
⇒ Credit assessments of eligible external credit assessment institutions (ECAIs) coupled to risk weight and risk grades

⇒ Risk weights to exposure amounts, based on the type of counterparty and presence/absence of credit assessments

⇒ CRM techniques (choice of 3 types – included in attachment i-1 and i-2).

- <u>Assets excluded from SS 1C</u>: All assets and investments in banking, subsidiaries and other (institutions) which are already deducted from Tier 1 and 2, as set out in SS 1B.

In-depth review CA-SS (cont'd)



<u>SS 1C: Risk-weighted assets (RWA) standardized credit risk (cont'd)</u>

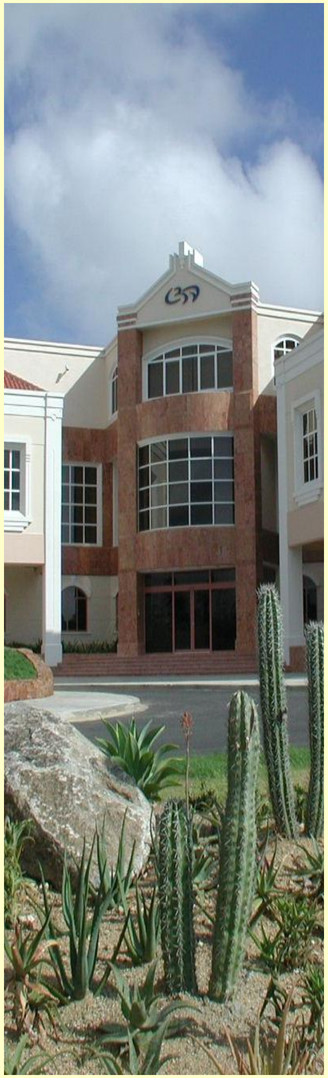
<u>Treatment of mortgages in SS 1C</u>

- <u>Sup- report II</u>: consists of Part II-A, II-B, II-C and II-D

$\Rightarrow$ Part II-A, II-B and II-C should be reported gross (for monetary and prudential purposes). Total of A,B and C should equal line item 1403.

$\Rightarrow$ Part II-D: should be reported net (after deduction of specific provisions) = for prudential purposes only. Inclusion in part D depends of qualification requirements .

In-depth review CA-SS (cont'd)



SS 1C: Risk-weighted assets (RWA) standardized credit risk (cont'd)

- Qualification requirements for inclusion in Part II-D:

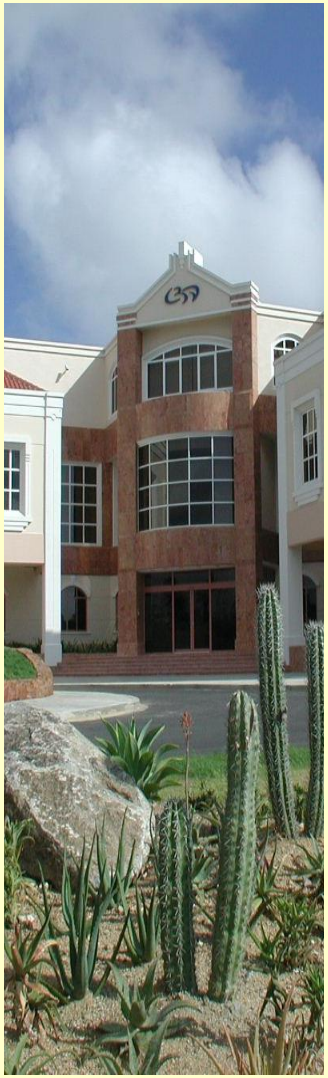
⇒ For residential mortgages only!

⇒ Other requirements

⇒ Qualifying mortgage insurers

⇒ Final step: inclusion in SS 1C

In-depth review CA-SS (cont'd)



<u>SS 1D: Risk-weighted assets standardized credit risk Contingent Liabilities</u>

- <u>Objective:</u> overview of RWA relating to credit risk in connection with off-balance sheet (OBS) exposures => for inclusion in SS 1C.

- <u>Potential credit risk of OBS instruments</u> = face amount (notional principal amount) * appropriate credit conversion factor (CCF) = Credit equivalent amount (CEA).

⇒ In summary: CEA = notional amount x CCF
RWA = CEA x Risk weight

- <u>Off-balance sheet transactions:</u>

⇒ Drawn portions of commitment form part of on-balance sheet credit exposure

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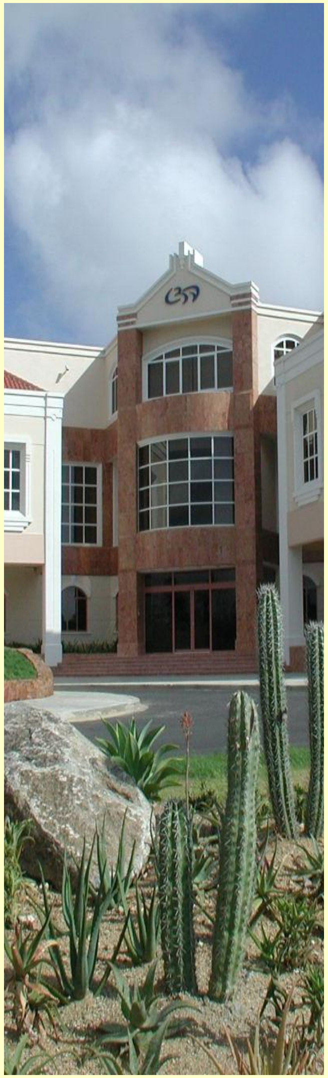
In-depth review CA-SS (cont'd)



SS 1D: Risk-weighted assets standardized credit risk Contingent Liabilities (cont'd)

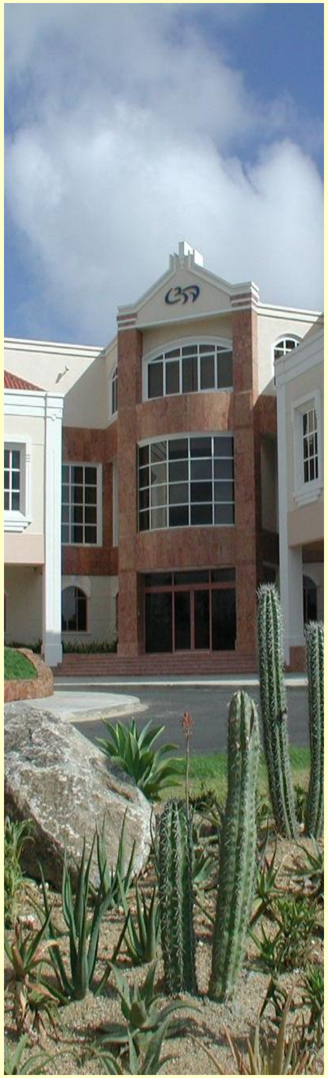
- Off-balance sheet transactions (cont'd):

⇒ maximum unused portion of commitment must be included in CEA

⇒ Undrawn balances of revolving facilities must be reported in this schedule (line item 8506)

⇒ All commitments must be included regardless whether or not a material adverse change clause is included

In-depth review CA-SS (cont'd)



SS 1E: Risk-weighted assets standardized credit risk Derivatives

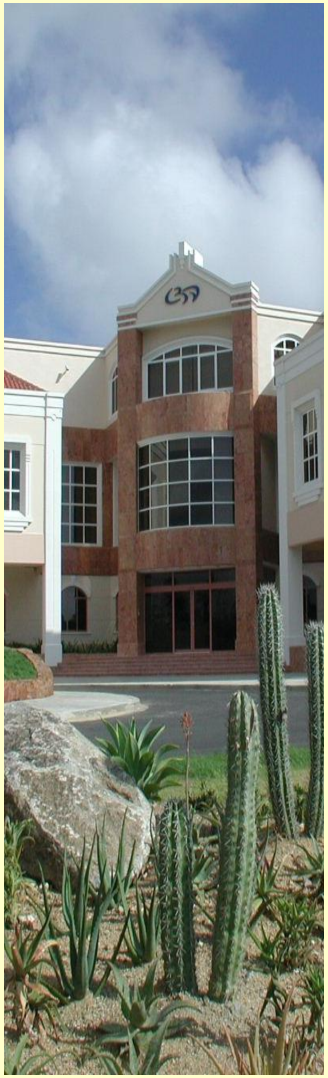
- Objective: overview of RWA relating to credit risk of derivatives contracts under standardized approach => for inclusion in SS 1C. For the OTC derivatives only!

- Derivative contracts = all type of market related transactions held in the banking and trading books that give rise to OBS credit risk (e.g. swaps, forward rate agreement, options…).

- RWA is determined by a 2-step process:

1. CEA = sum for each contract of (i) the MTM-value (ONLY if positive amount) and (ii) an estimate of the potential future increase in credit exposure (see next slide) over the remaining life of the instrument.

In-depth review CA-SS (cont'd)



SS 1E: Risk-weighted assets standardized credit risk Derivatives

RWA is determined by a 2-step process (cont'd):

2. CEA is treated like a balance sheet asset and gets a risk weight assigned that is appropriate to the counterparty or, if relevant, the guarantor or the collateral. => RWA = CEA x RW

- Potential future credit exposure of a contract (see previous slide) = notional principal amount (even if MTM results in a negative amount) * CCF (see attachment G).

- Exemptions: foreign exchange (except gold) contracts with original term of 14 days or less, and futures and options exchanges subject to daily MTM and margin payments.

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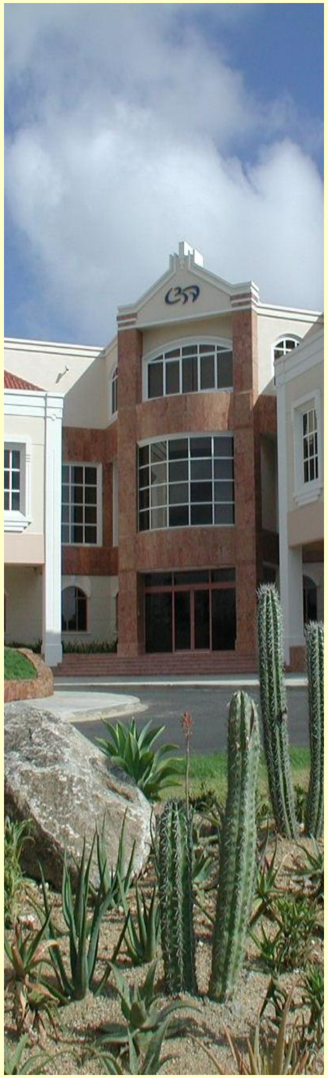
In-depth review CA-SS (cont'd)



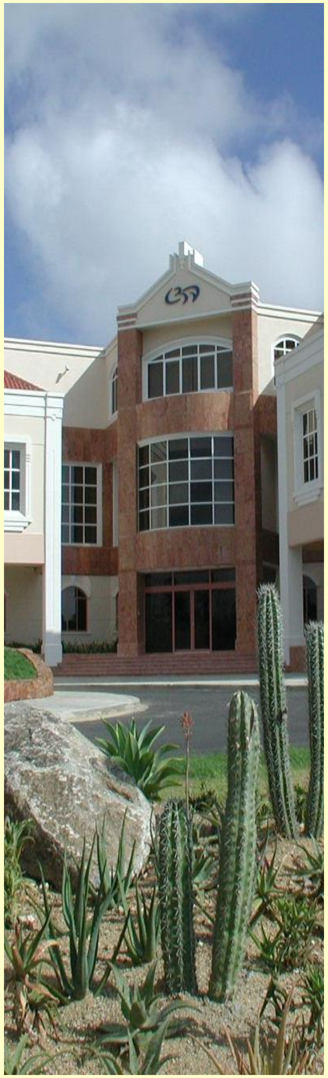
SS 1F-1: Risk-weighted assets Basic Indicator Approach- Operational Risk (BIA)

- Objective: overview of required data relating to the reporting institution's operational risk under BIA => for inclusion in SS 1A.

- Basic Indicator approach = reporting institutions must hold a capital charge for operational risk equal to the average over the previous 3 years of a fixed % (alpha / α) of positive annual gross income.
- α = set at 15% by the Basel Committee

☝ Until further notice by the CBA = BIA method MUST be used for operational risk reporting purposes.

In-depth review CA-SS (cont'd)



SS 1G:Market Risk (MR) Standard Method Summary

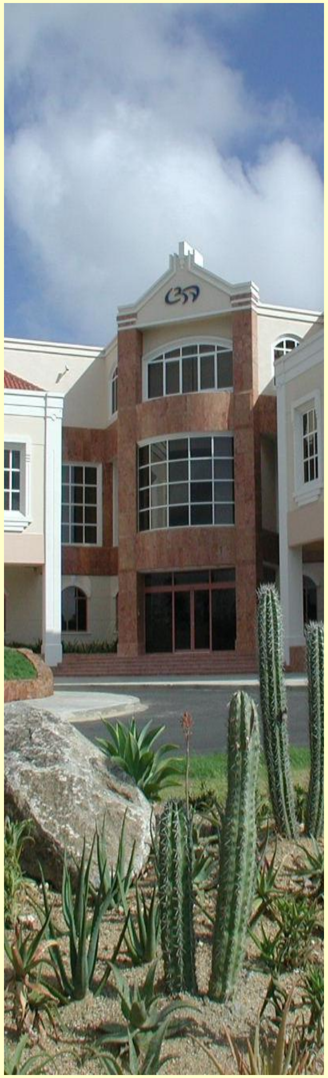
- Objective: SSs on market risk provide an overview of the reporting institution's exposure to market risk arising from positions in the trading book (interest rate and equity positions risks) and the entire business (foreign exchange and commodities risks) => for inclusion in SS 1A.

- All exposures should be converted in local currency (at spot rate on reporting date).

- Following **minimis rule** applies for market risk:

⇒ If total capital charge for MR = or < than 1% of total assets or Afl. 100.000, only SS 1G must submitted; however, total RWA for MR shall NOT be included in SS 1A when calculating the CAR + nr. 31 to be entered in row 180, column 3 of SS 1G.

In-depth review CA-SS (cont'd)



SS 1G:Market Risk (MR) Standard Method Summary

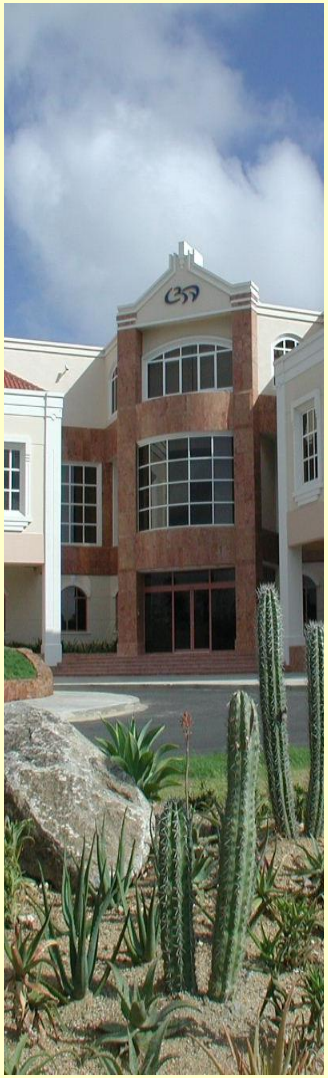
- Following **minimis rule** (cont'd):

⇒ If total capital charge for MR < than 5% of total minimum required capital amount of previous reporting month (but above aforementioned limit), only SS 1G must submitted and total RWA for MR shall be included in SS 1A when calculating the CAR + nr. 32 to be entered in row 180, column 3 of SS 1G.

⇒ In case of 3 or less market positions (below abovementioned limits), exemption to report market risk. However, SS 1G must be submitted + nr. 33 to be entered in row 180, column 3 of SS 1G.

- SS 1G is linked to: SS 1H-1/ SS 1H-2/SS 1H-3, SS 1i-1/ SS 1i-2, SS 1J, SS 1K and SS 1L

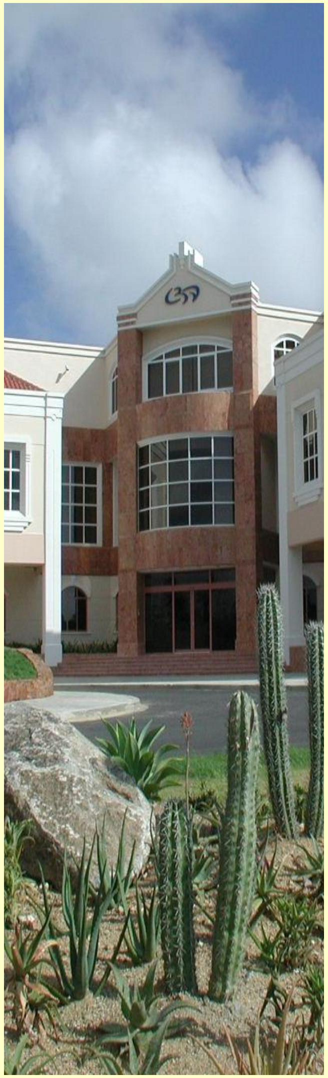
In-depth review CA-SS (cont'd)



SS 1H-1/ 1H-2/ 1H-3: Market Risk Standard method Interest Rate Risk (Specific risk, general market risk and general market risk summary)

- All positions in debt securities and other interest rate related instruments in the trading book, including interest rate derivatives and quasi-debt securities that behave like debt should be reported in SS 1H-1, SS 1H-2 and SS 1H-3
- All positions in interest rate options must be reported under SS 1L
- Total capital requirement for interest rate risk comprises capital charges of SS 1H-1/SS 1H-3 and SS 1L.

In-depth review CA-SS (cont'd)



SS 1H-1: Market Risk Standard method Interest Rate Risk – Specific risk

- SS 1H-1 includes 3 categories of issuers (government, qualifying, other) for which a pre-determined risk weight % is applied.

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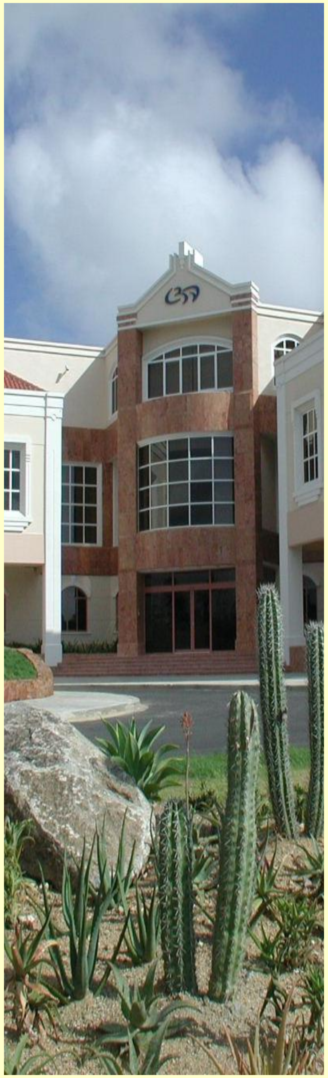
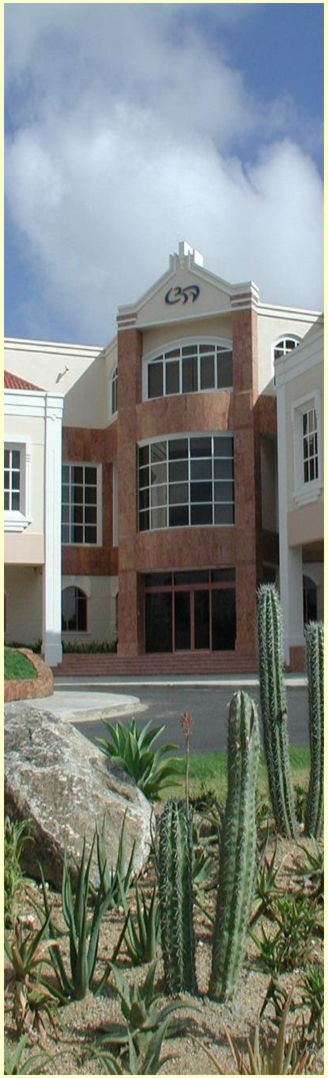
In-depth review CA-SS (cont'd)



SS 1H-2: Market Risk Standard method Interest Rate Risk – General market risk

- SS 1H-2 should be completed for each currency in which a significant interest exposure is held. Per currency => 1 SS!
- In case of currencies in which the institution's business is insignificant => all those currencies may be reported in one SS 1H-2. In this case the word "insignificant" must be written on the SS.
- Predetermined codes that indicate the currencies in which positions might be held will be provided by the CBA. These codes must be filled out on SS 1H-2.

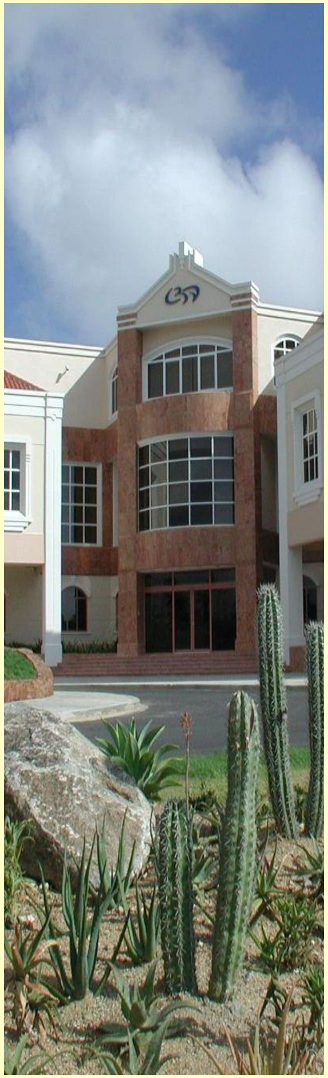
In-depth review CA-SS (cont'd)



SS 1H-3: Market Risk Standard method Interest Rate Risk – General market risk (Summary)

- SS 1H-3 provides a summary including all SS 1H-2 amounts (per currency).

In-depth review CA-SS (cont'd)

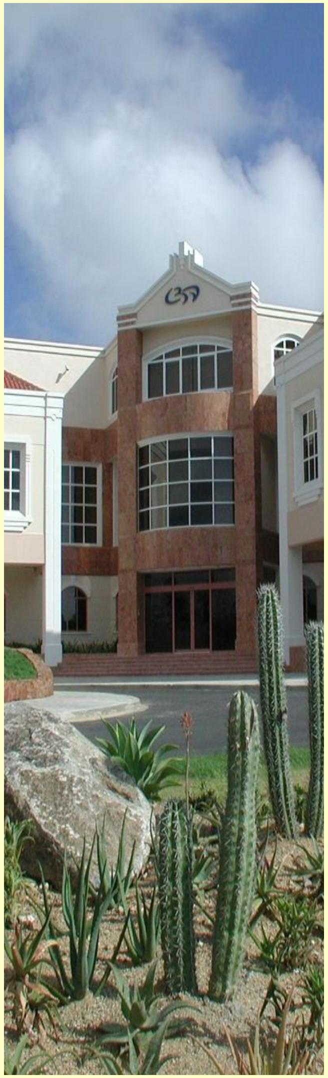


SS 1i-1/ 1i-2: Market Risk Standard method Equity position risk (per national market- country and summary)

- All long and short equity positions in the trading book including all instruments that exhibit market behavior similar to equities must be reported in SS 1i-1.

- All positions in equity options must be reported in SS 1L.

In-depth review CA-SS (cont'd)



SS 1J: Market Risk Standard method Foreign exchange risk

- Objective: sets out the minimum capital standard to cover the risk of holding or taking positions in foreign currencies, including gold.
- Each foreign currency must be reported on a separate line item, including the mix of long and short term positions in the different currencies.
- Net open positions in each foreign currency should be converted at spot rates into the reporting currency (column G and H).
- When calculation net positions in each foreign currency:

⇒ Include all transactions as contracted at reporting date

⇒ Forward positions must be valued at spot market exchange rates or using net present values.

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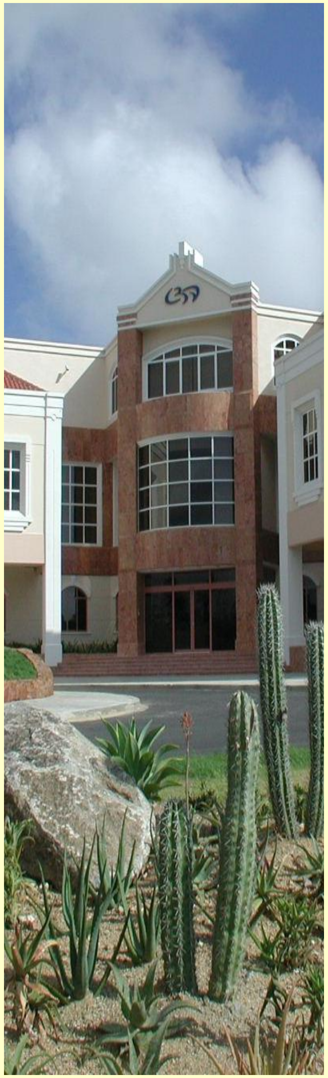
In-depth review CA-SS (cont'd)

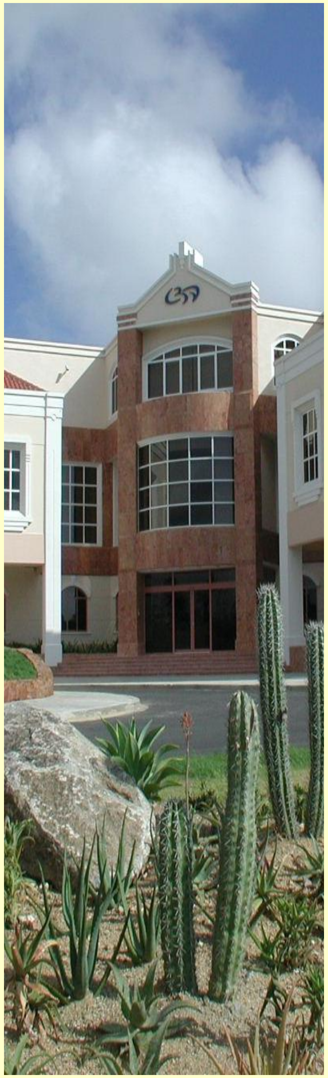


<u>SS 1J: Market Risk Standard method Foreign exchange risk (cont'd)</u>

- <u>Capital requirement</u>: 14%

$\Rightarrow$ Total capital charge for foreign exchange risk is 14% of the higher of either the absolute value of the net short currency position or net long currency position plus the net position in gold.

In-depth review CA-SS (cont'd)



SS 1K: Market Risk Standard method Commodoties risk – Simplified approach

- Objective: to report all commodity positions (forwards, futures and swaps), both on balance and off balance sheet, which are affected by commodity prices.

- Each commodity position must be expressed in terms of standard unit of measurement (e.g. barrels, kilos, grams) and converted into local currency at spot rates at the close of the business on the reporting date.

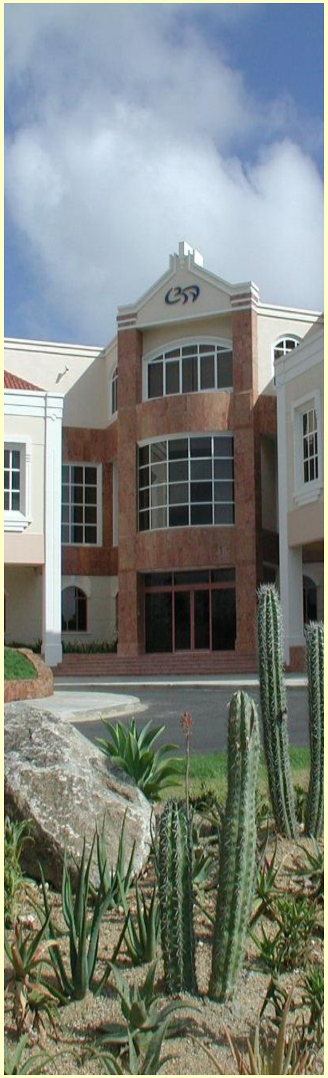
- Capital requirement:

⇒ Separate per commodity

⇒ Positions may not be offset (except for the permissible offsetting)

⇒ Capital charges: (i) 15% on net open positions and additional 3% on gross positions (long plus short)

In-depth review CA-SS (cont'd)



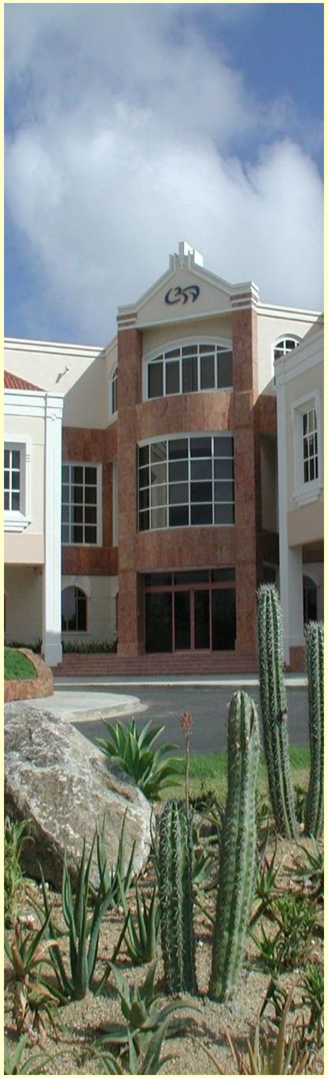
SS 1L: Market Risk Standard method Options risk – Simplified approach

- Objective: to report all positions for open contracts and related hedging positions in the associated underlying instruments, commodity, index, cash or forward.

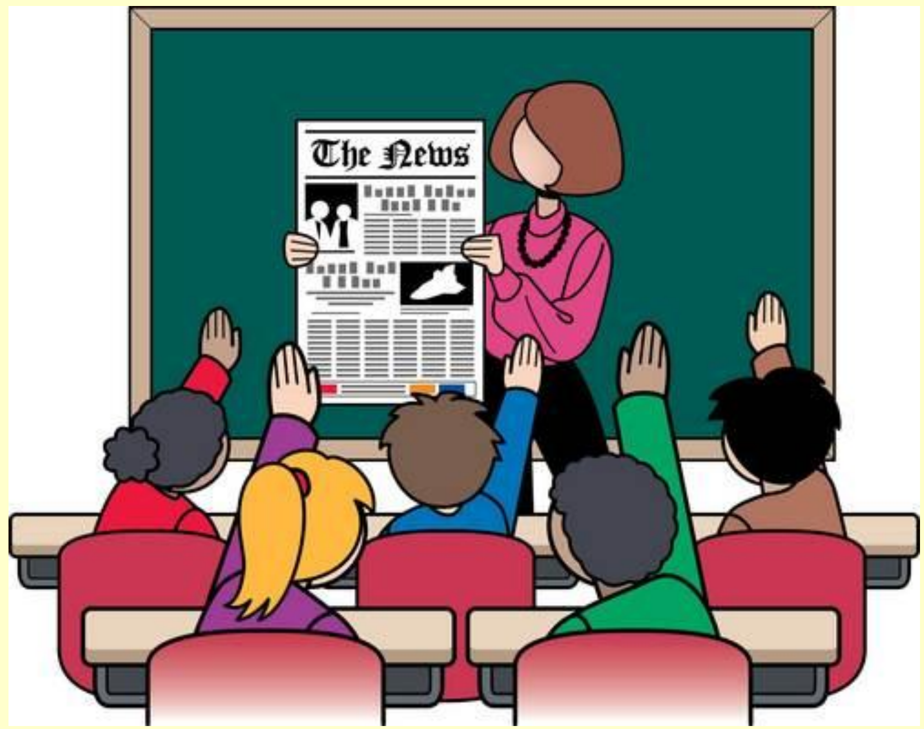
- Capital requirement:

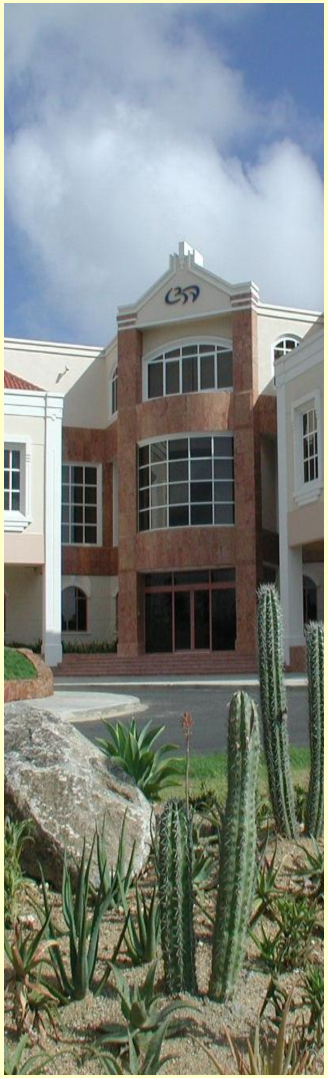
⇒ Calculate separately capital charges that include both general market risk and specific risk

⇒ Results shall also be included in capital requirements for interest rate related instruments, equities, foreign exchange and commodities risk.



Questions ?





Thank you for your attention!

Centrale Bank van Aruba