Central Bank of Jordan

Regulatory Capital Instructions

According to the revised standard No. (15) issued by the Islamic Financial Services Board No. (72/2018)

Contents

Chapter one: Scope of application ………………………………………………… 4
Chapter two: Capital Requirements ……………………………………………. 7
First: Components of Capital …………………………………………… 7
Second: Elements of Capital ………………………………………………… 7
Third: Capital Qualifying Criteria ………………………………………… 8
Fourth: Regulatory adjustments and deductions …………………………… 15
Fifth: Calculating the capital adequacy ratio ……………………………… 20
Sixth: Instructions application …………………………………………… 21
Chapter three: Additional capital requirements …………………………………. 22
Chapter four: Risk Coverage ……………………………………………………. 24
First: Credit risk (standardized approach) ………………………………… 24
Second: Credit Risk Mitigations (CRM) ………………………………… 33
Third: Operational Risk …………………………………………………… 41
Fourth: Market Risk – Standardized Approach …………………………… 47
Chapter five: Leverage Ratio …………………………………………………… 56
Chapter Six: Islamic finance formulas ………………………………………….. 58

Annexes

Annex (1) Investments in banks, securities companies, and other financial companies in the event of non- consolidation ………………………………………… 71

Annex (2) Minority interest illustrative example……………………………………… 72

Annex (3) Corresponding Deduction Approach ……………………………………… 74

Annex (4) Threshold deductions illustrative example………………………………… 75

Annex (5) The Regulatory Capital…………………………………………………… 76

Annex no. (6) The steps that the Central Bank will follow regarding the countercyclical buffer……………………………………………………… 78

Annex (7) External Risk Rating Mapping………………………………………….. 79

Annex (8) Ministries and institutions eligible for Jordanian government risk weights (zero%)……………………………………………………………… 80

Annex (9) Establishments and institutions that eligible for banks risk weights……… 82

Annex (10) Establishments and institutions that eligible for companies' risk weights 84

Annex (11) Conditions that must be met by a small enterprise to be included in the retail portfolio……………………………………………………….. 85

Annex (12) Qualifying residential financing………………………………………. 86

Annex (13) Mapping of Business Lines……………………………………………. 88

Annex (14) The capital charge for equities risk……………………………………. 89

Annex (15) Specific risk for return rate related Sukūk in the trading book…………… 90

Annex (16) General risk for return rate related Sukūk in the trading book……………. 91

Annex (17): calculation of General risk for return rate related to Sukūk…………….. 92

Annex (18) Market risk for foreign exchange rate and gold/ silver…………………… 94

Annex (19) Simplified approach used to calculate commodities risk…………………. 95

Annex (20) Leverage Ratio………………………………………………………… 96

Chapter one: Scope of application

First: These instructions shall be applied to all licensed Islamic banks in the Kingdom on a consolidated basis, as well as at the levels shown below, so that the banks shall provide the Central Bank with capital adequacy models for these levels as follows:

1. The banking group[1], including the financial subsidiaries and holding companies (excluding *Takaful* companies)
2. Jordan and abroad branches.
3. Jordan branches.
4. Cross-border establishments separately.
5. The banking subsidiaries separately.

Second: The consolidation mechanism for the purposes of implementing the capital adequacy standard

1. Banks and other financial companies consolidated within the banking group:
   a. Companies' financial statement may not be consolidated if they are acquired as debt payment or kept for a temporary period for the purpose of sale, or if they are subject to special legislation that does not allow for consolidation.
   b. In the event of non-consolidation for the purposes of calculating capital adequacy and the company's financial statements are consolidated for accounting purposes, then the value of the bank's investment in the non-consolidated company must be subtracted (the bank's own funds) from the regulatory capital of the banking group, and at the same time, for the purposes of capital adequacy calculation, the assets, liabilities and minority interest (related to the non-consolidated company) from the financial statements of the banking group.

2. Investments in banks, securities companies, and other financial companies:
   a. Banks, securities firms, and other financial companies owned or controlled by the bank should fully consolidate their accounts to the maximum extent possible, in all cases, the financial statement of banks, securities companies and other financial companies owned by more than 50% of their capital must be consolidated, except in cases in which this matter cannot be achieved due to lack of benefit, as cases where the share is temporary in nature or where non-consolidation is a legal requirement of the host supervisory authority. In the event of non- consolidation, the carrying value of the bank’s share in the capital of these companies shall subtracted from the regulatory capital if it is financed from the bank’s own funds, and the bank’s share in capital of these companies shall subtracted from the carrying value of its contribution of the

[1] The banking group belongs to the Jordanian Islamic banks.

regulatory capital, when the funds are commingled, as indicated in annex no. (1).

b. When consolidating the accounts of banks, securities companies and other financial companies owned by a majority (50% or more) or controlled (according to the definition of control mentioned in the accounting standards) from the bank with its financial accounts, and for the purposes of calculating the capital, the recognition of these companies' capital in the parent bank's capital is subject to the guidelines for the recognition of minority interest. See clause (third / 5) of chapter two.

c. In the case of subsidiary companies (that consolidate their financial statement) that have a deficit in the capital which was decided by the supervisory authority (the host), the concerned licensed bank must directly inform the Central Bank of Jordan of this deficit. In turn, the Central Bank of Jordan will monitor the measures taken by that subsidiary company to rectify its situation. If the company does not correct during the period granted to the bank, this deficit will be subtracted from the regulatory capital of the licensed bank (the parent bank).

3. Investments in the capital of banks, financial companies and *Takaful* companies that are not consolidated within the banking group:

a. Investments[2] financed from the bank's own funds and financed from sharing investment accounts in the capital of banks, financial companies and *Takaful* companies that are less than (10%) of the capital of these companies are treated with as described in clause (fourth/ 10) of chapter two.

b. Investments financed from the bank's own funds and financed from sharing investment accounts in the capital of banks, financial companies and *Takaful* companies that exceed (10%) of the capital of these companies are treated with as described in clause (fourth/ 11) of chapter two.

c. When consolidating *Takaful* companies accounts that are majority owned and/or controlled by the bank that financed from the bank's own funds. The Central Bank of Jordan will only allow recognition of the surplus in the *Takaful* companies capital (which is the amount that exceeds the regulatory capital required of the *Takaful* company) under certain conditions[3] within the regulatory capital of the licensed bank, as indicated in Minority Interests clause no. (third/ 5) of Chapter Two. The banks that have recognized the surplus in the capital of the subsidiary *Takaful* companies must disclose to the public the amount of this surplus. Note that if the bank's ownership in the

[2] It includes direct and indirect investments, whether classified within the banking or trading book.

[3] The amount deducted from investments in equity and other investments in regulatory capital will be subject to adjustment to reflect the amount of the surplus in capital of these companies that exceeds the regulatory requirements. That is, the deducted amount will be the amount of investment and / or the regulatory capital requirements, whichever is less, as indicated in clause (third / 5) of chapter Two. The amount representing the surplus (the difference between the investment in these companies and their regulatory capital) will be given a risk-weight like any other investment.

Takaful company's capital (more than 50% and less than 100%), then the recognized surplus must be proportional to the ownership percentage. For the surplus in *Takaful* companies' capital which the bank owns minority interest and not major to the bank, it will not be recognized, as the bank does not have the ability to transfer the surplus in the capital of these companies because the bank has no control over that.

3.4 In the case of subsidiary *Takaful* companies (which consolidate their financial statement) that have a deficit in the capital, which was decided by the supervisory authority. The concerned licensed bank must directly inform the Central Bank of Jordan of this deficit. In turn, the Central Bank of Jordan will monitor the measures taken by that subsidiary company to correct its position. If the company does not rectify its positions during the period granted to the bank, this deficit will be subtracted from the regulatory capital of the licensed bank (the parent bank).

Chapter two: Capital Requirements

First: Components of Capital

This section provides a definition of capital base components for Islamic banks. The eligible capital along with the total risk-weighted assets shall be used in calculating the Capital Adequacy Ratio (CAR) for the Islamic banks. Where the eligible capital will be used as a numerator of the capital adequacy ratio and the total risk-weighted assets will be the denominator of that ratio. This section will further explain the criteria and characteristics of each component of eligible capital.

Second: Elements of Capital

1. The eligible regulatory capital will include the following capital elements:
   a. Tier 1 Capital (going-concern capital):
      1. Common Equity Tier 1 (CET1)
      2. Additional Tier 1 (AT1).

   b. Tier 2 (T2) Capital (gone-concern capital), it consists of financial instruments that comply with the Islamic Sharia provisions and such reserves as indicated in Clause (third / 3) of this chapter [4].

2. For each of the three capital types (CET1, AT1 and T2), there is a specific set of criteria that the financial instrument must fulfill before being included in the relevant category, as shown later. The inclusion of any of the instruments within Additional Tier 1 in the Tier 1 or Tier 2 is subject to the discretion of the Central Bank of Jordan after meeting the relevant criteria, in particular the ability to absorb losses.
3. All capital elements will be after the regulatory adjustments specified in clause (fourth) of this chapter. So that the total regulatory capital must be at least (12%) of the risk-weighted assets for credit, market and operational risks at all times. So that the components of the ratio are as follows:
   a. Common Equity Tier 1 must be at least 6% of risk-weighted assets at all times.
   b. The additional Tier 1 (AT1) shall not exceed (1.5%) of risk-weighted assets at all times.
   c. Tier 2 (T2) shall not exceed (2%) of risk-weighted assets at all times.
   d. The Conservation Buffer is (2.5%) of risk-weighted assets and it should be from (CET1).
4. For the purposes of classifying the bank within the first category "Well Capitalized", its capital adequacy ratio must not be less than (14%), but if the bank is classified within D-SIBs and for the purposes of its classification within the Well Capitalized category, its capital adequacy ratio must not be less than (14%+ capital required from D-SIBs, according to the category to which the bank belongs, and according to the time frame set out in the Domestic Systemically Important Banks (D-SIBs) instructions).

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[4] In the event that the bank encounters substantial financial problems, the Central Bank has the right to issue instructions that include these instruments absorbing losses.

5. Regarding banks that have cross-border establishments, in the event that the host supervisory authorities impose a capital adequacy ratio higher than (12%). The bank, upon consolidating its financial statements for the purposes of capital adequacy, must increase the risk-weight assets of its external presence as a proportion and proportionate to reflect the capital adequacy ratio required of its external presence. For example, if the bank has an external subsidiary and the required capital adequacy ratio of this company is (16%) and the risk weighted assets is (1) billion JD. In this case, the required capital of this company according to the instructions of the host supervisory authority is (160) million JD, while the required capital according to the Central Bank instructions is (120) million JD. In order to reflect the increase in the capital adequacy ratio of this company, the risk-weighted assets of the subsidiary upon consolidating the financial statements will equal (160 million x 1 billion) / 120 million = 1,333 billion JD.

Third: Capital Qualifying Criteria

1. Common Equity Tier 1

a. Common Equity Tier 1 shall consist of the following items[5] (after the regulatory adjustments used to calculate (CET1) according to clause (Fourth) of this chapter):
   1. Common shares issued by the bank that meet the criteria for classification as common shares for regulatory purposes.
   2. Retained earnings (losses).
   3. Accumulated other comprehensive income, including the fair value reserve in full, foreign currency translation differences and the bank's share of these items, when the funds are commingled[6].
   4. Disclosed reserves: regulatory reserve, voluntary reserve, stock surplus (share premium), and treasury shares premium.
   5. Any other unrestricted reserves subject to the prior approval of the Central Bank of Jordan.
   6. Minority interest, which are the common shares issued by consolidated subsidiaries of the bank and held by third parties that meet the criteria for inclusion in Common Equity Tier 1 capital. As described in clause (third/5) of this chapter.

b. Interim net profit is entered after deducting the tax and subtracting the value of the expected distributions within (CET1), while losses for the period are subtracted.

c. Qualification criteria for common shares issued by the bank:
   For an instrument to be included in Common Equity Tier 1 (CET1) it must meet all of the following criteria:
   1. Represents the most subordinated claim in liquidation of the bank.
   2. Entitled to a claim on the residual assets that is proportional with its share of issued capital, after repaid all seniority claims in case of liquidation (i.e. has an unlimited and variable claim, not a fixed or capped claim).

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[5] Proposed dividend is not included in CET1.

[6] If the reserve resulted from assets not valued at fair value, then this reserve is not recognized as receivables and financing.

3. To bear any losses first that may occur.
4. Principal is permanent and never repaid outside of liquidation (regardless of whether there is a repurchases option or other means of reducing capital on optional manners that are allowed by relevant laws).
5. The bank does not create any expectation at issuance that the instrument will be bought back, redeemed or cancelled nor do the contractual terms provide any feature which might give rise to such an expectation.
6. Distributions are paid out of distributable items (included retained profits), and the distributions level is not in any way linked to the amount paid in at issuance and is not subject to a contractual cap.
7. There are no circumstances under which the distributions are obligatory. Therefore, non-payment is not an event of default.
8. Distributions are paid only after all legal and contractual obligations have been met and payments on more seniority capital instruments have been made.
9. The paid in amount is recognized as equity capital (i.e. not recognized as a liability) for determining balance sheet insolvency, it is also classified as equity under the relevant accounting standards.
10. It is directly issued and full paid-in and the bank or any related entity[7] cannot directly or indirectly have funded the purchase of the instrument.
11. The paid in amount is neither secured nor covered by a guarantee of the issuer or related entity[7] or subject to any other terms or contractual arrangement that legally or economically enhances the seniority of eligible issued instruments to claim in the event of liquidation or default.
12. It is only issued with the approval of the bank shareholders, either given directly by the shareholders or by other persons duly authorized by the shareholders.
13. It is clearly and separately disclosed on the bank's balance sheet.

2. Additional Tier 1 capital

a. Additional Tier 1 capital consists of the sum of the following elements (after the regulatory adjustments used to calculate AT1):

1. Instruments issued by the bank that meet the criteria for inclusion in Additional Tier 1 capital [as described in clause (2/b)] and are not included in Common Equity Tier 1 such as *Mushārakah Sukūk*. Where the bank may (and after the approval of the *Shariah* Supervisory Board) issue *Mushārakah Sukūk* in the underlying total assets of the bank, and these *Sukūk* must have the ability to absorb losses, so that they are included in the Additional Tier 1.
2. Stock surplus (share premium) resulting from the issue of instruments included in Additional Tier 1 capital and not included in CET1 [Stock surplus (share premium) that is not eligible for inclusion in Common Equity Tier 1,

[7] A related entity can include a parent company, a sister company, a subsidiary or any other affiliate. A holding company is a related entity irrespective of whether it a part of the banking group.

will only be permitted to be included in Additional Tier 1 capital if the shares giving rise to the stock surplus are permitted to be included in Additional Tier 1 capital].

3. Minority interest, which are the instruments issued by consolidated subsidiaries of the bank and held by third parties that meet the criteria for inclusion in Additional Tier 1 capital and are not included in Common Equity Tier 1.

b. The following list sets out the minimum set of criteria for an instrument issued by the bank to meet or exceed in order for it to be included in Additional Tier 1 capital. Criteria for inclusion in Additional Tier 1 capital:

1. Issued and paid-in.
2. Subordinated to current accounts, non-profit-sharing investment accounts, other creditors, and subordinated good loans of the bank.
3. Is neither secured nor covered by a guarantee of the issuer or related entity or other arrangement that legally or economically enhances the seniority of claiming the rights of the instrument against other creditors of the bank.
4. Perpetual in nature and has no maturity date. It must not have step-up features (i.e. periodic increases in the rate of return) and is without any other incentive to the issuer to redeem it.
5. If the *Mushārakah Sukūk* issued by the bank has a right to exercise a call option, the call option can be exercised at the initiative of the issuer only after a minimum of five years, provided that the bank should meet the following requirements:
    - Receive prior supervisory approval.
    - Not do anything which creates an expectation that the call will be exercised; note that the bank must not exercise a call unless:
        a. They replace the called instrument with capital of the same or better quality and the replacement of this capital is done at conditions maintains the banks' ability to maintain sustainable income[8].
        b. The bank proves that its capital position is above the minimum capital requirements after the call option is exercised[9].
6. Any repayment of principal (through repurchase or redemption) must be with prior CBJ approval and banks should not assume or create market expectations that CBJ approval will be given.
7. Dividend payment:
    - The bank has the right at all times to cancel dividends payments.
    - Cancellation of payments must not be an event of default.
    - Banks must have full access to cancelled payments to meet obligations as they fall due.

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[8] Replacement issues can be concurrent with but not after the instrument is called.

[9] If the redemption option is implemented, the assessment of the bank's capital adequacy is subject to verification by the Central Bank of Jordan.

- The cancellation of dividends payments must not impose legal or regulatory restrictions on the bank.

8. Dividends payment must be paid out of distributable items.
9. The instrument cannot have a credit sensitive dividend feature, that is a dividend that is reset periodically based in whole or in part on the banking organization's credit standing.
10. Neither the bank nor a related party over which the bank exercises control or significant influence can have purchased the instrument, nor can the bank directly or indirectly have funded the purchase of the instrument.
11. The instrument cannot have any features that hinder recapitalization, such as provisions that require the issuer to compensate the shareholder if a new instrument is issued at a lower price during a specified time frame.
12. If the instrument is not issued out of an operating entity or the holding company in the consolidated group (e.g. a special purpose vehicle – "SPV"), proceeds must be immediately available without limitation to an operating entity or the holding company in the consolidated group in a form which meets or exceeds all of the other criteria for inclusion in Additional Tier 1 capital.

3. Tier 2 Capital

a. Tier 2 capital consists of the sum of the following elements (Regulatory adjustments applied in the calculation of Tier 2 Capital), as follows:

1. Instruments issued by the bank that meet the criteria for inclusion in Tier 2 capital (and are not included in Tier 1 capital). It might be possible, for Islamic banks, to issue T2 capital instruments in the form of *Muḍārabah* or *Wakālah Sukūk*, the underlying assets of which would be convertible (as specified in the contract) into shares of common equity at the point of non-viability or insolvency. It is essential that the terms of conversion, notably the trigger point and the conversion ratio, are clearly specified in the *Sukūk* contract so as to avoid *gharar*. Prior to conversion, the underlying assets of such *Sukūk* would not be available to meet the claims of the bank's current account holders or other creditors[10]. After conversion of the *Sukūk* in case of the bank's non-viability or insolvency, T2 capital would rank pari passu with CET1, along with AT1 capital.
2. General provisions reserves (the bank's own funds) and the bank's share of the general provisions reserves (commingled): will be limited to a maximum of 1.25 percentage points of credit risk-weighted assets calculated under the standardized approach. Note that any provisions or reserves deducted by the bank to meet losses that have occurred are not recognized.

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[10] The term "general obligation" is used to refer to this loss absorbency characteristic. It should be noted that this would not be the case with *Muḍārabah Sukūk*, since the *Rabb al-Māl* would not be liable for the general liabilities of the bank (and notably for the amount owed to current account holders). So-called general obligation *Muḍārabah Sukūk* are in fact a form of *Mushārakah Sukūk*.

3. Stock surplus (share premium) resulting from the issue of instruments included in Tier 2 capital.
4. Minority interest, which are the Instruments issued by consolidated subsidiaries of the bank and held by third parties that meet the criteria for inclusion in Tier 2 capital and are not included in Tier 1 capital.
5. The Bank's share of the surplus of the Investment Risk Management Fund.

b. Instruments issued by the bank that meets Tier 2 criteria:

The objective of Tier 2 is to provide loss absorption on a gone-concern basis. Based on this objective, the following list sets out the minimum set of criteria for an instrument to meet or exceed in order for it to be included in Tier 2 capital:

1. Loss absorbency.
2. Issued and paid-in. So that the bank nor a related party over which the bank exercises control or significant influence can have purchased the instrument, nor can the bank directly or indirectly have funded the purchase of the instrument.
3. The financial instrument does not have priority in the claim over the current accounts funds and non-profit-sharing investment accounts.
4. The amounts paid during issuance are not secured nor guaranteed by the bank or its related entities, there should not be any arrangement that legally or economically increases the seniority of the claim vis-à-vis the current accounts funds and non-profit-sharing investment accounts in case of liquidation.
5. Maturity:
   - Minimum original maturity of at least five years;
   - Recognition in regulatory capital in the remaining five years before maturity will be amortized according to the following:

The remaining period of maturity	weight
Year or less	0%
More than a year - two years	20%
More than two years - three years	40%
More than three years - four years	60%
More than four years - five years	80%
more than five years	100%

   - The financial instrument is not subject to modifications that may increase its value or any incentives by the issuer for early repayment.
6. May be callable at the initiative of the issuer only after a minimum of five years, and to exercise a call option a bank must:
   - Receive prior Central Bank approval; and
   - Not do anything that creates an expectation that the call will be exercised; note that banks must not exercise a call unless:

a. They replace the called instrument with capital of the same or better quality and the replacement of this capital is done at conditions which are sustainable for the income capacity of the bank[11].
b. The bank demonstrates that its capital position is well above the total applicable capital requirements is exercised[12].

7. The investor must have no rights to accelerate the repayment of future scheduled payments (coupon or principal), except in bankruptcy and liquidation.
8. The instrument cannot have a credit sensitive dividend feature, that is a dividend/returns that is reset periodically based in whole or in part on the banking organisation's credit standing.
9. If the instrument is not issued out of an operating entity or the holding company in the consolidated group (e.g. an SPV), proceeds must be immediately available without limitation to an operating entity or the holding company in the consolidated group in a form which meets or exceeds all of the other criteria for inclusion in Tier 2 Capital.

4. Treatment of Profit-sharing Investment Account (PSIA), Profit Equalization Reserve (PER) and Investment Risk Reserve (IRR).

Profit-sharing investment accounts of Islamic banks are not classified as part of the bank's capital because they do not meet the above-mentioned criteria regarding Tier1 and Tier2. Furthermore, all the investment risk reserve (IRR) and a portion of the profit equalization reserve (PER) belong to the equity of investment account holders, and thus are not part of the capital of the bank. As the purpose of a PER is to smooth the profit payouts and not to cover losses, any portion of a PER that is part of the bank's reserves should also not be treated as part of the regulatory capital of the bank. It may be noted that the impact of PER and IRR has already been incorporated in the denominator of the supervisory discretion formula for calculation of the CAR, as discussed later in the instructions.

5. Minority interest (non-controlling interest) and other capital issued out of consolidated subsidiaries that is held by third parties and funded by the bank's own funds:

a. Common shares issued by consolidated subsidiaries:
Minority interest arising from the issue of common shares by a fully consolidated subsidiary of the bank (funded by the bank's own funds) may be treated as Common Equity Tier 1 only if:

[11] Replacement issues can be concurrent with but not after the instrument is called.

[12] Subject to an assessment of the licensed bank's capital adequacy by the Central Bank of Jordan if the call were to be exercised.

1. The instrument giving rise to the minority interest would meet all of the criteria for classification as common shares for regulatory capital purposes (as if it were issued by the bank itself).
2. The subsidiary issuing the instrument should be an Institution offering Islamic financial services.
3. The amount of minority interest meeting the criteria above that will be recognised in consolidated Common Equity Tier 1 will be calculated as follows:
   - Total minority interest meeting the two criteria above minus the amount of the surplus Common Equity Tier 1 of the subsidiary attributable to the minority shareholders.
   - Surplus Common Equity Tier 1 of the subsidiary is calculated as the Common Equity Tier 1 of the subsidiary minus the lower of:
     a. The minimum Common Equity Tier 1 requirement of the subsidiary plus the Conservation Buffer (8.5% of the risk weighted assets of the subsidiary) and
     b. The portion of the consolidated minimum Common Equity Tier1 requirement plus the Conservation Buffer (8.5%[13] of consolidated risk weighted assets) that relates to the subsidiary.
   - The amount of the surplus Common Equity Tier 1 that is attributable to the minority shareholders is calculated by multiplying the surplus Common Equity Tier 1 of the subsidiary by the percentage of Common Equity Tier1 that is held by minority shareholders.
   - Annex no. (2) shows an example of the calculation method.

b. Tier 1 qualifying capital issued by consolidated subsidiaries:
The condition is that the relevant instruments issued by a fully consolidated subsidiary of the bank (which must itself be an Institution offering Islamic financial services) to third-party investors should meet all the criteria for being considered as Tier 1 capital. The amount of this capital that will be recognised in Tier 1 will be calculated as follows:
   1. Total Tier 1 of the subsidiary issued to third parties minus the amount of the surplus Tier 1 of the subsidiary attributable to the third party investors.
   2. Surplus Tier 1 of the subsidiary is calculated as the Tier 1 of the subsidiary minus the lower of:
      a. The minimum Tier 1 requirement of the subsidiary plus the capital conservation buffer (10%[14] of risk weighted assets) and
      b. The portion of the consolidated minimum Tier 1 requirement plus the capital conservation buffer (10% of consolidated risk weighted assets) that relates to the subsidiary.

[13] In the event that the requirements of the host supervisory authority are higher, they are taken into consideration

[14] In the event that the requirements of the host supervisory authority are higher, they are taken into consideration.

3. The amount of the surplus Tier 1 that is attributable to the third party investors is calculated by multiplying the surplus Tier 1 by the percentage of Tier 1 that is held by third party investors.
4. The amount of the Tier 1 capital that will be recognised in "additional capital" will exclude amounts already considered part of CET1.
5. Annex no. (2) shows an example of the calculation method.

c. Tier 1 and Tier 2 qualifying capital issued by consolidated subsidiaries:

Total capital instruments (Tier 1 and Tier 2 capital instruments) issued by a fully consolidated subsidiary of the bank (that should be an institution offering Islamic financial services) to third party investors may receive recognition in total Capital only if the instruments would, if issued by the bank, meet all of the criteria for classification as Tier 1 or Tier 2 capital.

The amount of this capital that will be recognised in consolidated total capital will be calculated as follows:

1. Total capital instruments of the subsidiary issued to third parties minus the amount of the surplus total capital of the subsidiary attributable to the third party investors.
2. Surplus Total Capital of the subsidiary is calculated as the total capital of the subsidiary minus the lower of:
   a. The minimum total capital requirement of the subsidiary (T1+T2) plus the capital conservation buffer (12%[15] of risk weighted assets) and
   b. The portion of the consolidated minimum total capital requirement (T1+T2) plus the capital conservation buffer (12% of consolidated risk weighted assets) that relates to the subsidiary.
3. The amount of the surplus total capital that is attributable to the third party investors is calculated by multiplying the surplus total capital by the percentage of total capital that is held by third party investors.
4. Annex no. (2) shows an example of the calculation method.

Fourth: Regulatory adjustments and deductions

The adjustments to regulatory capital are intended to make its quantification more conservative so that it is available at all times to absorb losses. Elements which shall be recognised or adjusted in the calculation of eligible capital from a regulatory perspective are as follows:

1. Goodwill and other intangible assets

Goodwill and other intangible assets should be deducted from CET1. Also deducted goodwill that is a part of the significant investments valuation in the capital of banks, financial and *Takāful* entities which are outside the scope of regulatory consolidation. The entire subtraction is made in case that these assets are generated from the bank's own funds, and the bank's share in those assets is subtracted when the bank's funds

[15] In the event that the requirements of the host supervisory authority are higher, they are taken into consideration.

are commingled with the funds of sharing investment accounts holders. International Financial Reporting Standards (IFRS's) definitions are used to identify elements which fall under the definition of intangible assets and are thus required to be deducted.

2. **Deferred tax assets (DTAs):**

   a. Deferred tax assets that rely on future profitability of the bank to be realized are to be deducted in the calculation of Common Equity Tier 1 in the case that these assets are generated from the bank's own funds, and the bank's share in those assets is subtracted when the bank's funds are commingled with the funds of sharing investment accounts holders. Deferred tax assets may be netted with associated deferred tax liabilities (DTLs) only if the DTAs and DTLs relate to taxes levied by the same taxation authority and offsetting is permitted by the relevant taxation authority.

   b. An over installment of tax or, in some jurisdictions, current year tax losses carried back to prior years may give rise to a claim or receivable from the Income tax department in Jordan or any tax authority in the countries in which the bank operates. Such amounts are typically classified as current tax assets for accounting purposes. The recovery of such a claim or receivable would not rely on the future profitability of the bank and would be assigned the relevant sovereign risk weighting.

3. **Securitisation exposure:**

   Any increase in equity capital resulting from a securitisation transaction shall be deducted from the calculation of CET1. Certain securitisation exposures arise from the provision of credit enhancement by the banks as originator by retaining a residual equity interest in a percentage of the securitized asset. In such cases, the capital treatment of the bank's residual equity share will be a risk weighting of 1250% irrespective of the minimum capital requirement.

4. **Unrealized gains and losses:**

   The bank shall derecognize from CET1 any component of equity resulting from changes in the fair value of liabilities due to its own credit risk variations.

5. **Deferred provisions** (the bank's own funds) **with the approval of the Central Bank (if any) and the bank's share of the investment risk fund's deficit are deducted from CET1.**

6. **Investment in own shares (treasury shares):**

   The bank's investment in its own shares shall be deducted in the calculation of CET1 since such an investment has an effect similar to calling the shares – that is, to reduce the capital. Furthermore, in case of any contractual obligation of the bank to purchase its own shares, such shares will be deducted from CET1.

   The bank should likewise deduct investments in their own additional capital in the calculation of additional capital.

7. **Reciprocal cross-holdings in the capital of banking, financial and *Takāful* entities:**
Reciprocal cross holdings of capital that serve to inflate artificially the capital position of banks will be deducted in full when the investments are financed by the bank's own funds, and the bank's share in those assets is subtracted when the funds are commingled. Banks must apply a "corresponding deduction approach" to such investments in the capital of other banks, other financial institutions and *Takāful* entities. This means the deduction should be applied to the same component of capital.

8. **Investments in the capital of subsidiaries that are not consolidated with the bank's accounts,** as described in annex no. (1). So that the carrying value of the bank's contribution is subtracted in full if it was financed from the bank's own funds, and the bank's share in the carrying value is subtracted when the bank's funds are commingled with the funds of profit-sharing investment accounts.

9. **Former deductions from capital (Basel II), according to the Instructions of the pillar1 of the Capital Adequacy Standard for Islamic Banks in accordance with the standard issued by IFSB:**
The following items, which under the Instructions of the pillar1 of the Capital Adequacy Standard for Islamic Banks in accordance with the standard issued by IFSB were deducted 50% from Tier 1 and 50% from Tier 2 (or had the option of being deducted or risk weighted), will be completely deducted from CET1, if it was financed from the bank's own funds, and the bank's share in the those items is subtracted when the bank's funds are commingled with the funds of sharing investment account holders.According to the time arrangements shown in Annex No (1):
    - Some securitisation transactions.
    - Significant investments that exceed (10%) in commercial entities.

10. **Investments in the capital of banking, financial and *Takāful* entities that are outside the scope of regulatory consolidation and where the bank does not own more than 10% of the issued common share capital of the entity. It includes investments classified in the banking book and in the trading book, including any investments in *sukuk* issued by other banks.**
    - If the capital instrument of the entity in which the bank has invested does not meet the criteria for Common Equity Tier 1, Additional Tier 1, or Tier 2 capital of the bank, the capital is to be considered common shares for the purposes of this regulatory adjustment. If the investment is issued by a financial institution that is subject to supervision and the investment is not included in the regulatory capital of the financial company, this investment should not be subject to deduction.
    - If the total of all holdings listed above in aggregate exceed 10% of the bank's common equity (after applying all other regulatory adjustments in full listed prior

to this one) then the amount above 10% of CET1[16] is required to be deducted, applying a corresponding deduction approach. This means the deduction should be applied to the same component of capital for which the capital would qualify if it was issued by the bank itself, as shown in annex no. (3).

- If, under the corresponding deduction approach, a bank is required to make a deduction from a particular tier of capital and it does not have enough of that tier of capital to satisfy that deduction, the shortfall will be deducted from the next higher tier of capital (e.g. if a bank does not have enough Additional Tier 1 capital to satisfy the deduction, the shortfall will be deducted from Common Equity Tier 1).
- Amounts below the threshold (10% from CET1), will continue to be risk weighted. That is, the amount contained within the trading portfolio is subject to weights of market risk, and contained within the banking portfolio is subject to weights of credit risk).

11. Significant investments in the capital of banks, financial and *Takāful* entities that are outside the scope of regulatory consolidation where the bank owns more than 10%[17] (Taking into account not to violate the provisions of the Instructions No. (12/2002) dated 2002 on Banks Ownership of Shares and Stocks in Companies' Capital). **It includes investments classified in the banking book and in the trading book, including any investments in *sukuk* issued by other banks.**

- If the capital instrument of the entity in which the bank has invested does not meet the criteria for Common Equity Tier 1, Additional Tier 1, or Tier 2 capital of the bank, the capital is to be considered common shares for the purposes of this regulatory adjustment. If the investment is issued by a financial institution that is subject to supervision and the investment is not included in the regulatory capital of the financial company, this investment should not be subject to deduction.
- All investments included above that are not common shares must be fully deducted following a corresponding deduction approach. This means the deduction should be applied to the same tier of capital for which the capital would qualify if it was issued by the bank itself. If the bank is required to make a deduction from a particular tier of capital and it does not have enough of that tier of capital to satisfy that deduction, the shortfall will be deducted from the next higher tier of capital (eg if a bank does not have enough Additional Tier 1 capital to satisfy the deduction, the shortfall will be deducted from Common Equity Tier 1).

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[16] The full value of the investments, if they were financed from the bank's own funds, and the bank's share in investments financed by commingled funds.

[17] Investments in entities that are outside of the scope of regulatory consolidation refers to investments in entities that have not been consolidated at all or have not been consolidated in such a way as to result in their assets being included in the calculation of consolidated risk-weighted assets of the group.

- Investments included above that are common shares will be subject to the threshold deductions, instead of a full deduction[18], the following items may each receive limited recognition when calculating Common Equity Tier 1, with recognition capped at 10% of the bank's common equity (after the application of all regulatory adjustments set out in clause Fourth):

  a. Full value of significant investments in the common shares of unconsolidated financial institutions (banks, *Takāful* and other financial entities) as referred to in Clause (Fourth / 11) of Chapter Two, in case it was financed from the bank's own funds, and the bank's share in investments financed by the bank's commingled funds with the funds of sharing investment accounts.

  b. DTAs that arise from temporary differences of those investments, if they were generated by the bank's own investments, and the bank's share in those assets when the bank's funds are commingled with the funds of sharing investment account holders.

     - From 31/3/2018 to 31-12-2018, a bank must deduct the amount of investments and DTAs exceeds 15% of its common equity component of Tier 1 (calculated prior to the deduction of these items but after application of all other regulatory adjustments applied in the calculation of Common Equity Tier 1). The items included in the 15% aggregate limit are subject to full disclosure.
     - As of 1 January 2019, the calculation of the 15% limit will be subject to the following treatment: the amount of the two items that remains recognised after the application of all regulatory adjustments must not exceed 15% of the Common Equity Tier 1 capital, calculated after all regulatory adjustments. See Annex 4 for an example.
     - The amount of the items (a+b) that are not deducted in the calculation of Common Equity Tier 1 will be risk weighted at 250%.

Annex no. (5) shows the elements of regulatory capital and regulatory amendments (Deductions). Noting that the sharing investment accounts' share of the items that are not subject to the above regulatory adjustments are weighed according to their risk weight (trading book or banking book) within the risk-weighted assets.

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[18] Full deduction if it was financed from the bank's own funds, and the bank's share in the investments financed by bank's commingled funds with the funds of investment accounts.

Fifth: Calculating the capital adequacy ratio

1. The capital adequacy ratio is calculated as follows:

Regulatory capital divided by:

{Total risk-weighted assets[19] (Credit Risks[20] + Market Risks[20]) + Operational risks

Less (1 – α[21]) [Risk-weighted assets funded by unrestricted investment account[22] (Credit Risks[20] + Market Risks[20])]

Less α[21] [Risk-weighted assets funded by Profit equalization reserve and Investment risk reserve of unrestricted investment account[23] (Credit Risks[20] + Market Risks[20])}

2. The Central Bank may set any restrictions on and/or exclude any of the regulatory capital elements when calculating the capital adequacy ratio, whether at the level of all banks or at the level of a single bank.
3. In case that the Central Bank is convinced of the high level of risks at any bank or at the level of all banks, the following shall be imposed:
   - Raising the minimum of the capital adequacy ratio.
   - Excluding an amount from the regulatory capital to meet these risk.
4. Calculating the percentage of participation of the unrestricted investment accounts (forward, notice, saving) to the total assets:

   The unrestricted investment accounts participation ratio is calculated as follows:

   a. Weighting the unrestricted investment accounts in proportion to their participation in the profits.

   b. Added to it:
      1. Profit equalization reserve.
      2. Investment risk reserve.

   c. Divide the output by the total assets, according to the following equation:

$$\boldsymbol{K} = \frac{(\sum_{i=1}^{n}(Xi*Yi)) + PER + IRR}{\mathbf{TA}}$$

Where:

The percentage of the participation of the unrestricted investment accounts after weighting it with the percentage of their participation in the profits	K
Forward Investment Accounts (Clients)	X_1
Notice Investment Accounts (Clients)	X_2
Saving Investment Accounts (Clients)	X_3
Forward Investment accounts participation rate in profits (Clients)	Y1
Notice Investment accounts participation rate in profits (Clients)	Y2
Saving Investment accounts participation rate in profits (Clients)	Y3
Profit Equalization Reserve	PER
Investment Risk Reserve	IRR
Total assets financed from commingled funds	TA

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[19] Total RWA include those financed by unrestricted investment account and banks' own funds.

[20] Credit and market risks for on- and off-balance sheet exposures.

[21] Alpha (α) refers to the percentage set by the Central Bank pf Jordan of (30%).

[22] Where the funds are commingled, the RWA funded by unrestricted investment account are calculated based on their pro-rata share of the relevant assets. Unrestricted investment account balances include Profit equalization reserve and Investment risk reserve. Item No. 4 above specifies the mechanism for calculating the ratio of the participation of the unrestricted investment account to the total assets funded by the commingled funds.

[23] The relevant proportion α of risk-weighted assets funded by Profit equalization reserve and Investment risk reserve is deducted from the denominator. The Profit equalization reserve has the effect of reducing the displaced commercial risk, and the Investment risk reserve has the effect of reducing any future losses on the investment financed by the investment accounts.

Sixth: Instructions application

1. The implementation will be on 31/3/2018, as banks will be required to meet the following new minimum requirements in relation to risk-weighted assets (RWAs):
   - The minimum for CET1 should not be less than (6%)[24].
   - The minimum (Tier 1) should not be less than (7.5%).
   - The minimum regulatory capital (CAR) is not less than (12%)[25].
2. With regard to capital instruments that are no longer eligible to include in (CET1) or (AT1) or (T2), they will be subject to transitional arrangements as of 31/3/2018 for a period of ten years by reducing them (10%) annually, so that the recognition of these instruments will be within the year 2028 equals zero.

[24] (4.5%) according to the IFSB 15, and (1.5%) additional risk hedging margin from the Central Bank.

[25] The minimum is included in the Conservation Buffer of (2.5%) of risk weighted assets, so that it is CET1.

Chapter three: Additional capital requirements

In addition to the capital requirements mentioned in Chapter Two, banks must maintain additional capital requirements, as follows:

A. Conservation Buffer

1. A capital conservation buffer of 2.5%, comprised of Common Equity Tier 1, is established above the regulatory minimum capital requirement.
2. In the event that the bank is unable to meet the minimum CET1 (6%) in addition to the conservation buffer (2.5%), the Central Bank has the right to impose restrictions on the distribution of profits, as follows:

CET1 ratio (6%) in addition to conservation buffer (2.5%)	Percentage of profits not allowed to be distributed
Less than 6.625%	100%
6.625% - 7.25%	80%
7.25% - 7.875%	60%
7.875% - 8.5%	40%
More than 8.5%	0

B. Countercyclical Buffer

1. The Central Bank of Jordan will calculate countercyclical buffer that varies between zero and 2.5% from total risk weighted assets. The Central Bank will ask banks - if needed - to build this buffer within a year from the date of providing them with the ratio. The buffer must be from CET1. Annex no. (6) shows the steps that the Central Bank will follow regarding the countercyclical buffer.
2. The Central Bank (in case of need) asks the banks to increase countercyclical buffer by more than 2.5%, provided that this increase in the buffer shall be built within one year from the date of providing the Islamic banks with the percentage.
3. In case that the bank is unable to meet the minimum CET1 (6%) in addition to the conservation buffer (2.5%) and countercyclical buffer (2.5%)[26], the Central Bank has the right to impose restrictions on the distribution of profits, as follows:

CET1 ratio + conservation buffer + (2.5%)	Percentage of profits not allowed to be distributed
Less than 6 %	100%
7.25% - 8.5%	80%
8.5% - 9.75%	60%
9.75% - 11%	40%
More than 11%	0

[26] Assuming that the maximum value of countercyclical buffer is imposed.

C. Capital required from Domestic Systemically Important Banks D-SIBs.

1. The Central Bank will adopt a methodology for calculating the additional capital (Surcharge) required from banks that will be considered D-SIBs, note that this methodology will be issued in a circular coinciding with the issuance of these instructions, and so that it will enter into force with the entry into force of Regulatory Capital Instructions according to the revised standard no. (15) issued by the Islamic Financial Services Board.
2. Restrictions on distributing profit in the event that the bank is unable to maintain the capital required from D-SIBs will be specified in the instructions that will be issued later.

Chapter four: Risk Coverage

First: Credit risk (standardized approach)

A. Scope of application

The methodology for allocating risk weights to on-balance sheet exposures cover all items within the on-balance sheet except for the following :

1. All assets and investments that must be deduct from Tier1 and Tier2 Capita, and according to the arrangements mentioned in annex no. (1).
2. All *Sukūk*, equity instruments and commodities and inventory items held within the trading book which are dealt within the framework of market risk.

B. Risk Weights- On Balance Sheet Items

General Rules:

1. The total credit exposures within the risk-weighted balance sheet is equal to the sum of all risk-weighted assets, or
2. The total credit exposures within the risk-weighted balance sheet is equal to the algebraic sum of items into the same category after weighting them with an appropriate risk weight.
3. The risk-weighted value of the item within the balance sheet is determined by multiplying its net book value by its appropriate weight, taking into account item (4) below:
   - The net book value means the balance of the credit exposure (and/ or the nominal value of capital market instruments) including any accrued returns, this is after subtracting the special provision, deferred revenues and suspense revenues and/ or depreciation charges, taking into account the differences of re-assessing.
   - The special provision means the provision for credit facilities impairment, wherever it is stated in these instructions.
4. In case that the item within the balance sheet is secured by one of the qualifying collateral or guaranteed by an acceptable guarantee, the bank has the right to use the credit risk mitigations stipulated in clause (second) of this chapter (Credit Risk Mitigations), to reduce the risk weighted value of this item when calculating the capital adequacy.
5. The bank shall refer to the Central Bank of Jordan if it is unable to determine the risk-weighted value of any of the balance sheet item.

Types of claims/exposures:

1. Claims on Sovereigns:

a. Claims on sovereigns and/or their central banks will be risk weighted as follows:

Credit rating as S&P *	AAA to AA-	A+ to A-	BBB+ to BBB-	BB+ to B-	Below B-	Unrated
Risk Weight	0%	20%	50%	100%	150%	100%

* The ratings of other entities (mentioned in annex no. 7) accepted by the Central Bank and whose ratings are equivalent to the above rating.

b. All obligations on the Jordanian government and the Central Bank of Jordan (in Jordanian dinars) are given a risk weight equal to (zero%), provided that the sources of financing these obligations are in Jordanian dinars.
c. The above rule applies to the host countries' obligations of the Jordanian banks branches and subsidiary banking companies in the event that they are in the local currency of those countries and provided reciprocity.
d. Banks may recognize the country risk scores assigned by Export Credit Agencies (ECAs) that approved by the Central Bank of Jordan. These ECA risk scores will correspond to risk weight categories as detailed below:

ECA risk scores	0-1	2	3	4-6	7
Risk weight	0%	20%	50%	100%	150%

If the country is unrated, claims are given a risk weight of 100%.

2. <u>Claims on International Organizations</u>:

The following organizations are given a 0% risk weight of:

- Bank for International Settlements.
- International Monetary Fund.
- European Central Bank.
- Arab Monetary Fund.
- European Community.

3. **<u>Claims on non-central government public sector entities (PSEs)</u>:**

These entities are divided into three types:

a. Regional governments and local authorities could qualify for the same treatment as claims on their sovereign or central government if these governments and local authorities have specific revenue raising powers and have specific institutional arrangements the effect of which is to reduce their risks of default.
b. Administrative bodies responsible to central governments, regional governments or to local authorities and other non-commercial entities owned by the governments or local authorities may not warrant the same treatment as claims on their sovereign if the entities do not have revenue raising powers or other arrangements as described above. If strict lending rules apply to these entities and a declaration of bankruptcy is not possible because of their special public status, it may be appropriate to treat these claims in the same manner as claims on banks (except for preferential treatment for short-term claims).
c. Commercial entities owned by central or regional governments or local authorities: although most of the shares of these entities are owned by the state or local authority, they are treated the same as commercial entities, and companies' risk weights are given according to their credit rating.

In light of the above definitions, the Central Bank of Jordan has classified public sector entities and companies according to the above-mentioned categories (according to the annexes numbers 8,9,10).

4. **Claims on Multilateral Development Banks (MDBs):**

a. Claims on these banks are treated the same as banks - with the exception of the preferential treatment for short-term claims - except for the following banks that are given a risk weight (zero%):

World Bank Group for Reconstruction and Development (IBRD)
International Finance Corporation (IFC)
The Asian Development Bank (ADB)
The African Development Bank (AFDB)
The European Bank for Reconstruction and Development (EBRD)
Inter-American Development Bank
The European Investment Bank (EIB)
The European Investment Fund
The Nordic Investment Bank (NIB)
The Caribbean Development Bank (CDB)
The Islamic Development Bank (IDB)
The Council of Europe Development Bank (CEDB)

b. A risk weight (0%) is applied to any similar banks, subject to the prior approval of the Central Bank of Jordan.

5. **Claims on banks:**

a. Banks' claims are given a risk weight according to the external rating of the concerned bank according to the following table, so that the risk weight is not less than (20%) in any case:

Credit rating as S&P *	AAA to AA-	A+ to A-	BBB+ to BBB-	BB+ to B-	Below B-	Unrated
Risk Weight	20%	50%	50%	100%	150%	50%
Risk weight for short-term foreign currency claims	20%	20%	20%	50%	150%	20%
Risk weight for short-term Jordanian currency claims	20%					

* The ratings of other entities (mentioned in annex no. 7) accepted by the Central Bank and whose ratings are equivalent to the above rating.

b. Short-term claims are defined as those claims with an original maturity period of three months or less.

c. The preferential treatment of short-term claims in foreign currencies applies to all banks that are rated or unrated, except for those rated and whose risk weight is (150%).

d. Short-term claims lose their preferential treatment in the presence of the phrase "automatically renewed" or any other expressions of the same connotation.

6. **Claims on Securities Firms:**

Claims on securities firms may be treated as claims on banks provided these firms are subject to supervisory and regulatory arrangements comparable to those under

this framework (including, in particular, risk-based capital requirements), otherwise such claims would follow the rules for claims on corporates.

7. **Claims on Corporates:**

a. Entities' claims are given a risk weight according to the external rating of the concerned entity according to the following table:

Credit rating as S&P *	AAA to AA-	A+ to A-	BBB+ to BBB-	Below B-	Unrated
Risk Weight	20%	50%	100%	150%	100%

* The ratings of other entities (mentioned in annex no. 7) accepted by the Central Bank and whose ratings are equivalent to the above rating.

b. Claim on an unrated corporate may be not given a risk weight preferential to that assigned to its sovereign of incorporation.

c. The Central Bank of Jordan may increase the risk weight more than (100%) for unrated claims, based on its observations of the default rates in the various sectors at the level of all banks operating in the Kingdom and / or at the level of a single bank.

d. A risk weight of 100% can be applied to all corporates, regardless of their external rating, subject to obtaining prior approval from the Central Bank of Jordan to allow this, provided that it is applied to all corporates' claims with the bank.

8. **Claims Included in the Regulatory Retail Portfolio (consistent with the standards set by the Central Bank that listed below):**

a. Claims that qualify under the criteria listed below may be considered as retail claims for regulatory capital purposes and included in a regulatory retail portfolio. Exposures included in such a portfolio may be risk-weighted at 75%:

1. **Orientation criterion**: The deferred receivables sales and *Ijārah Muntahia Bittamlīk* are granted to an individual person or related persons or to a small business; according to the definition contained in annex no. (11).
2. **Product criterion**: The retail portfolio should be within the following products:

Auto product	Building Materials product
Furniture product	Credit card product
Good loan product (education, treatment, marriage, social loan, and does not include overdraft accounts)	
Others (any credit with similar characteristics to the above products, and after obtaining the prior approval of the Central Bank)	

3. **Granularity criterion**: to be a well- diversified retail portfolio, so that no aggregate exposure to one client can exceed 0.2% of the overall retail portfolio, and it is calculated at the level of the geographical region / country.
4. **Maximum value criterion**: the total credit of all kinds (receivables and receivables from *Ijārah* payments) (excluding housing receivables claims)

granted to one client (whether at the level of the individual and/ or small business) does not exceed (250) thousand JD at the level of a single bank.

b. None of the following are included in this portfolio:
   1. Housing finance claims.
   2. *Sukūk* issued by small enterprises.
   3. Any credit granted (within a product) for speculation, such as financing the purchase of stocks and/ or lands, which aims to benefit from price differences in the foreseeable future.
   4. Any claims over an original life of more than seven years.
   5. Any client (individual) whose debt burden ratio - when granting and/ or renewing facilities - exceeds 50% of his net monthly income recorded in the client's file after deducting income tax and social security contributions. The debt burden ratio means the total amount owed on the customer to his net monthly income after the above deductions.

c. Retail portfolio that do not meet all of the above conditions are given a risk weight (100%) and are included under the item "Other retail portfolio".

9. <u>Residential real estate financing claims:</u>

a. These claims will be risk weighted at 35%, in the event that all of the following conditions and conditions stipulated in annex no. (12) are applied:
   1. Fully secured by mortgage of residential real estate (occupied by the buyer or by the lessee or leased to others and with a maximum of three rental housing units within the same building).
   2. The property must be owned by the bank and leased to an individual or group of individuals (*Ijārah Muntahia Bittamlīk).*
   3. The property is for residential and not for commercial purposes.
   4. The purpose of the financing is to build, buy, expand or renew a residential property (it does not include deferred receivables sales and other receivables and personal *Ijārah Muntahia Bittamlīk* secured by mortgages).
   5. The residential real estate financing to value does not exceed (80%) of the estimated value of the property or the purchasing value, whichever is less, upon granting.
   6. The property must be owned by an individual or group of individuals.

b. The Central Bank will raise the risk weight in case the losses resulting from the residential financing portfolio is greater than expected, whether at the level of the Islamic banks or a particular bank.

c. In case that all of the above conditions are not met, the full value of the credit exposure is subject to 100% risk-weight.

10. <u>Claims Secured by Commercial Real Estate (Deferred receivables sales/ *Ijārah Muntahia Bittamlīk*):</u>

a. These claims are given a 100% risk-weight, except for those that fall under high-volatility commercial real estate financing, which are given a minimum risk weight of 150%. High-volatility commercial real estate is defined as a way to

finance commercial real estate (similar to those listed within income-generating real estate), but it is exposed to higher loss rates than usual compared to other commercial real estate.

b. Financing high-volatility commercial real estate includes financing any of the three stages of establishing commercial real estate (Land acquisition, development and construction), if any of the following apply:
   1. The source of payment when granting credit exposure is based on the possibility of an uncertain future sale of the property and/or future cash flows that carry a high degree of uncertainty due to the absence of similar properties in the same geographical area, so that it cannot be judged on the degree of occupancy and /or rent and/ or market selling price.
   2. Commercial real estate financed by more than 70% of the estimated value of the construction cost, including the value of the land.
   3. Any real estate/category of real estate listed by the Central Bank of Jordan within this category, regardless of the financing ratio.
   4. Any real estate/category of real estate listed by any supervisory authority in the host country (in which the property is constructed) within this category, even if it is not explicitly classified as such by the Central Bank of Jordan.

c. In case granting funds (receivables, *Ijārah Muntahia Bittamlīk* and financing) to companies to finance buildings used for the company's purposes, it is treated as Corporates Claims.

d. The Central Bank may increase the risk weights from the above ratios at the level of all Islamic banks operating in the Kingdom and/or at the level of a single bank.

11. <u>Past Due Claims (Past Due Receivables) included as an independent category from the rest of the claim):</u>

a. The unsecured portion of any Past Due Claims (other than receivables and receivables from eligible residential rental payments) that is past due for more than 90 days, net of specific provisions and deferred and suspended revenue, will be risk-weighted as follows:
   1. 50% risk weight when specific provision is greater than 50% of the outstanding amount of the receivables or the receivables from *Ijārah* payments.
   2. 100% risk weight when specific provision is greater than or equal 20% and less than 50% of the outstanding amount of the receivables or the receivables from *Ijārah* payments.
   3. 150% risk weight when specific provision is less than 20% of the outstanding amount of the receivables or the receivables from *Ijārah* payments.

b. For the purpose of defining the secured portion of the past due claims (the receivables or the receivables from *Ijārah* payments), eligible collateral and guarantees will be the same as for credit risk mitigation purposes.

c. Past due retail claims are to be excluded from the overall regulatory retail portfolio when assessing the granularity criterion for risk-weighting purposes.

d. In the case of receivables or receivables from qualifying residential rental payments, when such loans are past due for more than 90 days they will be risk weighted at 100%, net of specific provisions and deferred and suspended revenue. If such loans are past due but specific provisions are no less than 20% of their outstanding amount, the risk weight applicable to the remainder of the loan will be 50%.

12. <u>Higher – Risk Categories:</u>

a. The following claims will be risk weighted at 150% (included as an independent category from the rest of the claims):
   1. Claims on sovereigns, PSEs, banks, and securities firms rated below B-.
   2. Claims on corporates rated below BB-.
   3. Facilities granted to finance Venture Capital (Venture capital financing: facilities granted for the purpose of financing the purchase of shares in the capital of companies, except for public joint-stock companies listed in the financial market).
   4. Facilities granted to finance the shares writing in public joint stock companies under incorporation.
   5. Direct and / or indirect writing by banks of public joint-stock companies shares under incorporation.
   6. Credit exposures that take the form of subordinated good loan, regardless of the borrower and its credit rating, except for those provided by banks, where they are excluded from the regulatory capital as mentioned in the instructions for the scope of application.
   7. Overdraft current accounts (with the exception of current accounts that have been overdrawn for a period of less than 30 days, which are included in a product guaranteed by a salary transfer and up to the maximum value of that salary).
   8. Any other claims that the Central Bank of Jordan includes in this category.

b. Securitisation tranches that are rated between BB+ and BB- will be risk weighted at 350% (as stated in the Securitisation Instructions), the value of the parts with a lower credit rating is subtracted from the regulatory capital.

c. For *Mushārakah* and *Muḍārabah* investments, which is not done for the purposes of trading and liquidity, but for the purposes of acquiring medium to long-term investment returns, a 400% RW is to be applied, subject to the following conditions:
   1. Not to keep it with the intention of trading or reselling it in a short period of time to take advantage of actual or expected price movements.
   2. Their prices are not adjusted according to the current market value on a daily basis.
   3. It is not actively monitored according to market sources.
   4. Being exposed to credit risks in the form of capital impairment risks.

d. Investments on a speculative basis that are subject to withdrawal by the investor based on short-term notice (maximum five working days), are given a 300% risk weight.

13. Other Assets (items not listed in any of the above categories):

a. Other assets will be (0%) risk-weight as follows:
   1. Cash (or any assets like cash) that is kept with the bank, regardless of currency.
   2. Deposits held with foreign branches (including deposits with the parent company and banking companies within the group) regardless of currency.
   3. Compulsory cash reserve maintained with central banks, regardless of currency

b. The risk weight for the following other assets will be 100%:
   1. Investments in equity (within the banking book) or any capital instruments issued by banks or securities and classified as regulatory capital, unless deducted from the capital base.
   2. All assets not included in the other assets category, with the exception of securitization assets.

c. Checks under collection and other items in transit are given (20%) risk weight.

d. Real estate investments (ready properties or real estate development stage) are given a 187.5% risk weight.

e. Real estate assets held for the purpose of financing under a non-binding promise during the implementation stages are given a 187.5% risk weight.

C. Off – Balance Sheet Items:

General Rules:

1. Calculation of credit risk-weighted amount for off-balance sheet items:
   - **The first step**: Converting the nominal value of the item into a credit factor for items within the on-balance sheet by multiplying it by its Credit Conversion Factor (CCF).
   - **The second step**: the outcome from the above step is multiplied by an appropriate risk weight for the item within the on-balance sheet and according to the type of claim.
2. In the case of eligible guarantees, the effect of the guarantee is calculated before the first step above (i.e. subtracted from the nominal value of the item and then transferred to a credit factor).

Types of claims/ exposures:

1. Direct Credit Substitutes

The following Off – Balance Sheet Items will receive a CCF of 100%:

- All types of payment guarantees, including down payment guarantees.
- All types of customs guarantee.
- All types of practicing the profession guarantees.
- All types of goods suppling guarantees (which are issued upon request of the buyer in favor of the supplier of goods).

- All types of facilities guarantee.
- Retention Guarantees.
- Deferred letters of credit.
- Sight letters of credit of more than (180) days.
- Bank acceptance.
- Enhancing letters of credit included in this category (direct credit substitutes).
- Enhancing bank acceptances of all kinds.
- Standby letters of credit (SBLC)[27] serving as financial guarantees.
- Any other obligations treated as direct credit, so that the bank's commitment under these obligations is an undertaking to pay a third party in the event of a deterioration in the credit position of the customer on whose behalf these obligations were issued.
- Any other obligations that the Central Bank of Jordan adds to this list.

2. Performance Related Contingencies:

The following Performance Related Contingencies will receive a CCF of (50%):

- Bid entry guarantees.
- Performance guarantees.
- Maintenance guarantees.
- Shipping guarantees (according to the maximum value of the goods).
- Compliance with legislation and laws guarantees.
- Warranties.
- Indemnities.
- SBLC serving as the above guarantees.

3. Trade Related Contingencies:

The following off – balance sheet items will receive a CCF of 20%:

- Sight letters of credit of (180) days or less, provided that it is self- liquidating and related to the transportation of goods and that it does not contain any condition that may negatively affect the value of the goods (for example: that the goods are perishable or that the shipment is by land ... etc).
- SBLC serving as the above letters of credit.
- Enhancing letters of credit in the two above items.

4. Credit Commitments:

- Commitments that are unconditionally cancellable at any time without prior notice are given (0%) credit conversion factor.

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[27] letters of credit that are used to present colletrals as a substitute for guarantees.

- Commitments with an original maturity of one year or less are given (20%) credit conversion factor.
- Commitments with an original maturity exceeding one year are given (50%) credit conversion factor.

5. **Other Off-Balance Sheet Items:**

   The following items are given (100%) credit conversion factor:
   - The unpaid portion of purchased shares and /or *Sukūk* that represent an obligation on the bank to pay this portion at a future date.
   - The bank's obligation to invest amounts for a future date (Unrestricted investment accounts, Restricted investment accounts and Investment agencies) with other parties.
   - The bank's credit obligations ceilings are given a credit conversion factor of 50% if their original maturity date is more than one year.

Second: Credit Risk Mitigations (CRM)

A. General Remarks

1. The framework set out in this instructions is applicable to the banking book exposures within the standardised approach only.
2. No transaction in which CRM techniques are used should receive a higher capital charge than an otherwise identical transaction where such techniques are not used.
3. The effects of CRM will not be double counted. Therefore, no additional supervisory recognition of CRM for regulatory capital purposes will be granted on claims for which an issue-specific rating is used that already reflects that CRM. Principal-only ratings will also not be allowed within the framework of CRM.
4. While the use of CRM techniques reduces or transfers credit risk, it simultaneously may increase other risks (residual risks). Residual risks include legal, operational, liquidity and market risks. Therefore, it is imperative that banks employ robust procedures and processes to control these risks, including strategy; consideration of the underlying credit; valuation; policies and procedures; systems; control of roll-off risks; and management of concentration risk arising from the bank's use of CRM techniques and its interaction with the bank's overall credit risk profile. The Pillar 3 requirements must also be observed for banks to obtain capital relief in respect of any CRM techniques.
5. Where these risks are not adequately controlled, CBJ may impose the following:
   a. Not recognition the impact of CRM.
   b. Increase the minimum regulatory capital requirements in accordance with the instructions related to pillar 2 issued pursuant to Circular No. (10/1533) dated 3/2/2010.

B. Legal certainty

1. In order for banks to obtain capital relief for any use of CRM techniques, the following minimum standards for legal documentation must be met:

a. All legal documents used in documenting credit finances covered by guarantees and/ or on-balance sheet netting and/ or guarantees must be binding on all parties and legally enforceable in all relevant jurisdictions.
b. Banks must have conducted sufficient legal review to verify this and have a well-founded legal basis to reach this conclusion, and undertake such further review as necessary to ensure continuing enforceability.

2. Overall Framework and Minimum Conditions:
    a. Banks may opt for either the simple approach or for the comprehensive approach, according to the following:
        1. Banks may operate under either, but not both, approaches in the banking book.
        2. Operate only under the comprehensive approach in the trading book.
        3. Partial collateralisation is recognised in both approaches.
        4. Mismatches in the maturity of the underlying exposure and the collateral will only be allowed under the comprehensive approach.
    b. In addition to the above general requirements for legal certainty, the legal mechanism by which collateral is pledged or transferred must ensure that the bank has the right to liquidate or take legal possession of it, in a timely manner, in the event of the default, insolvency or bankruptcy (or one or more otherwise-defined finance events set out in the transaction documentation) of the counterparty (and, where applicable, of the custodian holding the collateral).
    Furthermore, banks must take all steps necessary to fulfil those requirements under the law applicable to the bank's interest in the collateral for obtaining and maintaining an enforceable security interest, e.g. by registering it with a registrar, or for exercising a right to net or set off in relation to title transfer collateral.
    c. The credit quality of the counterparty and the value of the collateral must not have a material positive correlation. For example, securities issued by the counterparty or by any related group entity.
    d. Banks must have clear and robust procedures for the timely liquidation of collateral 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.
    e. Where the collateral is held by a custodian, banks must take reasonable steps to ensure that the custodian segregates the collateral from its own assets.

C. <u>Credit Risk Mitigation Techniques</u>

Collateralized Exposures:

1. A collateralised transaction is one in which banks have a credit exposure or potential credit exposure, and that exposure is hedged in whole or in part by collateral posted by a counterparty or by a third party on behalf of the counterparty.
2. Where banks take eligible financial collateral (Contained within clause no. (D) below), they are allowed to reduce their credit exposure to a counterparty when

calculating their capital requirements to take account of the risk mitigating effect of the collateral.

D. <u>Collaterals</u>

Eligible financial collaterals:

a. The following collaterals are eligible for recognition in the simple approach:
   1. Cash on deposit: (Profit-sharing investment account or Cash) that duly mortgaged in favor of the bank granting the funds. In case that the cash guarantee is with another bank, the following is required in order to receive the risk weight of the third-party bank:
      a. It should have a clear and explicit indication of the mortgage in favor of the bank granting the funds.
      b. The bank granting the funds shall have the right to request its transfer without restriction or condition.
      c. This right is irrevocable.
   2. *Hamish Jiddiyah:* (security deposit) only for agreements to purchase or lease preceded by a binding promise. The bank shall have the right of recourse against the dealers if the *Hamish Jiddiyah* is not sufficient to cover the value of the damages.
   3. *Urbūn*: The advance payment that is kept after the contract as a guarantee for the execution of the contract if the buyer or lessee rescinds the contract within the agreed period.
   4. *Sukūk* rated by a recognised external credit rating institution where these are either:
      a. At least BB- when issued by sovereigns or PSEs that are treated as sovereigns.
      b. At least BBB- when issued by other entities (including banks and securities firms).
      c. At least A-3/P-3 for short-term debt *Sukūk*.
   5. *Sukūk* that are not rated by a recognised external credit rating institution where these are:
      a. Issued by an Islamic bank or a conventional bank or a sovereign.
      b. Listed in a recognised financial market.
      c. All rated issues of the same seniority by the issuing bank that are rated at least BBB- or A-3/P-3 by a recognised external credit rating institution.
      d. The bank holding the *Sukūk* as collateral has no information to suggest that the issue justifies a rating below BBB- or A-3/P-3.
      e. The Central Bank is sufficiently confident about the market liquidity of the *Sukūk*.
   6. Mutual investment funds and what they are based on, where:
      a. A price for the units is publicly quoted daily.
      b. The mutual fund is limited to investing in the instruments listed above.
   7. Traded shares that are included in a main index.

b. The following collaterals are eligible for recognition in the comprehensive approach:
   1. All of the collaterals in simple approach.
   2. Traded shares which are not included in a main index but which are listed on a recognised financial market.
   3. Mutual funds which include such equities.

E. Simple Approach

In the simple approach the risk weighting of the collateral instrument collateralizing or partially collateralizing the exposure is substituted for the risk weighting of the counterparty.

F. Minimum conditions to be met in collaterals

1. The collateral must be pledged for at least the life of the exposure.
2. It must be marked to market and revalued with a minimum frequency of six months.
3. In the event of partial coverage, the claim is divided into two parts, covered part which is given the risk weight of the guarantee, and not covered part is given the risk weight of the counterparty.
4. The part covered by an eligible guarantee is subject to a minimum risk weight (20%), taking into account the exceptions mentioned in clause (G) below.

G. Exceptions to the Risk Weight Floor:

A 0% risk weight can be applied where the exposure and the collateral are denominated in the same currency, and:

1. The collateral is cash on deposit.
2. The collateral is in the form of sovereign/PSE *Sukūk* eligible for a 0% risk weight, and its market value has been discounted by 20%.
3. If the collateral is a cash where the exposure and the collateral are denominated in different currency, then the cash collateral discounted by (8%).

H. Comprehensive Approach:

1. In the comprehensive approach, when taking collateral, banks will need to calculate their adjusted exposure to a counterparty using haircuts, so banks are required to adjust the amount of the exposure to the counterparty upwards and the value of the collateral downwards to take account of possible future fluctuations in the value of either.
2. Where the exposure and collateral are held in different currencies an additional downwards adjustment must be made to the volatility adjusted collateral amount to take account of possible future fluctuations in exchange rates.
3. Where the volatility-adjusted exposure amount is greater than the volatility-adjusted collateral amount (including any further adjustment for foreign exchange risk), banks shall calculate their risk-weighted assets as the difference between the two multiplied by the risk weight of the counterparty (according to what is shown

within the methodology for calculating capital requirements within the comprehensive approach).

4. The bank shall use the standard supervisory haircuts shown in the table of deduction rates contained in clause (I).
5. The size of the individual haircuts will depend on:
   a. The type of instrument.
   b. The type of currency.
   c. Periodic re-evaluation.

I. Calculation of capital requirements:

1. For a collateralised transaction, the exposure amount after risk mitigation is calculated as follows:

$$E^{*}=\max \{0, [E*(1 + He) - C * (1 - Hc - Hfx)]\}$$

where:

E*	:	the exposure value after risk mitigation
E	:	the exposure value before risk mitigation
He	:	haircut appropriate to the exposure
C	:	the current value of the collateral received
Hc	:	haircut appropriate to the collateral
Hfx	:	haircut appropriate for currency mismatch between the collateral and exposure

2. The exposure amount after risk mitigation (E*) will be multiplied by the risk weight of the counterparty to obtain the risk-weighted asset amount for the collateralised transaction.

$$RWA = E^{*} * RW$$

3. The treatment for transactions where there is a mismatch between the maturity of the counterparty exposure and the collateral is given in paragraph of the maturity mismatch below.
4. Where the collateral is a basket of assets, the haircut on the basket will be $\boldsymbol{H = \sum_i ai\, Hi}$, where: a_i is the weight of the asset in the basket , H_i the haircut applicable to that asset and **H** the standardized haircut.

J. Standard Supervisory Haircuts:

These are the standard supervisory haircuts approved by the Central Bank of Jordan and are subject to amendment as the Central Bank deems appropriate:

<table>
<tr><th>Types of Collateral</th><th>Residual Maturity</th><th>Sovereigns*</th><th>Other issuers</th></tr>
<tr><td rowspan="3">Sukūk rated
AAA to AA-/A-1</td><td>Less than or equal to a year</td><td>0.5 %</td><td>1 %</td></tr>
<tr><td>More than a year and less than or equal to 5 years</td><td>2%</td><td>4%</td></tr>
<tr><td>More than 5 years</td><td>4%</td><td>8%</td></tr>
<tr><td rowspan="3">1. Sukūk rated A+ to BBB-/A-2/A-3/P-3
2. Unrated Sukūk and issued by qualified banks whose rate is no less than BBB-</td><td>Less than or equal to a year</td><td>1%</td><td>2%</td></tr>
<tr><td>More than a year and less than or equal to 5 years</td><td>3%</td><td>6%</td></tr>
<tr><td>More than 5 years</td><td>6%</td><td>12%</td></tr>
<tr><td>Sukūk rated BB+ to BB-</td><td>All</td><td>15%</td><td></td></tr>
<tr><td>Unrated Sukūk</td><td>All</td><td colspan="2">25%</td></tr>
<tr><td colspan="2">Main index equities included in the main market index.</td><td colspan="2">15%</td></tr>
<tr><td colspan="2">Main index equities not included in the main market index, but listed on a recognised financial market</td><td colspan="2">25%</td></tr>
<tr><td colspan="2">Mutual funds</td><td colspan="2">Highest haircut applicable to any security in which the fund can invest</td></tr>
<tr><td colspan="2">Eligible cash collateral in the same currency</td><td colspan="2">0%</td></tr>
<tr><td colspan="2">Currency risk where exposure and collateral are denominated in different currencies</td><td colspan="2">8%</td></tr>
<tr><td colspan="2">Jordanian dinars securities issued by the Jordanian government, the Central Bank of Jordan, and PSEs which are treated as sovereigns</td><td colspan="2">0%</td></tr>
</table>

* Includes PSEs which are treated as sovereigns. Also, Multilateral development banks receiving a 0% risk weight will be treated as sovereigns.

K. Credit Risk Mitigation for *Muḍārabah* Classified as Equity Exposures:

1. A placement of funds made under a *Muḍārabah* contract guarantee from a third party. Such a guarantee relates only to the *Muḍārabah* capital, not to the return. In such cases, the capital should be treated as subject to credit risk with a risk-weighting equal to that of the guarantor provided that the RW of that guarantor is lower than the RW of the *Muḍārib* as a counterparty. Otherwise, the RW of the *Muḍārib* shall apply.
2. In a *Muḍārabah* investment in project finance, collateralisation of the progress payments made by the ultimate customers can be used to mitigate the exposure to unsatisfactory performance by the *Muḍārib.*

L. On Balance Sheet Netting:

If the following conditions apply to the bank, it may use the net exposure of loans and deposits as the basis for its capital adequacy calculation in accordance with the formula in paragraph (10). Assets (loans) are treated as exposure and liabilities (deposits) as collateral. The haircuts will be zero% except when a currency mismatch exists:

1. Has a well-founded legal basis for concluding that the netting or offsetting agreement is enforceable in each relevant jurisdiction regardless of whether the counterparty is insolvent or bankrupt.
2. Is able at any time to determine those assets and liabilities with the same counterparty that are subject to the netting agreement.
3. Monitors and controls its roll-off risks.
4. Monitors and controls the relevant exposures on a net basis.

M. <u>Guarantees:</u>

In order to fulfill the operational requirements, the guarantee or the counter-guarantee must fulfill all of the following conditions:

1. Must represent a direct claim on the protection provider.
2. Must be explicitly referenced to specific exposures or a pool of exposures, so that the extent of the cover is clearly defined and incontrovertible.
3. Non-payment by a protection purchaser of money due in respect of the credit protection contract it must be irrevocable; there must be no clause in the contract that would allow the protection provider unilaterally to cancel the credit cover or that would increase the effective cost of cover as a result of deteriorating credit quality in the hedged exposure.
4. Must be unconditional; there should be no clause in the protection contract outside the direct control of the bank that could prevent the protection provider from being obliged to pay out in a timely manner in the event that the original counterparty fails to make the payments due.

N. <u>Additional Operational Requirements for Guarantees:</u>

In addition to the legal certainty requirements mentioned above, in order for a guarantee to be recognised, the following conditions must be satisfied:

1. On the qualifying default/non-payment of the counterparty, the bank may in a timely manner pursue the guarantor for any monies outstanding or pursue the guarantor to make one lump sum payment of all monies according to a schedule agreed upon with him.
2. The bank must have the right to receive any such payments from the guarantor without first having to take legal actions in order to pursue the counterparty for payment.
3. The guarantee is an explicitly documented obligation assumed by the guarantor.
4. the guarantee covers all types of payments the underlying obligor is expected to make. Where a guarantee covers payment of principal only, returns and other uncovered payments should be treated as an unsecured amount in accordance with proportional coverage paragraph.

O. <u>Range of eligible guarantors:</u>

Credit protection given by the following entities will be recognised:

1. Sovereign entities and PSEs.
2. Banks, other MDBs and securities firms with a lower risk weight than the obligor.

3. The Bank for International Settlements, the International Monetary Fund, the European Central Bank and the European Community.
4. MDBs eligible for a 0% risk weight or other entities rated A- or better. This would include credit protection provided by parent, subsidiary and affiliate companies when they have a lower risk weight than the obligor.

P. Risk Weights:

1. The protected portion is assigned the risk weight of the protection provider. The uncovered portion of the exposure is assigned the risk weight of the underlying counterparty.
2. Materiality thresholds on payments below which no payment is made in the event of loss are equivalent to retained first loss positions and must be deducted in full from the capital of the bank purchasing the credit protection.

Q. Proportional Coverage:

Where the amount guaranteed, or against which credit protection is held, is less than the amount of the exposure, and the secured and unsecured portions are of equal seniority, i.e. the bank and the guarantor share losses on a pro-rata basis capital relief will be afforded on a proportional basis: i.e. the protected portion of the exposure will receive the treatment applicable to eligible guarantees/ credit derivatives, with the remainder treated as unsecured.

R. Currency Mismatches:

Where the credit protection is denominated in a currency different from that in which the exposure is denominated — i.e. there is a currency mismatch — the amount of the exposure deemed to be protected will be reduced by the application of a haircut *HFX*, as following:

$$GA = G * (1 - H_{FX})$$

where:

GA	:	the amount of the exposure deemed to be protected
G	:	nominal amount of the credit protection
H_{FX}	:	haircut appropriate for currency mismatch between the credit protection and underlying obligation

S. Sovereign Guarantees and Counter-guarantees:

1. A zero% risk weight may be applied to a bank's exposures to the sovereign and/or central banks, where the exposure is denominated in domestic currency and funded in that currency. In the event the coverage is partial, only the covered part gives a (zero%) risk weight.
2. If the claim covered by a guarantee that is indirectly counter-guaranteed by a sovereign and/or central banks. Such a claim may be treated as covered by a sovereign and/or central banks guarantee provided that:
   a. The sovereign counter-guarantee covers all credit risk elements of the claim.

b. Both the original guarantee and the counter-guarantee meet all operational requirements for guarantees, except that the counter-guarantee need not be direct and explicit to the original claim.

c. The supervisor is satisfied that the cover is robust and that no historical evidence suggests that the coverage of the counter-guarantee is less than effectively equivalent to that of a direct sovereign guarantee.

T. Maturity Mismatches:

1. A maturity mismatch occurs when the residual maturity of a hedge is less than that of the underlying exposure.
2. When the maturity mismatch occurs and the original life of a hedge is less than one year, the hedge will not recognize.
3. If the original life of the hedge is more than one year, the hedge will be partially recognized.
4. Under the simple approach for collateral maturity mismatches will not be allowed.

U. Definition of Maturity:

Maturity means the effective maturity of the underlying exposure, and should be gauged as the longest possible remaining time before the counterparty is scheduled to fulfil its obligation, taking into account any applicable grace period.

V. Risk weights for maturity mismatches:

When there is a maturity mismatch with recognised credit risk mitigants, the following adjustment will be applied:

$$Pa = P * (t - 0.25) / (T - 0.25)$$

where:

Pa	:	value of the credit protection adjusted for maturity mismatch
P	:	credit protection adjusted for any haircuts
t	:	min (T, residual maturity of the credit protection arrangement) expressed in years
T	:	min (5, residual maturity of the exposure) expressed in years

W. Other items related to the treatment of CRM techniques:

Treatment of pools of CRM techniques:

In the case where a bank has multiple CRM techniques covering a single exposure, the bank will be required to subdivide the exposure into portions covered by each type of CRM technique and the risk-weighted assets of each portion must be calculated separately.

Third: Operational Risk

Operational risk is defined as the risk of losses resulting from inadequate or failed internal processes, people and systems or from external events. This definition includes legal risk and *Sharī`ah* non-compliance risk, but excludes strategic and reputational risk.

***Sharī`ah* non-compliance risk**: Risks faced by Islamic banks that could lead to non-recognition of income and losses resulting from their related operations.

A. The measurement methodologies

The framework outlined below presents three methods for calculating operational risk:

1. The Basic Indicator Approach.
2. The Standardised Approach/ The Alternative Standardized Approach.
3. Advanced Measurement Approaches (AMA).

B. The Basic Indicator Approach

1. Banks using the Basic Indicator Approach must hold capital for operational risk equal to the average over the previous three years of a fixed percentage (denoted alpha) of positive annual gross income. Figures for any year in which annual gross income is negative should be excluded from the numerator of the percentage denominator, accordingly, the number of years is adjusted. The charge may be expressed as follows:

$$KBIA = [\Sigma (GI\ 1\ldots n \times \alpha)] / n$$

where:

K_{BIA}	:	the capital charge under the Basic Indicator Approach
GI	:	annual gross income, where positive, over the previous three years
N	:	number of the previous three years for which gross income is positive
α	:	15%.

Operational risks are calculated according to the following equation:

$$\text{Operational risks} = KBIA * 12.5$$

2. Definition of gross income:

The gross income is defined as the bank's share of the investment accounts income as a speculator (*Muḍārib*) or agent and money owner, plus the net income from its own investments, and is calculated as follows:

The bank's share of the investment accounts income as a speculator (Muḍārib) or agent and *Rabb al-Māl* owner, excludes: − The bank's share of the profits / losses of financial assets at fair value through other comprehensive income statement items − The bank's share of the profits / losses of extinguished cost assets
+ Revenues from deferred sales, financings, *Ijārah Muntahia Bittamlīk* and other receivables (the bank's own funds)
+ The bank's share of restricted investment revenues as *Muḍārib*
+ The bank's share of restricted investment revenues as agent
+ Foreign currency gains (losses)
+ Profits (losses) of financial assets at fair value through income statement (the bank's own funds)
+ Real estate investment revenues (the bank's own funds)
+ Dividend income from financial assets through other comprehensive income statement items (the bank's own funds)
+ The bank's share of the profits / (losses) of affiliates (the bank's own funds)
+ The bank's share of dividends / subsidiary and affiliates (in the non-consolidated financial statements) (the bank's own funds)
+ Other revenues (mentioned in detail), with the exception of: − revenues derived from *Takaful* insurance operations − extraordinary or irregular revenues (mentioned in detail)
Gross income

3. Banks have to comply with the Basel Committee's guidance on Sound Practices for the Management and Supervision of Operational Risk, June 2011 (Until guidance is issued by the Islamic Financial Services Board in this regard). In case that the Central Bank finds deficiencies in applying these practices, the factor (α) mentioned in the aforementioned calculation equation will be increased.
4. Banks wishing to switch to the standardized approach for calculating operational risks, must fulfill all quantitative and qualitative requirements that qualify them for that. This will be according to the Basel committee, especially dividing their activities into eight business lines (according to the reality of the situation with them), provided that the prior approval of the Central Bank is obtained before starting to move to this approach.

C. <u>Standardized Approach/ The Alternative Standardized Approach</u>

1. <u>Standardized Approach:</u>

To apply the Standardized Approach, the bank must do the following:

a. banks' activities are divided into eight business lines: corporate finance, trading and sales, retail banking, commercial banking, payment and settlement, agency services, asset management, and retail brokerage. The business lines are defined in detail in annex (13).

b. Within each business line, gross income is a broad indicator that serves as a proxy for the scale of business operations and thus the likely scale of operational risk exposure within each of these business lines.

c. The capital charge for each business line is calculated by multiplying gross income by a factor (denoted beta) assigned to that business line. Beta serves as a proxy for the industry-wide relationship between the operational risk loss experience for a given business line and the aggregate level of gross income for that business line. It should be noted that in the Standardised Approach gross income is measured for each business line, not the whole institution, i.e. in retail banking, the indicator is the gross income generated in the retail banking business line.

d. The total capital charge is calculated as the three-year average of the simple summation of the regulatory capital charges across each of the business lines in each year. In any given year, negative capital charges (resulting from negative gross income) in any business line may offset positive capital charges in other business lines without limit. However, where the aggregate capital charge across all business lines within a given year is negative, then the input to the numerator for that year will be zero. The total capital charge may be expressed as:

$$K=\sum \text{business lines } 1-8\{\max [(\sum \text{years} 1-3\ GI_{1-8} / 3) \times \beta_{1-8}\}, 0]$$

Where:

K	:	the capital charge under the Standardised Approach
GI_{1-8}	:	annual gross income in a given year (at the end of year), for each of the eight business lines
β_{1-8}	:	a fixed percentage, for each of the eight business lines as below:

Business Lines	Beta Factor %
Corporate finance	18
Trading and sales	
Payment and settlement	
Commercial banking	15
Financial brokerage services (Agency services)	
Retail banking	12
Asset management	
Retail brokerage	

e. In case that the gross income is negative for the past three years, or in the case of newly licensed bank with operations of less than three years, or in the case of mergers, acquisitions, or substantial restructuring, the Central Bank of Jordan negotiates with the licensed bank regarding an alternative method for calculating capital requirements on operational risks. For example, the newly licensed bank may be required to use the expected gross income in the business plan for the next three years, and the other method is that the Central Bank of Jordan may require those banks to adhere to higher standards of the Capital Adequacy Ratio (CAR).

2. The Alternative Standardized Approach

a. based on the Alternative Standardized Approach (ASA), the operational risk capital charge methodology is the same as for the Standardised Approach except for two business lines — retail banking and commercial banking. Banks under this approach may use a three-year average for the total value of funds in place of gross income. The betas for retail and commercial banking are unchanged from the Standardised Approach. The ASA operational risk capital charge for retail banking (with the same basic formula for commercial banking) can be expressed as:

$$K_{RB} = \beta_{RB} \times m \times F_{RB}$$

Where:

K_{RB}	:	the capital charge for the retail banking business line
β_{RB}	:	the beta for the retail banking business line
F_{RB}	:	total outstanding retail funding portfolio (non-risk weighted and gross of provisions), averaged over the past three years
m	:	0.035

b. For the purposes of the Alternative Standardized Approach, total funding value in the retail banking business line consists of the total drawn amounts in the following credit portfolios: retail, SMEs treated as retail including irregular financing. For commercial banking, total funds consist of the drawn amounts in the following credit portfolios: corporate, sovereign, banks, specialized lending, SMEs treated as corporate including irregular financing. The book value of *Sukūk* held in the banking book should also be included.

c. Under the Alternative Standardized Approach, banks may aggregate retail and commercial banking (if they wish to) using a beta of 15%. Similarly, those banks that are unable to disaggregate their gross income into the other six business lines can aggregate the gross income for these six business lines using a beta of 18%, with negative gross income treated.

d. As under the Standardised Approach, the total capital charge for the Alternative Standardized Approach is calculated as the simple summation of the regulatory capital charges across each of the eight business lines.

3. <u>Qualifying criteria</u>

a. The banks must develop specific policies and have documented criteria for mapping gross income for current business lines and activities into the standardised framework. And it must be able qualitatively and quantitatively to fulfill the requirements of this method, and it has to explain the reasons for this mapping in accordance with the requirements of the Central Bank of Jordan. The criteria must be reviewed and adjusted for new or changing business activities as appropriate.

b. The approach used by the bank to define its activities into eight business lines must meet the following requirements:

- Its senior management are actively involved in the oversight of the operational risk management framework which must approved by board of directors.
- It has sufficient resources in the use of the approach in the major business lines as well as the control and audit areas.
- All activities of the licensed bank must be defined in the form of eight business lines of the first level in a comprehensive and exclusive manner.
- Any banking or non-banking activities that cannot be easily identified within the framework of business activities and that represent an activity attached to the original activity, must be assigned to the business lines that supports it (including it to the nearest business line).
- When identify the gross income and if it is not possible to specify an activity in a specific activity plan, the bank activity that meets the highest percentage of the capital requirement must be used (18%), and any ancillary and accompanying activities will be subject to the same treatment.

- The bank’s operational risk management system must be well documented. The bank must have a routine in place for ensuring compliance with a documented set of internal policies, controls and procedures concerning the operational risk management system, which must include policies for the treatment of non-compliance issues.
- There must be procedures for defining any new activities or products.
- The bank’s operational risk management processes and assessment system must be subject to validation and regular independent review by the Risk Management Department and internal and external auditors.
- The Central Bank of Jordan has the right, and before permanently adopting this approach for the purposes of calculating the operational risks capital charge, monitoring the bank's experience in the application for a period of time and ensuring its commitment to quantitative and qualitative standards. In the event that the bank does not meet the requirements, it will not be permitted to convert to this approach.

4. <u>Operational risks</u>

The total exposures weighted for operational risks is determined by multiplying the capital requirements for operational risk by (12.5) and adding the result to the total credit and market risk-weighted assets, to obtain the total risk weighted exposures that will be used to calculate the capital adequacy ratio (CAR).

Fourth: Market Risk – Standardized Approach

This clause of instructions aims to ensure that all banks operating in the Kingdom that exercise activities that entail risks associated with potential changes in market prices applying the minimum administrative and supervisory duties, and continuously adheres to the regulatory capital requirements in proportion to these risks.

A. Definitions:

Market risk is defined as the losses that the bank may suffer as a result of any on and off-balance-sheet financial positions arising from movements in market prices.

1. Included within the definition any actual financial positions.
2. Market risk is divided into three main categories:
   a. Equity position risk and trading positions in *Sukūk* risk.
   b. Exchange rate risk.
   c. Commodities and inventory risk.
3. Market risk consists of two main types:
   a. General Market Risk:
      The risk of loss arising from changes in market prices, which affects the value of financial positions related to equity positions, exchange rates and commodities and inventory.
   b. Specific Risk:
      The risk of changing the price of a financial instrument due to factors related to the issuer, it applies to financial positions related to equity instruments issued by this entity.

B. Key Principles:

1. Banks are required to provide the Central Bank with a trading book policy that specifically states all financial activities and positions that fall within this book.
2. The bank must have prudent policies and procedures for evaluating positions within the trading book, in addition to having effective systems for measuring and managing market risks.
3. Market risk is calculated at the end of each business day, and the values of the calculation process must be included in the quarterly report on all business days during that quarter.

C. Responsibilities of the Board of Directors and Executive Management:

1. The Board of Directors shall approve strategies and policies related to market risks and ensure that the executive management takes all necessary steps to monitor and control these risks.
2. The board of directors should ensure that the bank has adequate systems in place to identify, measure, monitor and control market risks, including specifying responsibilities, separating tasks and avoiding any conflict of interest. The bank must also inform the Central Bank of any material changes that occur to these systems, as well as to its market risk profile.

3. The board of directors should ensure that the bank adheres to capital adequacy requirements to continuously face market risks, while not exaggerating daytime positions.

D. <u>Trading Book:</u>

1. Trading book consists of positions in financial instruments and commodities held with trading intent. Note that the positions taken with trading intent are those that meet any of the following conditions:
   a. Held for short-term resale (The short term for this purpose is known as a period not exceeding 90 days).
   b. Held with the intent of benefiting from actual or expected short-term price movements.
   c. Resulted from brokerage and market making processes.
2. The following will be the basic requirements for positions eligible to receive trading book capital treatment:
   a. Clearly documented trading strategy for the positions and/or financial instrument and/or portfolios, approved by senior management (which would include expected holding horizon).
   b. Clearly defined policies and procedures to manage the positions, which must include:
      - Positions are managed on a trading desk.
      - Position limits are set and monitored for appropriateness.
      - Dealers have the autonomy to manage the positions within agreed limits and according to the agreed strategy.
      - Positions are marked to market at least daily and when marked to model the parameters must be assessed on a daily basis.
      - Positions are reported to senior management as an integral part of the institution's risk management process.
      - Positions are actively monitored with reference to market information sources (assessment should be made of the market liquidity and/or the portfolio risk profiles).
      - The necessity to assess the quality and availability of market inputs to the valuation process, level of market turnover, sizes of positions traded in the market (Market Depth Assessment).
3. In the case that the bank finances its investments in financial positions through the issuance of securities, such securities are included in the trading book only if the provisions of the trading book mentioned in clause (fourth) above apply to them.
4. The bank shall subject the process of classifying any position or instrument within the banking book or trading book to internal auditing as soon as it arises, to ensure that it meets all the conditions mentioned in these instructions.

E. <u>Trading book policy:</u>

1. The trading book policy prepared by the bank should include the following:

a. The department authorized to approve or amend the policy.
b. The activities the bank considers to be within the trading book for regulatory capital purposes.
c. The evaluation methodology for trading book positions includes the following:
   1. The extent to which an exposure can be marked-to-market daily by reference to an active, liquid two-way market.
   2. For exposures that are marked-to-model, the extent to which the bank can:
      - Identify the material risks of the exposure.
      - Dependence on the correctness and reliability of the key assumptions and parameters used in the model.
d. That this policy be subjected to periodic review, no more than annually.
e. The extent to which legal restrictions and/or other operational requirements would impede the bank's ability to effect an immediate liquidation of the exposure.
f. With regard to internal transactions, whether at the bank or banking group level:
   1. The bank may neutralize the effect of all transactions between different portfolios within its trading book before calculating the financial positions exposed to market risks, or that any/ or all internal transactions in the positions are included, provided that one of the two methods is consistently adhered to.
   2. The bank may not neutralize the impact of internal transactions between the trading book and the banking book when calculating the trading book positions.
g. The extent of the bank's ability to effectively manage all the risks of the trading book positions.
h. The need to inform the Central Bank of Jordan immediately of any material changes that occur to it.
i. Description of the bank's market risk management system
j. That this policy appears in the Annual Management Attestation

F. <u>Valuation of the trading book:</u>

Banks must establish and maintain adequate systems and controls sufficient to give management and Central Bank the confidence that their valuation estimates are prudent and reliable. These systems must be integrated with other risk management systems within the organization. Such systems must include:

1. Documented policies and procedures for the process of valuation. This includes:
   a. Clearly defined responsibilities of the various areas involved in the determination of the valuation.
   b. Sources of market information and review of their appropriateness.
   c. Timing of closing prices.
   d. Frequency of independent valuation.
   e. Procedures for adjusting valuations.

f. End of the month and ad-hoc verification procedures.

2. Clear and independent (i.e. independent of front office) reporting lines for the department accountable for the valuation process. The reporting line should ultimately be the board of directors.

G. <u>Valuation methodologies</u>:

1. Marking to Market:
   a. Marking-to-market is at least the daily valuation of positions at readily available close out prices that are sourced independently. Examples of readily available close out prices include exchange prices, screen prices, or quotes from several independent reputable brokers.
   b. Banks must mark-to-market as much as possible. The more prudent side of bid/offer must be used unless the institution is a significant market maker in a particular position type and it can close out at mid-market.
2. Marking to Model:
   a. Where marked-to-market is not possible, banks may mark-to-model.
   b. Marked-to-model is defined as any valuation which has to be benchmarked, extrapolated or otherwise calculated from a market input.
   c. If this methodology is used, the Central Bank will consider the following in assessing:
      1. Senior management should be aware of the elements of the trading book which are subject to mark to model and should understand the materiality of the uncertainty this creates in the reporting of the risk/performance of the business.
      2. Market inputs should be sourced, to the extent possible, in line with market prices. The appropriateness of the market inputs for the particular position being valued should be reviewed regularly (no more than one month).
      3. Where available, generally accepted valuation methodologies for particular products should be used as far as possible.
      4. Where the model is developed by the bank itself, it should be based on appropriate assumptions, which have been assessed and challenged by suitably qualified parties independent of the development process. The model should be developed or approved independently of the front office. It should be independently tested. This includes validating the mathematics, the assumptions and the software implementation.
      5. There should be formal change control procedures in place and a secure copy of the model should be held and periodically used (Maximum monthly) to check valuations.
      6. Risk management should be aware of the weaknesses of the models used and how best to reflect those in the valuation output.
      7. The model should be subject to periodic review to determine the accuracy of its performance (e.g. assessing continued appropriateness of the assumptions, analysis of P&L versus risk factors, comparison of actual close out values to model outputs).

8. Valuation adjustments should be made as appropriate, for example, to cover the uncertainty of the model valuation.

H. <u>Independent price verification:</u>

1. Independent price verification is distinct from daily mark-to-market. It is the process by which market prices or model inputs are regularly verified for accuracy. While daily marking-to-market may be performed by dealers, verification of market prices or model inputs should be performed by a unit independent of the dealing room, at least monthly (or, depending on the nature of the market/trading activity, more frequently).
2. In cases that Independent price verification entails a higher standard of accuracy in that the market prices or model inputs are used to determine profit and loss figures, for independent price verification, where pricing sources are more subjective, e.g. only one available broker quote, prudent measures such as valuation adjustments may be appropriate.
3. Banks must establish and maintain procedures for considering valuation adjustments/reserves. Banks using third-party valuations have to consider whether valuation adjustments are necessary. Such considerations are also necessary when marking-to-model.
4. The bank should consider the following valuation adjustments/reserves to be formally considered at a minimum wherever required:
   a. Close-out costs.
   b. Operational risks.
   c. Early termination.
   d. Investing and funding costs.
   e. Future administrative costs.
   f. Model risk.
5. Banks must make downward valuation adjustments/reserves for less liquid positions, and to review their continued appropriateness on an on-going basis. Banks must consider all relevant factors when determining the appropriateness of valuation adjustments/reserves for less liquid positions. These factors may include, but are not limited to:
   a. The time it would take to hedge out the risks position.
   b. The average volatility of bid/offer spreads.
   c. The availability of independent market quotes.
   d. The average and volatility of trading volumes
   e. Market concentrations.
   f. The aging of positions.
   g. The extent to which valuation relies on marking-to-model.
   h. The impact of other model risks.

I. <u>Market risk – The standardised approach method:</u>

1. <u>Equity position risk and trading positions in *Sukūk* risk</u>

In this method, a ready-made form is used in which various market risks are measured, and the following is an explanation of the measurement of these risks according to this method:

a. **Equity position risk:**

1. The risk of holding or taking positions in equities in the trading book. It applies to long and short positions. This includes:
   a. Common stocks.
   b. Contributions to investment funds that contain such aforementioned instruments, for the purposes of these instructions, investment funds that are fully formed or (at least 20%) of them from the above-mentioned instruments shall be treated as equity instruments.
2. Specific and general market risks are calculated as shown in annex no. (14), and as follows:
   a. Determine the longs and shorts positions in each time-band. In this regard, it is permissible to offset between these positions if they belong to the same issuance only and regardless of sign.
   b. Determine the total position of the bank, which represents the sum of long and short positions.
   c. Determine the capital charge for specific risk which represents the result of multiplying the total positions by 8%.
   d. Determine the net positions of the bank, which represents the offset between long and short positions.
   e. Determine the capital charge for general market risk which represents the result of multiplying the net positions by 8%.
   f. Calculating the specific and general market risk, which represents the outcome of sum the required capital for each of them.
   g. The market risk for equity instruments is calculated by multiplying the required capital by (12.5).

b. *Sukūk* in trading book:

The minimum capital requirement is expressed in terms of two separately calculated charges:

- **First**: to cover the "specific risk", whether it is a short or a long position.
- **Second**: to cover "general market risk" where long and short positions in different instruments can be offset.

1. Specific Risk: the losses that may arise from adverse movements in the prices of a *Sukūk* held for trading due to factors related to the issuer of those *Sukūk* (credit risk). Where the capital requirements to meet the return rates risks are calculated as shown in the table below, noting that the method of calculation is shown in annex no. (15).

If the issuer is the same, no offsetting will be permitted, but it is permissible for long and short positions of the same issue, taking into account the following:

a. Government *Sukūk*: are the *Sukūk* issued by the Jordanian government or its guarantee in Jordanian dinars, provided that the sources of financing these *Sukūk* are in Jordanian dinars, as these *Sukūk* do not need capital requirements, but if they are issued in foreign currency, the capital requirements are determined according to the state's credit rating.
b. Qualifying *Sukūk*, includes:
    1. *Sukūk* issued by public sector entities and multilateral development banks (as it is explained in Credit Risk Instructions).
    2. *Sukūk* that meet one of the following conditions:
        a. Rated investment-grade by at least two credit rating agencies recognized by the Central Bank of Jordan.
        b. Rated investment-grade by one rating agency recognized by the Central Bank of Jordan. Or unrated, subject to CBJ approval, and the issuer has securities listed on a recognised financial market.

Categories	External credit rating	residual term to final maturity	Specific risk capital charge %
Government *Sukūk*	AAA to AA-		0
	A+ to BBB-	6 months or less more than 6 and up to 24 months more than 24 months	0.25 1.00 1.60
	BB to B- or Unrated		8
	Below B-		12
Qualifying *Sukūk*		6 months or less more than 6 and up to 24 months more than 24 months	0.25 1.00 1.60
Other *Sukūk*	BB+ to BB- or Unrated		8
	Below BB-		12

2. General risk:

Maturity method will be adopted for the purposes of calculating general risks, in which positions that are exposed to return rate risk are slotted into a maturity ladder comprising thirteen time-bands.

a. *Sukūk* in trading book are divided according to the return rate into two categories, first: *Sukūk* with a return rate of more than or equal (3%), and the second: *Sukūk* with a return rate of less than (3%). As shown in annex no. (16) [noting that the method of calculation is shown in table no. (17/ A) and no. (17/ B).

b. Long and short positions are slotted according to maturities or re-pricing periods with no offsetting between different positions in different currencies, Whereas, offsetting is only allowed for positions for the same currency and for the same maturity date.

c. Calculation mechanism:
   1. Positions are weighted according to the weights corresponding to the position type (long or short) and the appropriate time category.
   2. Calculate the bank's net open position, regardless of sign.
   3. Calculate the weighted longs and shorts in each time-band, resulting in a single short or long position for each band. Since, however, each band would include different instruments and different maturities, a 10% capital charge to reflect basis risk and gap risk will be levied on the smaller of the offsetting positions, be it long or short. This is called Vertical Disallowance.
   4. Calculate the covered positions in the first, second and third zones, as follows (Horizontal disallowances):

Zones	Within the zone	Between adjacent zones	between zones 1 and 3
Zone 1	40%	40%	100%
Zone 2	30%		
Zone 3	30%	40%	

   5. The capital required for general return rate risk is the sum of capital from the above clauses (2, 3, 4).
   6. The market risk for these *Sukūk* is calculated by multiplying the required capital by (12.5).

2. **<u>Foreign exchange and gold/ silver risk:</u>**

The capital charge to cover the risk of holding or taking long positions in foreign currencies, and in gold and silver.

a. Calculate the net spot position (i.e., all asset items less all liability items, including accrued or unpaid revenue).

b. Net position of a binding unilateral promise by the bank to buy and/or sell currencies on a specified future date (that are not included in the spot position).

c. Net positions in foreign currencies are calculated through the items below:
   1. Guarantees and similar off-balance sheet instruments that are likely to be called and irrecoverable.
   2. Any other items representing an exposure to risk in foreign currencies.

d. Measuring the foreign exchange and gold/ silver risk as shown in annex no. (18) and as follows:
   1. Determine the net open positions (long or short) for each currency separately.
   2. Determine the total net open positions (long or short) for all currencies.
   3. Determine the sum of long or short positions, whichever is greater.
   4. Determine the net open position in gold (long or short).

5. Determine the net open position in silver (long or short).
6. The capital charge is 8% on the overall net position as calculated above in clauses (3), (4) and (5).
7. The market risk for foreign exchange rates and gold/silver is calculated by multiplying the required capital by (12.5).

3. <u>Commodities and inventory risk:</u>

a. The risk of holding/ taking positions in commodities, including precious metals, but excluding gold and silver.
b. Inventory risk is defined as arising from holding items in inventory either for resale under a *Murābahah* contract, or with a view to leasing under an *Ijārah* contract.
c. The simplified approach will be used to calculate the commodities risk according to annex no. (19), and as follows:
   1. The net commodities positions are calculated by adding the net spot positions and net future positions.
   2. List the net individual positions, whether long or short, in annex no. (19).
   3. Calculate the gross positions of the bank, whether long or short, regardless of the sign, which represents the result of the sum of the long and short positions.
   4. The capital charge will equal 15% of the net position plus 3% of the bank's gross positions.
d. The inventory risk is calculated as follows:
   - Calculating the capital charge of inventory risk, by multiplying it by (15%).
   - Calculating the commodities and inventory risk, which represents the required capital multiplied by (12.5).
e. For *Istisnā* work-in-process (WIP), WIP inventory belonging to the banks shall attract a capital charge of 8%. In the case of the balance of unbilled work-in-process inventory under *Istisnā* without parallel *Istisnā*`, in addition to the RW for credit risk a capital charge of 1.6% is applied to cater for market risk exposure.

Chapter five: Leverage Ratio

A. To introduce a simple, transparent, non-risk based leverage ratio that is calibrated to act as a credible supplementary measure to the risk based capital requirements. The leverage ratio is intended to achieve the following objectives:

1. Constrain the build-up of leverage in the banking sector, helping avoid destabilizing deleveraging processes which can damage the broader financial system and the economy.
2. Inforce the risk based requirements with a simple, non-risk based "backstop" measure.

B. Definition and calculation of the leverage ratio:

1. The minimum leverage ratio is (4%), so that it is calculated as follows:
   a. The numerator of the ratio is (T1) capital as defined in paragraph (A) of clause (Second/ 1) of chapter two of these instructions. Items that are deducted completely from capital do not contribute to leverage, and should therefore also be deducted from the measure of exposure. That is, the capital and exposure should be measured consistently and should avoid double counting. This means that deductions from Tier 1 capital should also be made from the exposure measure. Note that the items that are deducted are defined in the fourth item of the second chapter of these instructions.
   b. The denominator for the ratio consists from on-balance and off-balance sheet items, as follows:

   On-balance sheet items: are net of specific provisions and unpaid returns. The impact of credit risk mitigation (including physical or financial collateral, guarantees, *Urbun*, *Hamish Jiddiyah*, etc.) should not be considered, and on-balance sheet exposures should not be adjusted for the purpose of calculating the total exposure. Netting of financing exposures against profit-sharing investment account /deposits shall not be allowed.

   Off-balance sheet items: as indicated in annex no. (20) and according to credit conversion factor (CCF) for each of the off-balance sheet items shown in the annex. Note that these factors are for the purpose of calculating leverage ratio only.
2. An appropriate proportion of assets financed by unrestricted profit-sharing investment account shall be included in the exposure calculation, whether considered on- or off-balance sheet by the bank. The appropriate proportion of such assets is calculated by multiplying the relevant assets by the alpha parameter applicable to the bank for capital adequacy purposes. Assets financed by restricted profit-sharing investment account shall not be included in the exposures unless they are a source of displaced commercial risk to the bank, in which case they should be treated in a similar manner to unrestricted profit-sharing investment account.

C. Application arrangements:

- Banks start with the trial calculation starting from the date of applying these instructions and disclosing them in the regulatory capital statements. Based on the impact study that will be carried out by the bank in light of the results of the pilot application, the Central Bank will introduce any amendments in this regard.
- The percentage is applied at the level of Jordan branches, Jordan and abroad branches, and the consolidated bank.
- The Central Bank may request a higher leverage ratio for any bank according to the nature of the risks related to it.

Chapter Six: Islamic finance formulas

The minimum capital requirements for the Islamic financing assets:

A. *Murābahah* and *Murābahah* for the Purchase Orderer:

Murābahah: is an agreement whereby the bank sells to a customer at acquisition cost (purchase price plus other direct costs), plus an agreed profit margin, a specified kind of asset that is already in its possession.

***Murābahah* for the Purchase Orderer (MPO):** is an agreement whereby the bank sells to a customer at cost plus an agreed profit margin, a specified kind of asset that has been purchased and acquired by the bank based on a promise to purchase given by the customer, which may be considered to be either a binding or a non-binding promise to purchase.

***Murābahah* and *Murābahah* for the Purchase Orderer are divided into:**

1. *Murābahah* and non-binding MPO:

a. The price risk in these contracts ceases and is replaced by credit risk in respect of the amount receivable from the customer following the transfer of title in the asset to the customer.
b. In the case that the customer abandons the promise of purchase, *Hamish Jiddiyah* is not considered as a credit risk mitigation.

Credit Risk:

1. The credit exposure consists of the balance of the account receivable under the contract which is recorded at its cash-equivalent value – that is, the amount due from the customer at the end of the financial period less any provision for doubtful debts.
2. The account receivable (net of specific provisions) arising from a *Murābahah* sale shall be assigned a RW based on the credit standing of the obligor (purchaser or guarantor) as rated by an ECAI that is approved by the Central Bank of Jordan. In cases where the obligor is unrated, a RW of 100% shall apply.
3. The risk weight of the financial guarantor can be replaced by the risk weight of the customer (the buyer), provided that the financial guarantor has a better credit rating than the customer (the buyer), and that the guarantee is legally enforceable.

Market Risk:

In the case of an asset in possession in a *Murābahah* transaction and an asset acquired specifically for resale to a customer in a non-binding MPO transaction, the asset would be treated as inventory of the bank and the capital charge for such a market risk exposure would be 15% of the amount of the position (carrying value), which equates to a RW of 187.5%. The 15% capital charge is also applicable to assets held by a bank in respect of incomplete non-binding MPO transactions at the end of a financial period.

2. Binding MPO

The bank is exposed to counterparty risk in the event that the orderer in a binding MPO does not honour his/her obligations under the promise of purchase, resulting in the bank having to dispose of the asset to a third party at a selling price which may be lower than the cost to the bank. The risk of selling at a loss may be mitigated by requiring the customer to deposit a *Hamish Jiddiyah* upon executing

the promise of purchase. The bank would have recourse to the customer for any shortfall in the *Hamish Jiddiyah* to compensate for the loss.

Credit Risk:

1. In case the bank has the right to recoup any loss from the orderer (the asset in bank's possession), the exposure shall be measured as the amount of the asset's total acquisition cost to the bank, less the market value of the asset, and less the amount of any *Hamish Jiddiyah*, multiple by RW (100%). The bank is required to ensure that the purchase agreement is properly documented and legally enforceable.
2. When selling the asset and delivered it to the customer, the amount of accounts receivable after deducting the allowance for impairment, deferred and suspense revenue shall be assigned a RW based on the credit standing of the client as rated by an ECAI that is approved by the Central Bank of Jordan. In cases where the obligor is unrated, a RW of 100% shall apply.
3. The risk weight of the financial guarantor can be replaced by the risk weight of the customer (the buyer), provided that the financial guarantor has a better credit rating than the customer (the buyer), and that the guarantee is legally enforceable.

Market Risk:

1. In the case of an asset in possession in a *Murābahah* transaction and an asset acquired specifically for resale to a customer in a binding MPO transaction with a no proper documentation and the possibility of legal enforcement., the asset would be treated as inventory of the bank and the capital charge for such a market risk exposure would be 15% of the amount of the position (carrying value), which equates to a RW of 187.5%. The 15% capital charge is also applicable when the bank does not have the right to recourse against the customer to recover any loss that exceeds the *Hamish Jiddiyah*. The cost of the asset after deducting the *Hamish Jiddiyah* represents market risks.
2. The capital charge for such asset risk exposure of the bank is calculated on the basis of (sale or return) in implementation of the option of the condition, would be 8%, which equates to a RW of 100%, in the case that the accounts payable is not settled, provided that:
   a. Provide documents proving such an arrangement with the seller.
   b. Not to exceed the specified period for returning the assets to the seller.

Foreign exchange Risk:

1. The funding of an asset purchase or the selling of an asset may well expose the bank to foreign exchange risk.
2. The capital charge for such asset risk exposure would be 8%, which equates to a RW of 100%.

B. *<u>Salam</u>*:

Salam: is a contract to purchase, at a pre-determined price, a specified kind of commodity (fungible physical product which is and can be traded on a secondary market – for example, agricultural products, minerals (including oil) and precious metals, excluding gold and silver) which is to be delivered on a

specified future date in a specified quantity and quality. The bank as the buyer makes full payment of the purchase price upon execution of a *Salam* contract.

The parallel *Salam*: Back-to-back contract, to sell a commodity with the same specification as the purchased commodity under a *Salam* contract to a party other than the original seller. The parallel *Salam* allows the bank to sell the commodity for future delivery at a pre-determined price and prevents the bank from having to take delivery of and to warehouse the commodity.

The risks that the bank is exposed to when concluding *Salam* contracts:

1. The credit risk of the transacting party (the supplier) that resulting from the bank not receiving the purchased commodity after paying the purchase price to the seller (the supplier).
2. Price (market) risk: it is the risk that the bank is exposed to from the date of implementing the *Salam* contract and continues during the contract period, and extends beyond its maturity date as long as the commodity remains included in the bank's statement of financial position.

***Salam* contracts are divided into:**

1. *Salam* contracts that are that are executed without any parallel *Salam* contracts.
2. *Salam* contracts that are backed by independently executed parallel *Salam* contracts.

Credit Risk:

1. The receivable amount generated from the purchase of a commodity based on a *Salam* contract shall be assigned a RW based on the credit standing of supplier as rated by an ECAI that is approved by the Central Bank of Jordan. If the supplier is unrated, a RW of 100% shall apply.
2. The credit RW is to be applied from the date of the contract made between both parties until the maturity of the Salam contract, which is upon receipt of the purchased commodity.
3. The credit exposure amount of a Salam contract cannot be offset against the exposure amount of a parallel Salam contract, as an obligation under one contract does not discharge an obligation to perform under the other contract.

Market Risk:

The price risk on the commodity exposure in *Salam* can be measured using either:

1. The simplified approach.
2. The maturity ladder approach.
   - The simplified approach will be used to measure market risk in a *Salam* contract.
   - The capital charge for market risk exposure in a *Salam* contract (in the absence of a parallel *Salam* contract), would be 15%, which equates to a RW of 187.5%.
   - The capital charge for market risk exposure in separate parallel *Salam* contract will be equal to 15% of the net position in each commodity (which

equates to a RW of 187.5%), plus an additional charge equivalent to 3% of the gross positions, which equates to a RW of 37.5%.

- The long and short positions in a commodity, which are positions of *Salam* and parallel *Salam* may be offset for the purpose of calculating the net open positions, provided that the positions are in the same group of commodities.

Foreign exchange Risk:

1. The funding of an asset purchase or the selling of an asset may well expose the bank to foreign exchange risk.
2. The capital charge for such asset risk exposure would be 8%, which equates to a RW of 100%.

C. _Istisnā:_

***Istisnā*:** is a contract to manufacture or construct a non-existent asset which is to be manufactured or built according to the buyer's specifications and is to be delivered on a specified future date at a pre-determined selling price.

Parallel *Istisnā*: is a two separate contracts, one with the customer, and the bank is (*al-sani'*), and the other is with the manufacturers or contractors, and the bank is (*al-mustasni'*).

The risks that the bank is exposed to when concluding *Istisnā* contracts:

1. The credit risk: arise once the work is billed to the customer and he/ she approves it.
2. Market risk: arise on unbilled work-in-process.

***Istisnā* contracts are divided into:**

a. *Istisnā* contracts that are executed without any parallel *Istisnā* contracts.

b. *Istisnā* contracts that are backed by independently executed parallel *Istisnā* contracts.

   1. The price of an asset under this contract is agreed or determined on the contractual date, and such a contract is binding. The price cannot be increased or decreased on account of an increase or decrease in commodity prices or labor cost.
   2. The price can be changed subject to the mutual consent of the contracting parties, which is a matter for the commercial decision of the bank and can result in a lower profit margin.
   3. The credit exposure amount of an *Istisnā*` contract is not to be offset against the credit exposure amount of a parallel *Istisnā*` contract, because an obligation under one contract does not discharge an obligation to perform under the other contract.
   4. The obligations of the bank under *Istisnā*` and parallel *Istisnā*` contracts are not interconditional or interdependent, which implies that there is no legal basis for offsetting credit exposures between the contracts.
   5. The credit RW is to be applied from the date when the manufacturing or construction process commences and until the selling price is fully settled by the bank, either in stages and/or on the maturity of the *Istisnā*` contract, which is upon delivery of the manufactured asset to the *Istisnā*` ultimate buyer.

A distinction can be made between two main types of *Istisnā*, as follows:

1. *Istisnā* with reliance on all sources (including project revenues) to collect the price:
   - **a. *Istisnā`* with parallel *Istisnā`*:**
     1. **The Bank is exposed to credit risk, as follows:**
        - a. Unbilled work-in-process inventory:
          Amount of accounts receivable (parallel *Istisnā*) shall be assigned a RW based on the credit standing of customer as rated by an ECAI that is approved by the Central Bank of Jordan. If the customer is unrated, a RW of 100% shall apply.
        - b. Amounts receivable after contract billings:
          Amount receivable shall be assigned a RW based on the credit standing of customer as rated by an ECAI that is approved by the Central Bank of Jordan. If the customer is unrated, a RW of 100% shall apply.
     2. **The Bank is exposed to market risk, as follows:**
        Unbilled work-in-process inventory:
        There is no capital charge for market risk, subject to there being no provisions in the parallel *Istisnā`* contract that allow the seller to increase or vary its selling price.

   - **b. *Istisnā`* without parallel *Istisnā`*:**
     1. **The Bank is exposed to credit risk, as follows:**
        - **a. Unbilled products inventory:**
          Amount receivable shall be assigned a RW based on the credit standing of customer as rated by an ECAI that is approved by the Central Bank of Jordan. If the customer is unrated, a RW of 100% shall apply.
        - **b. Issuance of current extracts to the client:**
          Amount receivable shall be assigned a RW based on the credit standing of customer as rated by an ECAI that is approved by the Central Bank of Jordan. If the customer is unrated, a RW of 100% shall apply.
     2. **The Bank is exposed to market risk, as follows:**
        - **a. Unbilled products inventory:**
          Amount receivable shall be assigned a RW based on the credit standing of customer as rated by an ECAI that is approved by the Central Bank of Jordan. If the customer is unrated, a RW of 100% shall apply.
        - **b. Amounts receivable after contract billings:**
          The project shall be assigned a RW based on the credit standing of buyer as rated by an ECAI. If the project is unrated, a RW of 150% shall apply.

Foreign exchange Risk:

1. Any foreign exchange exposures arising from the purchasing of input materials, or from parallel *Istisnā`* contracts made, or the selling of a completed asset in foreign currency, should be included in the measures of foreign exchange risk.
2. The capital charge for such asset risk exposure would be 8%, which equates to a RW of 100%.

D. Operating *Ijārah* and *Ijārah Muntahia Bittamlīk*:

Operating *Ijārah*: A contract whereby assets are leased to the customer by the bank, for an agreed period, in return for rent paid in the form of known installments.

Ijārah Muntahia Bittamlīk: an *Ijārah* contract that provides the lessee with an option to own the asset at the end of the lease period, either to purchase the asset for a substantial or non- substantial price, or under a gift contract.

1. In an Ijārah contract, the bank as the lessor maintains its ownership of the leased asset while transferring the right to use the asset, or usufruct, to a customer as the lessee, for an agreed period at an agreed consideration. All liabilities and risks pertaining to the leased asset are to be borne by the bank as lessor, including obligations to restore any impairment and damage to the leased asset arising from wear and tear and natural causes which are not due to the lessee's misconduct or negligence. Thus, the risks of ownership remain with the lessor (the bank), except for the residual value risk at the term of an *Ijārah Muntahia Bittamlīk* which is borne by the lessee.
2. In an *Ijārah Muntahia Bittamlīk* contract, the lessor promises to transfer to the lessee its ownership in the leased asset at the end of the contract as a gift or as a sale for a specified consideration, provided that: (a) the promise is separately expressed and independent of the underlying Ijārah and the lessor concludes the contract of gift or sale while still completely owning the asset; or (b) a gift contract is entered into that is dependent upon the fulfilment of all the Ijārah obligations, whereupon ownership shall be automatically transferred to the lessee.
3. In both operating *Ijārah* and *Ijārah Muntahia Bittamlīk*, the bank either possesses the asset before entering into a leased contract or enters into the contract based on a specific description of an asset to be leased and acquired in the future before it is delivered to the lessee.

Operating *Ijārah* is divided into:

1. **Operating *Ijārah* preceded by a non-binding promise:**

   In the operating *Ijārah* preceded by a non-binding promise, the bank is exposed to market risk only, as follows:

   a. **Asset available for lease (prior to signing a lease contract):**

      The capital charge for the carrying value risk would be 15%, which equates to a RW of 187.5%.

   b. **Upon consigning a leasing contract and the lease rental payments are due from the lessee:**

      The capital charge for the book value risk would be 8%, which equates to a RW of 100%.

2. **Operating *Ijārah* preceded by a binding promise:**

   In the operating *Ijārah* preceded by a binding promise, the bank is exposed to credit risk only, as follows:

Upon consigning a leasing contract and the lease rental payments are due from the lessee:

The exposure shall be measured as the carrying value of the asset multiple by the customer (lessee) risk weight based on the credit standing as rated by an ECAI approved from the Central Bank of Jordan. If the customer (lessee) is unrated, a RW of 100% shall apply.

When the bank does not have the right to recourse to the customer to recover a loss in excess of the *Hamish Jiddiyah* (the operating *Ijārah* preceded by a binding promise), the cost of the asset after deducting the *Hamish Jiddiyah* represents market risks, as is the case in the operating *Ijārah* preceded by a binding promise.

***Ijārah Muntahia Bittamlīk* is divided into**:

1. ***Ijārah Muntahia Bittamlīk* preceded by a non-binding promise:**

   In the *Ijārah Muntahia Bittamlīk* preceded by a non-binding promise, the bank is exposed to market risk only, as follows:

   Asset available for lease (prior to signing a lease contract):

   The capital charge for the carrying value risk would be 15%, which equates to a RW of 187.5%.

2. ***Ijārah Muntahia Bittamlīk* preceded by a binding promise:**

   In the *Ijārah Muntahia Bittamlīk* preceded by a binding promise, the bank is exposed to credit risk only, as follows:

   Upon consigning a leasing contract and the lease rental payments are due from the lessee:

   The exposure shall be measured as the total estimated value of lease receivables for the whole duration of leasing contract less the deferred revenue and suspended revenue multiple by the customer (lessee) risk weight based on the credit standing as rated by an ECAI approved from the Central Bank of Jordan. If the customer (lessee) is unrated, a RW of 100% shall apply.

   When the bank does not have the right to recourse to the customer to recover a loss in excess of the *Hamish Jiddiyah* (*Ijārah Muntahia Bittamlīk* preceded by a binding promise), the cost of the asset after deducting the *Hamish Jiddiyah* represents market risks, as is the case of the *Ijārah Muntahia Bittamlīk* preceded by a non-binding promise.

E. *Mushārakah* and Diminishing *Mushārakah*:

A *Mushārakah*: is an agreement between the bank and a customer to contribute capital in various proportions to an enterprise, whether existing or new, or to ownership of a real estate or movable asset, either on a permanent basis, or on a diminishing basis where the customer progressively buys out the share of the bank (diminishing *Mushārakah*). Profits generated by that enterprise or real estate/asset are shared in accordance with the terms of the *Mushārakah* agreement, while losses are shared in proportion to the respective contributor's share of capital.

Diminishing *Mushārakah*: It is a contract concluded by the bank with the customer as a means of providing financing to the customer on the basis of profit and loss

sharing, whereby the customer purchases the participation share in the bank's share gradually over the term of the contract.

1. *Mushārakah* and Diminishing *Mushārakah* are applicable to both:
   a. *Mushārakah*, in which all the partners' shares remain constant throughout the contract period.
   b. Diminishing *Mushārakah*, in which the share of the bank is gradually reduced during the tenure of the contract until all of it has been sold to the other partner.
2. The bank acts as a partner in a *Mushārakah* contract and is exposed to the risk of losing its capital upon making payment of its share of capital.
3. A *Mushārakah* can expose the bank to capital impairment risk or to credit risk, depending on the structure and purpose of the *Mushārakah* and the types of asset in which the funds are invested.
4. The bank is exposed to entrepreneurial risk of an active partner that manages the partnership and business risks associated with the underlying activities and types of investments or assets of the partnership.
5. In Diminishing *Mushārakah*, the bank is exposed to credit risk in relation to the customer's payments to purchase the bank's share, and to market risk related to the bank's share in the assets that are the subject of the partnership. The selling price of the bank's share depends on the fair value of the part transferred to the partner at the date of each purchase.
6. For *Mushārakah*, the equity exposure can be measured based on the nature of the underlying investments as follows:
   a. For investments held in the trading book, exposure is equal to the fair value.
   b. For investments held to maturity, exposure is equal to the historical cost less any provisions for capital impairment.

For the purpose of determining the minimum capital adequacy requirement, this section makes distinctions between the three main categories of *Mushārakah*. The risks related to *Mushārakah* are calculated after deducting the special provisions, as set out below:

1. <u>Private commercial enterprise to undertake trading activities in foreign currency, shares or commodities:</u>
   a. The capital charge for the assets risk (foreign currency, gold and silver) would be 8%, which equates to a RW of 100%.
   b. The capital charge for the assets risk (shares in the trading book) would be 16%, which equates to a RW of 200%.
   c. The capital charge for the assets risk (commodities) will be equal to 15% of the net position in each commodity (which equates to a RW of 187.5%), plus 3% of the gross positions, (which equates to a RW of 37.5%).
2. <u>Private commercial enterprise to undertake a business activity (other than mentioned in paragraph (1) above</u>:

   The bank, as an investor in the capital, bears the loss in proportion to its share in the capital. The bank may not obtain its rights and entitlements except after fulfilling the claims and entitlements of secured and unsecured creditors.

The RW shall be applied to the exposures (net of specific provisions). The RW under the simple RW method for equity position risk in respect of an equity exposure in a business venture shall entail a 400% RW for shares less any specific provisions for impairment. If there is a third- party guarantee to make good impairment losses, the RW of the guarantor shall be substituted for that of the assets for the amount of any such guarantee.

3. Joint ownership of real estate or movable assets is divided into two sub-categories:
   - **a. *Mushārakah* contract with *Ijārah* sub- contract:**
     Mushārakah in this type is by leasing the asset to a third party via an *Ijārah* sub- contract, the exposure shall be measured as the total carrying value of *Mushārakah* financing multiple by the customer (lessee) risk weight based on the credit standing as rated by an ECAI approved from the Central Bank of Jordan. If the customer (lessee) is unrated, a RW of 100% shall apply.
   - **b. *Mushārakah* contract with *Murābahah* sub- contract:**
     Mushārakah in this type is through the sale of the asset to a third party via a sub- *Mushārakah* contract. The receivables shall be assigned a RW based on the credit standing of the customer as rated by an ECAI approved from the Central Bank of Jordan. If the customer is unrated, a RW of 100% shall apply.

F. *Muḍārabah*:

A *Muḍārabah*: is an agreement between the bank and a customer whereby the bank would contribute capital to an enterprise or activity which is to be managed by the customer as the *Muḍārib*. Profits generated by that enterprise or activity are shared in accordance with the terms of the *Muḍārabah* agreement, while losses are to be borne solely by the bank unless the losses are due to the *Muḍārib's* misconduct, negligence, or breach of contracted terms.

1. *Muḍārabah* can be executed on a restricted basis, where the capital provider allows the *Muḍārib* to make investments subject to specified investment criteria or certain restrictions, or on an unrestricted basis, where the capital provider allows the *Muḍārib* to invest funds freely based on the latter's skills and expertise.
2. As the fund provider, the bank is exposed to the risk of losing its capital investment, (capital impairment risk), upon making payment of the capital to the *Muḍārib*. Any loss on the investment is to be borne solely by the capital provider (the bank), but is limited to the amount of its capital. Losses that are due to misconduct, negligence or breach of contractual terms are to be borne by the *Muḍārib.*
3. It is not permissible for a *Muḍārib* to give a guarantee to the bank against such losses, such a guarantee may be given by a third party on the basis of *Tabarru'* (donation). In such a case, the amount of the *Muḍārabah* capital so guaranteed may be considered as subject to credit risk with a risk-weighting equal to that of the guarantor.
4. In assigning the RW, consideration is given to the intent of the *Muḍārabah* investment, and to the nature of the underlying assets.
5. Purposes of *Muḍārabah*:

a. the purchase of assets for *Muḍārabah.*
b. investing on an equity basis in an ongoing business venture with the intention of holding the investment for an indefinite period, perhaps with a view to eventual sale.
c. Financing projects when the underlying assets are tradable.

6. For *Muḍārabah*, the equity exposure can be measured based on the nature of the underlying investments as follows:
   a. For investments held in the trading book, exposure is equal to the fair value.
   b. For investments held to maturity, exposure is equal to the historical cost less any provisions for capital impairment.
7. Much of the bank's credit exposure to the *Muḍārib* may be transferred to the ultimate beneficiary under the repayment structure involving the "repayment account". Provided the construction work proceeds normally and to the ultimate beneficiary's satisfaction, the risk attaching to the progress payments due from the ultimate beneficiary to the *Muḍārib* will be the credit risk of the ultimate beneficiary. However, this does not per se constitute a mitigation of the credit risk of the bank's exposure to the *Muḍārib*. In such a case, if an independent engineer employed to certify that the work has reached a certain stage of completion has issued a certificate to that effect, so that a progress payment is due from the ultimate beneficiary, from the point of view of the bank the amount of that progress payment due is no longer exposed to the risk of unsatisfactory performance by the *Muḍārib*, but only to the latter's failure to pay the bank (the *Muḍārib* being exposed to possible default by the ultimate beneficiary). However, if a binding agreement exists between the bank and the ultimate beneficiary whereby the latter will make the payment into a "repayment account" with the bank, the latter's credit exposure in respect of the amount due is transferred from the *Muḍārib* to the ultimate beneficiary.

For the purpose of calculating the minimum capital requirement, this section makes distinctions between the three main categories of *Muḍārabah*. The risks related to *Muḍārabah* are calculated after deducting the special provisions, as set out below:

1. <u>Private commercial enterprise to undertake commercial activities in foreign currency, shares or commodities:</u>
   This type of *Muḍārabah* exposes the bank to the risk of the underlying activities, namely foreign currency, equity or commodities.
   a. The capital charge for the assets risk (foreign currency, gold and silver) would be 8%, which equates to a RW of 100%.
   b. The capital charge for the assets risk (shares in the trading book) would be 16%, which equates to a RW of 200%.
   c. The capital charge for the assets risk (commodities) will be equal to 15% of the net position in each commodity (which equates to a RW of 187.5%), plus 3% of the gross positions (which equates to a RW of 37.5%).

2. <u>Private commercial enterprise to undertake a business activity (other than mentioned in paragraph (1) above)</u>:

   The bank, as an investor in the capital, serves as the first loss position. The bank may not obtain its rights and entitlements except after fulfilling the claims and entitlements of secured and unsecured creditors.

   The RW will calculated according to the simple approach. Where a standard risk weight of 400% is given to the amount contributed in the commercial project, less any specific provisions. A 300% risk weight can be applied if the funds are liable to be withdrawn from the investor with a short notice.

3. <u>*Muḍārabah* investments in project finance:</u>

   The bank advances funds to a customer who acts as *Muḍārib* in a construction contract for a third-party customer (ultimate beneficiary) which is characterized by the following:

   a. the bank has no direct or contractual relationship with the ultimate beneficiary.
   b. the bank as investor advances funds to the construction company as *Muḍārib* for the construction project and is entitled to a share of the profit of the project but must bear 100% of any loss.

The bank's overall credit exposure in respect of the *Muḍārabah* can be divided into:

1. The amount receivable by the bank from the *Muḍārib* in respect of progress payments due to the *Muḍārib* from the ultimate customer for work certified as having reached a certain stage of completion: If a binding agreement exists, whereby the amount will be paid by the ultimate customer into a "repayment account" with the bank, a RW will reflect the credit standing of the ultimate customer. In the absence of such an agreement, the RW would reflect the credit standing of the *Muḍārib* rated by an ECAI approved from the Central Bank of Jordan (or 100% RW for unrated customer).
2. The amount held in the "repayment account" with the bank, which would have a risk- weighting of 0%.
3. For any remaining balance of the funds advanced by the bank to the *Muḍārib*, which would have a risk- weighting of 400%.

G. <u>*Sukūk* held as investments in the banking book</u>:

***Sukūk*:** are certificates representing a proportional undivided ownership right in tangible assets or a pool of these assets, or in a specific project or investment activity in accordance with Sharī`*ah* rules and principles.

1. It applies to *Sukūk* or certificates that represent the ownership percentage of the *Sukūk* holder in an integral part of the relevant asset, where the *Sakk* holder enjoys all the rights of this asset and bears all its obligations, and does not cover certificates that give their holders the right to obtain returns from an asset whose ownership is not transferred to the *Sukūk* holders.

2. *Sukūk* are generally classified into:
   a. Assets- based ***Sukūk,*** where these assets provide *Sukūk* holders with returns that can be expected in a good way, as is the case in the *Salam*, *Istisnā* and *Ijārah Sukūk*.
   b. *Sukūk* based on capital investment in which returns are determined on the basis of profit and loss sharing in the relevant investment (*Mushārakah* or *Muḍārabah* for trading purposes).
3. The Central Bank of Jordan may specify the measurement approaches it deems appropriate for other types of *Sukūk* which not listed in this section, provided that they are approved by a *Shariah* supervisory board.

Types of *Sukūk:*

1. ***Salam Sukūk*:** *Salam Sukūk* represents proportionate ownership of the capital of a *Salam* transaction, where the *Salam* capital is constituted by an advance payment to a counterparty as supplier of a commodity (the subject matter) to be delivered at a future date. This type of *Sukūk* is generally considered to be non-tradable, since the subject matter is considered to be a financial asset (a receivable). The gross return to the *Sukūk* holders consists of the margin or spread between the purchase price of the subject matter and its selling price following delivery. In certain *Sukūk* issues, a third party gives an undertaking that the subject matter will be sold at a price exceeding the purchase price by a specified margin. This may be achieved by means of a parallel *Salam* transaction in which a third party purchases the subject matter for delivery on the same delivery date as in the original *Salam* contract.

2. ***Istisnā` Sukūk:*** represent proportionate shares in the financing of a project to construct an asset at a price to be paid in future instalments, the total of which equals the total face value of the *Sukūk*. It is allowed to trade in *Istisna Sukūk*, because the product is considered to be a non-financial asset (work-in-process inventory).

3. ***Ijārah Sukūk*:** represent the holder's proportionate ownership in leased assets where the *Sukūk* holders will collectively assume the rights and obligations of the lessor. The *Sukūk* holders are entitled to a share of the lease rentals in proportion to their ownership shares in the leased assets. *Ijārah Sukūk* are tradable from the issuance date, as the subject matter is a non-financial asset owned by the *Sukūk* holders. As a proportionate owner, an *Ijārah Sukūk* holder assumes a proportionate share of any loss if the leased asset is destroyed, or of the cost of meeting the obligation to provide an alternative asset, failing which the lessee can terminate the lease without paying future rentals.

4. ***Mushārakah Sukūk:*** represent the direct proportionate ownership shares of the holders in the assets of a private commercial enterprise or project, where the subscription money is normally employed in purchasing non-liquid assets or assets

such as real estate or movable assets. A *Mushārakah sakk* is a profit-sharing instrument where the exposure is of the nature of an equity position in the banking book for Islamic bank, except in the case of investments (normally short-term) in assets for trading purposes. *Mushārakah Sukūk* may be traded provided that assets other than cash and debts are not less than a percentage of more than 30% of the average capitalized market value.

5. ***Muḍārabah Sukūk:*** *Sukūk* holders subscribe to the certificates issued by a *Muḍārib* and share the profits and bear any losses arising from the *Muḍārabah* operations. The returns to the holders are dependent on the revenue by the underlying investment. *Muḍārabah Sukūk* may be traded provided that assets other than cash and debts are not less than a percentage of more than 30% of the average capitalized market value.

6. ***Murābahah Sukūk*:** In this case, the originator (and also, in some cases, the issuer) of the *Sukūk* is the buyer (on credit) of the *Murābahah* asset, the *Sukūk* investors are the sellers (on credit) of that asset, and the credit provided by the *Sukūk* investors and received by the issuer consists of the *Murābahah* selling price of the asset, which the originator sells to obtain the funds it seeks. The *Sukūk* holders own the *Murābahah* and are entitled to receive payment of that receivable (the selling price of the asset) either in instalments or in a lump sum at the end of the *Murābahah* contract.

Capital Requirements for *Sukūk*:

1. The RW for *Sukūk* issued by a sovereign authority is the same applied to that sovereign authority as rated by an external credit rating institution approved by the Central Bank of Jordan.
2. The applicable risk weight for *Sukūk* rated by external credit rating institutions approved by the Central Bank of Jordan, is based on the ratings of external credit rating institutions.
3. If the *Sukūk* is un-rated, then:
    a. The credit risk in the various types of *Sukūk* are similar to those in the *Sakk* contract.
    b. The market risk in the various types of Sukūk are similar to those in the *Sakk* contract.

Annex (1) Investments in banks, securities companies, and other financial companies in the event of non- consolidation

Year	2018	2019	2020	2021	2022
T1	60%	70%	80%	90%	100%
T2	40%	30%	20%	10%	0

Annex (2) Minority interest illustrative example

A banking group consists of two legal entities that are both banks. Bank A is the parent and Bank B is the subsidiary and their unconsolidated balance sheets are set out below.

Bank A			
Assets		**Liabilities and equity**	
100	Clients' Receivables and Financing	70	Clients' accounts
7	Investment in CET1 of Bank B	Equity	
4	Investment in the AT1 of Bank B	26	CET1
2	Investment in the T2 of Bank B	7	AT1
		10	T2
113	**Total**	**113**	**Total**

Bank B			
Assets		**Liabilities and equity**	
150	Clients' Receivables and Financing	127	Clients' accounts
		Equity	
		10	CET1
		5	AT1
		8	T2
150	**Total**	**150**	**Total**

The balance sheet of Bank A shows that in addition to its loans to clients, it owns 70% of the Common Shares of Bank B, 80% of the Additional Tier 1 of Bank B and 25% of the Tier 2 capital of Bank B. The ownership of the capital of Bank B is therefore as follows:

Capital issued by Bank B			
	Amount issued to parent (Bank A)	**Amount issued to third parties**	**Total**
CET1	7	3	10
AT1	4	1	5
T2	2	6	8
Total	13	10	23

The consolidated balance sheet of the banking group is set out below:

Consolidated balance sheet	
Assets	
Clients' Receivables and Financing	**250**
Liabilities and equity	
Clients' accounts	**197**
Tier 2 issued by subsidiary to third parties	**6**
Tier 2 issued by parent	**10**
Additional Tier 1 issued by subsidiary to third parties	**1**
Additional Tier 1 issued by parent	**7**
Common equity CET1 issued by subsidiary to third parties (minority interest)	**3**
Common equity CET1 issued by parent	**26**
Total	**250**

For illustrative purposes, Bank B is assumed to have risk weighted assets of 100. In this example, the minimum capital requirements of Bank B and the subsidiary's contribution to

the consolidated requirements are the same since Bank B does not have any loans to Bank A. This means that it is subject to the following minimum plus capital conservation buffer requirements and has the following surplus capital:

Minimum and surplus capital of Bank B		
item	**Minimum plus capital conservation buffer (2.5%)**	**Surplus**
CET1	8.5 (=8.5%*100)	1.5 (=10-8.5)
T1 (CET1+AT1)	10 (=10%*100)	5 (=10+5-10)
TC (CET1+AT1+T2)	12 (=12%*100)	11 (=10+5+8-12)

The following table illustrates how to calculate the amount of capital issued by Bank B to include in consolidated capital:

Bank B: amount of capital issued to third parties included in consolidated capital					
Item	**Total amount issued by Bank B (1)**	**Amount issued to third parties (minority interest) (2)**	**Surplus (3)**	**Surplus attributable to third parties (amount excluded from consolidated capital) (4) =(3)*(2)/(1)**	**Amount included in consolidated capital =(2)-(4)**
CET1	10	3	1.5	0.45	2.55
T1	15	4	5	1.33	2.67
TC	23	10	11	4.78	5.22

The following table summarizes the components of capital for the consolidated group based on the amounts calculated in the table above. Additional Tier 1 is calculated as the difference between Common Equity Tier 1 and Tier 1 and Tier 2 is the difference between Total Capital and Tier 1.

	Total amount issued by parent (all of which is to be included in consolidated capital)	**Amount issued by subsidiaries to third parties to be included in consolidated capital**	**Total amount issued by parent and subsidiary to be included in consolidated capital**
CET1	26	2.55	28.55
AT1	7	0.12	7.12
T1	33	2.67	35.67
T2	10	2.55	12.55
TC	43	5.22	48.22

Annex (3) Corresponding Deduction Approach

Million JD

Item	Example 1	Example 2
CET1	140	140
Investments in the capital of banks, financial companies and *Takaful* companies that are less than (10%) of the capital of these companies	30	30
CET1	15	30
AT1	5	0
T2	10	0
(10%) of CET1	14	14
Investments exceed 10% of the bank's common equity CET1	16	16
Deduction from CET1 (16*(15/30)) or (16*(30/30))	8	16
Deduction from AT1 (16*(5/30)) or (16*(0/30))	2.67	0
Deduction from T2 (16*(10/30)) or (16*(0/30))	5.33	0
The remaining investments are weighed in proportion to their risk weight	14	14

Annex (4) Threshold deductions illustrative example

Item	Million JD
The bank's common equity CET1	95
Investments in the capital of banks, financial companies and *Takaful* companies that are more than (10%) of the capital of these companies	20
CET1	15
AT1 *	3
T2 *	2
Deferred tax assets due to temporary differences	20

* Any capital instruments other than CET1 are fully deducted from the corresponding capital item in the bank's capital. In other words, if the bank invests in capital instrument (AT1) with a certain amount, it must be deducted from the AT1 in the corresponding capital.

First threshold deduction: more than (10%) of each item of CET1

Item	Million JD
10% of CET1	9.5
Deduction from CET1 (15-9.5=5.5)	5.5
Deduction from AT1	3
Deduction from T2	2
Deferred tax assets due to temporary differences (20-9.5=10.5)	10.5
Remaining from the investments and deferred tax assets due to temporary differences	9.5+9.5=19

Second threshold deduction: more than (15%) of aggregate CET1:

- 31/3/2018 – 31/12/2018

Item	Million JD
15% of the Common Equity Tier 1 capital (95*15%)	14.25
Deduction from CET1 that exceed the second threshold 35[28]-5.5-10.5=19 19-14.25=4.75	4.75
Total of deductions from CET1 (10.5+5.5+4.75)	20.75

- From 1/1/2019

Item	Million JD
15% of the Common Equity Tier 1 capital (95-35=60*17.65%)	10.59
Deduction from CET1 that exceed the second threshold 35-5.5-10.5 = 19 19-10.59 = 8.41	8.41
Total of deductions from CET1 (8.41+10.5+5.5)	24.41

[28] It is the sum of (15) million JD, which represents investments in banks, financial companies and *Takaful* companies that exceed (10%) within CET1 instruments, with an amount of (20) million JD, which represents deferred tax assets.

Annex (5) The Regulatory Capital

As of / /

1. Common Equity Tier 1 Capital	
Share Capital	
Retained earnings (losses)	
Other comprehensive income items	0
Fair value reserve in full (the bank's own funds)	
The bank’s share of fair value reserve in full, when the funds are commingled	
Exchange differences arising from the translation of foreign operations (the bank's own funds)	
The bank’s share of exchange differences arising from the translation of foreign operations, when the funds are commingled	
Share premium (discount)	
Statutory reserve	
Voluntary reserve	
Treasury share premium	
Other reserves approved by the Central Bank	
Minority interest	
Interim profit (loss) after tax and after deducted the value of the expected dividends	
Total of Common Equity Tier 1 Capital	**0**
Regulatory adjustments	
Goodwill and other intangibles assets	
The bank’s share of goodwill and other intangibles assets, when the funds are commingled	
Deferred tax assets	
The bank’s share of Deferred tax assets, when the funds are commingled	
Investments in own shares (treasury stock)	
Deferred provisions with the approval of the Central Bank (if any)	
The Bank's share of the deficit in the Investment Risk Management Fund	
Unrealized gain or loss resulting from a change in the fair value of obligations due to a change in credit risk	
Investments in the capital of subsidiaries that are not consolidated with the bank’s accounts, as described in attachment no. (1)	
The increase in capital resulting from the bank’s issuance of *Sukūk* and the provision of credit enhancements against it	
Reciprocal cross holdings in the capital of banking, financial and *Takaful* entities within CET1	
Investments in the capital of banking, financial and *Takaful* entities where the bank own less than 10% (According to what is indicated in the instructions)	
Significant investments in the capital of banking, financial and *Takaful* entities that are outside the scope of regulatory consolidation where the bank owns more than 10%	
Deferred tax assets (DTAs) that arise from the investments in First threshold (10%)	
The Bank's share of Deferred tax assets (DTAs) that arise from the investments in first threshold (10%), when the funds are commingled	
(DTAs) that arise from the investments in second threshold (15%)	
The Bank's share of Deferred tax assets (DTAs) that arise from the investments in second threshold (15%), when the funds are commingled	
Net of CET1	**0**

2. Additional Tier 1	
Long-term *Sukūk (Mushārakah Sukūk)*	
Instruments issued by the bank that meet the criteria for inclusion in Additional Tier 1 capital	
Stock surplus (share premium)	
Minority interest	
Total of AT1	0
Regulatory adjustments	
Reciprocal cross holdings in the capital of banking, financial and *Takaful* entities within AT1	
Investments in the capital of banking, financial and *Takaful* entities where the bank own less than 10% (According to what is indicated in the instructions)	
Investments in the capital of banking, financial and *Takaful* entities where the bank own more than 10% (According to what is indicated in the instructions)	
Net of AT1	**0**
Net of T1	**0**
3. Tier 2	
Instruments issued by the bank that meet the criteria for inclusion in Tier 2 capital, such as (Muḍārabah Sukūk, *Wakālah Sukūk* convertible into shares)	
Stock surplus (share premium)	
General provisions (the bank's own funds) and the bank's share of general provisions (commingled the funds) (limited to a maximum of 1.25 percentage points of credit risk-weighted risk assets	
Minority interest	
The Bank's share of the surplus in the Investment Risk Management Fund	
Total of T2	**0**
Regulatory adjustments	0
Investments in the capital of subsidiaries that are not consolidated with the bank's accounts, as described in attachment no. (1)	
Reciprocal cross holdings in the capital of banking, financial and *Takaful* entities within T2	
Investments in the capital of banking, financial and *Takaful* entities where the bank own less than 10% (According to what is indicated in the instructions)	
Investments in the capital of banking, financial and *Takaful* entities where the bank own more than 10% (According to what is indicated in the instructions)	
Net of T2	
The regulatory capital	0

It is filled out at the level of the banking group, Jordan and abroad branches, and Jordan branches

Annex no. (6) The steps that the Central Bank will follow regarding the countercyclical buffer

The countercyclical buffer calculation includes the following steps:

1. Calculate the private sector credit-to-GDP ratio.
2. Estimate the credit-to-GDP gap (the gap between the ratio and its trend), using statistical measures.
3. Calculate the required buffer based on the estimated gap, as follows:
   a. If the gap is less than (2%), the buffer is zero.
   b. If the gap exceeds (10%), the buffer is (2.5%).
   c. If the gap ranges between the minimum limit and the upper limit that mentioned above, the buffer is:

      (GAP-2%)*2.5%/8%

The Central Bank of Jordan will assess the need to increase or decrease the buffer according to systemic risk trends, before imposing the buffer, the central bank will give banks a grace period of (12) months for compliance in order to give banks sufficient time to fulfill the additional capital requirements, as for the reduction process, it is directly implementable as soon as it is announced by the Central Bank.

Annex (7) External Risk Rating Mapping

Long Term Rating Assessment			**Short Term Rating Assessment**			**Obligor**			
S&P's	**Moody's**	**Fitch's**	**S&P's**	**Moody's**	**Fitch's**	**Sovereign**	**Corporate**	**Banks**	
								M ≤ 3 months	**M > 3 months**
AAA to AA-	Aaa to Aa3	AAA to AA-	A-1+ A-1	P-1	F1+ F1	0%	20%	20%	20%
A+ to A-	A1 to A3	A+ to A-	A-2	P-2	F2	20%	50%	20%	50%
BBB+ to BBB-	Baa1 to Baa3	BBB+ to BBB-	A-3	P-3	F3	%	100%	20%	50%
BB+ to BB-	Ba1 to Ba3	BB+ to BB-				100%	100%	50%	100%
B+ to B-	B1 to B3	B+ to B-				100%	150%	50%	100%
CCC+ and below	Caa1 and Below	CCC+ and below	B-1, B-2, B-3, C	NP	Below F3	150%	150%	150%	150%

Annex (8) * Ministries and institutions eligible for Jordanian government risk weights (zero%)

No.	Name
1	Royal Hashemite Court
2	The Parliament
3	Council of Ministers
4	Ministry of Social Development
5	Jordan Armed Forces
6	Royal Medical Services
7	Royal Jordanian Air Force
8	Royal Jordanian Geographic Center
9	Ministry of Interior
10	Public Security Directorate
11	Civil Defense
12	General Intelligence Department
13	Ministry of Justice
14	Supreme Judge Department
15	Ministry of Foreign
16	Department of Palestinian Affairs
17	Ministry of Finance in all its departments
18	Ministry of Industry, Trade and Supply
19	Ministry of Tourism and Antiquities
20	Ministry of Local Administration
21	Ministry of Energy and Mineral Resources
22	Natural Recourses Authority
23	Ministry of Public Works and Housing
24	Government Tenders Department
25	Ministry of Agriculture
26	The Agricultural Marketing Corporation
27	Ministry of Water and Irrigation
28	Jordan Valley Authority

29	The Ministry of Education
30	Higher Education Council
31	Ministry of Health
32	Ministry of Social Development
33	Ministry of Labor
34	Ministry of Awqaf and Islamic Affairs
35	Ministry of Culture
36	Ministry of Transport / Jordan Civil Aviation Regulatory Commission
37	Ministry of Information and Communications Technology
38	Ministry of Environment
39	Social Security Corporation
40	Jordan Free and Development Zones Group
41	Water Authority of Jordan
42	Aqaba Special Economic Zone Authority
43	Aqaba Company for Ports Operation and Management
44	Telecommunications Regulatory Commissions
45	Jordan Securities Commission
46	Transport Regulatory Commission
47	Jordan Insurance Federation
48	Energy and Minerals Regulatory Commission
49	Jordan Deposit Insurance Corporation
50	Greater Amman Municipality
51	Others (subject to prior approval from the Central Bank)

* This Annex is exclusively approved for the purposes of implementing The Regulatory Capital for Islamic Banks Standard.

Annex (9) Establishments and institutions that eligible for banks risk weights[29]

No.	Name
1	Municipalities and Local Councils
2	Royal Jordanian
3	National Electric Power Company
4	Electricity Distribution Company
5	Central Electricity Generating Company
6	Jordan Industrial Estates Corporation
7	Jordan Export Development & Commercial Centers Corporation
8	Al-Aqsa Mosque Reconstruction Committee
9	Military Retired Foundation
10	Royal Scientific Society
11	The Military Consumer Institution
12	The University of Jordan
13	Yarmouk University
14	Al Albayt University
15	Mutah University
16	AlBalqa Applied University
17	Jordan University of Science and Technology
18	Amman Faculty of Engineering Technology
19	Al-Hussein Bin Talal University
20	The Hashemite University
21	The Higher Council for Science and Technology
22	Jordan University Hospital
23	Jordan Medical Council
24	Provident Fund for University of Jordan Employees

[29] If the exposures belonging to these institutions are in foreign currency, then the risk weight given to these exposures should not be less than the weight of the Jordanian government exposures in foreign currency.

25	End of service compensation fund for University of Jordan employees
26	The University of Jordan Investment Fund
27	Yarmouk University Investment Fund
28	Jordan University of Science and Technology workers housing fund
29	Jordan University of Science and Technology Provident Fund
30	Jordan Institute of Diplomacy
31	Military Housing Corporation / Housing Fund
32	Shared services councils in the provinces
33	Social Security Fund for Audit Bureau employees
34	Armed Forces Officers Club
35	Social Security Fund for Ministry of Education Employees
36	Housing Fund for Ministry of Education Employees
37	King Abdullah II Fund
38	King Hussein Cancer Center
39	King Abdullah University Hospital
40	The National Center for Diabetes Endocrinology
41	Diabetes Center Donation Fund
42	Tafila Technical University
43	Provident Fund for Tafila Technical University Employees
44	Technical and Vocational Education and Training Support Fund
45	General Intelligence Officers Housing Fund
46	The Armed Forces Development and Investment Projects Fund
47	The Civil Consumer Institution
48	National Aid Fund
49	Aqaba Railway Corporation
50	Vocational Training Corporation
51	General Organization for Environmental Protection
52	Housing and Urban Development Corporation
53	Development and Employment Fund
54	Jordan Hejaz Railway
55	Health Insurance Agency
56	Jordan Standards and Metrology Organization
57	Jordan Postal Saving Fund
58	The Royal Aal al-Bayt Institute for Islamic Thoughts
59	Higher Council for Youth and Sport
60	Others (subject to prior approval from the Central Bank)

Annex (10) Establishments and institutions that eligible for companies' risk weights

No.	Name
1	Jordan Petroleum Refinery Company
2	Jordan Phosphate Mines Company
3	Arab Potash Company
4	Arab Mining Company
5	Jordan Glass Industrials Company
6	Jordan Company for Wood Industry Company
7	Jordan Hotels and Tourism Company
8	Jordanian Company for Television Production
9	Jordan Real Estate Company
10	Syrian Jordanian Company for Industry
11	Arabian White Cement Company
12	Jordan Telecom Company

Annex (11) Conditions that must be met by a small enterprise to be included in the retail portfolio

1. Its legal status is not a public joint stock company.
2. The total credit (direct and indirect ceilings, including liabilities related to *Ijārah Muntahia Bittamlīk*) does not exceed (250) thousand JD with a single bank.
3. That its total assets do not exceed (500) thousand JD.
4. That its total annual sales do not exceed one million JD.
5. These conditions apply only to customers of bank branches within the Kingdom, as for customers of Jordanian bank branches operating abroad, the instructions of the host countries will apply, provided that the branch operating abroad proves its commitment to all instructions in this regard.
6. The bank shall ensure compliance with the above conditions periodically (for a period not exceeding one year).

Annex (12) Qualifying residential financing

A. General Rules:

1. Financing and receivables fully secured by mortgages on residential property will be risk weighted at 35% (As well as Ijārah Muntahia Bittamlīk for residential purposes) , in the case that all of the following standards are applied.
2. In the case that any of the above criteria are violated, the full value of the fund is included in the unqualified residential loans portfolio, which will be risk weighted at (100%).

B. Financing criteria:

1. The purpose of financing is to build, buy, expand or renew a residential property inside Jordan, in the case of the bank's branches abroad, the funded real estate must be in the host.
2. The bank must have at all times the legal right to implement on the property, including the right to sell or own in the event of borrower default.
3. The bank must have clear and written policies and procedures within its credit policy to assess the borrower's ability to fulfill all of its obligations.
4. The bank must have clear, written and documented procedures within its credit policy to ensure the correctness of the information used in the borrower's credit analysis process, especially those data related to the main income and other sources of income, if any, the customer job data and terms of employment, and data related to his other financial obligations with the bank or the banking system. These tasks are required to be performed before the final approval.
5. In the case that outsourcing services are used in the credit analysis process, for example: real estate office services and/ or real estate companies, the bank must have a clear policy that governs such relationships, also a clear and written procedures to ensure the safety of the standards approved by external parties when conducting the credit analysis process.
6. The credit policies and procedures of the bank must include clear and documented criteria for the real estate appraisal process, so that these criteria include cases in which the bank approves internal appraisers and cases in which an external appraiser is approved. The bank must also adopt a list of its external appraisers.
7. The bank's credit policies and procedures must include clear and documented criteria for the real estate re-assessing process, so that it includes at the minimum the following: the approved periodicity of revaluation, the requirements for re-evaluation in light of economic conditions that may negatively affect the value of real estate, and the requirements for re-evaluation in the event of default of the borrower.

8. The mortgaged residential real estate is required to be easy to liquidity, within a reasonable period of time, and without substantial loss in its market value, in the event that there is something that prevents this, the loan is not classified within the portfolio of eligible housing loans.

C. Funding ratio criteria:

1. The loan to value does not exceed (80%) of the estimated value of the property or the purchasing value, whichever is less, upon granting. Otherwise, it should be included in the unqualified housing financing portfolio and given a (100%) risk weight.
2. As for housing financing that are excluded from the qualified portfolio for violating this condition, they may be re-listed within the portfolio as soon as the outstanding balance reaches (80%) of the estimated or purchasing value of the property upon granting.

D. Mortgage criteria:

1. The financed property must be mortgaged of the first degree and subsequent degrees are accepted on the condition that there is no mortgage in favor of another party.
2. The value of the mortgage bond must not be less than the value of the granted loan.
3. Mortgages for the purposes of including the financing in the portfolio of eligible housing financing are not accepted if they are related to shares or commonly owned real estate.

E. *Takaful* Insurance criteria:

In the case that the financing is more than (80%) of the value of the property with mortgage insurance at a rate of not less than (40%) of the financing value issued by a *Takaful* insurance agency recognized by the Central Bank, in this case, the bank may include the financing in the eligible housing loan portfolio.

Annex (13) Mapping of Business Lines

Main Business Lines (Banks, Investment banks, non-banking companies)	Beta equivalent	Description
Corporate Finance	18%	Mergers and acquisitions, underwriting, syndications, IPO
Trading & Sales	18%	Private sector financing, banking services, trusts and real estate, providing consulting
Retail Banking	12%	Retail financing and deposits, retail banking services, card services
Commercial Banking	15%	Project finance, real estate, export finance, guarantees
Payment and Settlement	18%	Payments and collections, funds transfer, clearing and settlement
Agency Services	15%	Issuer and paying agents for corporate agency
Asset Management	12%	As stated in IFSB paper
Retail Brokerage	12%	As stated in IFSB paper

Annex (14) The capital charge for equities risk

Thousands JD

The book	Open positions		Total position	capital charge for specific risk	Net of position	capital charge for general risk	capital charge for specific and general risk
1	Long (2)	Short (3)	(4)	Total position (5)	(6)	Net of position (7)	(8)
			(2+3)	(4*8%)	(2-3)	(6*8%)	(5+7)
			0	0	0	0	0
			0	0	0	0	0
			0	0	0	0	0
			0	0	0	0	0
			0	0	0	0	0
			0	0	0	0	0
Total	0	0	0	0	0	0	0

Market risk for equity instruments= capital charge for specific and general risk * 12.5	0

Annex (15) Specific risk for return rate related *Sukūk* in the trading book

Thousands JD

Instruments	Rating	Maturity	Long Positions	short Positions	1+2	Risk weight	Capital 3*4
			1	**2**	**3**	**4**	**5**
Sukūk issued by the Jordanian government or its guarantee in Jordanian dinars	Regardless the rating				0	0%	0
Sukūk issued by governments (including the securities issued by the Jordanian government in foreign currency) classified as follows:	(AAA) – (AA-)				**0**	**0%**	**0**
	(A+) – (BBB-) and the residual term to maturity:	6 months or less			**0**	**0.25%**	**0**
		Over 6 to 24 months			**0**	**1%**	**0**
		Over 24 months			**0**	**1.6%**	**0**
	(BB+) – (B-)				**0**	**8%**	**0**
	Less than (B-)				**0**	**12%**	**0**
	Unrated				**0**	**8%**	**0**
Qualifying *Sukūk*	residual term to maturity:	6 months or less			**0**	**0.25%**	**0**
		Over 6 to 24 months			**0**	**1%**	**0**
		Over 24 months			**0**	**1.6%**	**0**
Other *Sukūk*	(BB+) – (BB-)				**0**	**8%**	**0**
	Less than (BB-)				**0**	**12%**	**0**
	Unrated				**0**	**8%**	**0**
Total charge for specific risk of return rate							**0**
Specific market risk = total charge for specific risk*12.5							**0**

Annex (16) General risk for return rate related *Sukūk* in the trading book

Sukūk 3% or more	*Sukūk* less than 3%	Risk weight
1 month or less	1 month or less	0%
1 to 3 months	1 to 3 months	0.20%
3 to 6 months	3 to 6 months	0.40%
6 to 12 months	6 to 12 months	0.70%
1 to 2 years	1.0 to 1.9 years	1.25%
2 to 3 years	1.9 to 2.8 years	1.75%
3 to 4 years	2.8 to 3.6 years	2.25%
4 to 5 years	3.6 to 4.3 years	2.75%
5 to 7 years	4.3 to 5.7 years	3.25%
7 to 10 years	5.7 to 7.3 years	3.75%
10 to 15 years	7.3 to 9.3 years	4.50%
15 to 20 years	9.3 to 10.6 years	5.25%
over 20 years	10.6 to 12 years	6.0%
	12 to 20 years	8.0%
	over 20 years	12.5%

Annex (17): calculation of General risk for return rate related to *Sukūk*

Table no. (17-A): *Sukūk* with more than 3% return

Thousands JD

No.		Zone 1				Zone 2			Zone 3						
	Time-band	0-1	1-3	3-6	6-12	1-3	2-3	3-4	4-5	5-7	7-10	10-15	15-20	Over 20	
	Open positions	Months				Years			Years						
	Total														
	Total of long positions	0	0	0	0	0	0	0	0	0	0	0	0	0	
	Total of short positions	0	0	0	0	0	0	0	0	0	0	0	0	0	
	Weight	0	0	0	0	0	0	0	0	0	0	0	0	0	
1	long positions*Weight (A)	0	0.2%	0.4%	0.7%	1.25%	1.75%	2.25%	2.75%	3.25%	3.75%	4.5%	5.25%	6%	
	Short positions*Weight (B)	0	0	0	0	0	0	0	0	0	0	0	0	0	
2	(A) + (B)	0	0	0	0	0	0	0	0	0	0	0	0	0	
3	Vertical disallowances (matched position within time-band *10%)	0	0	0	0	0	0	0	0	0	0	0	0	0	
4	horizontal disallowances: matched position within the zones * (40%,30%)	0				0			0						0.00
	horizontal disallowances: matched position between adjacent zones*40%							0.00						0	0.00
	horizontal disallowances: matched position between zones 1and3 * 100%														0.00
5	The capital required for general risk of debt instruments subject to return rate risk equal:														0.00
6	The market general risk for return rate = the required capital * 12.5														

Table no. (17-B): ***Sukūk*** **with less than (3%) coupon** **Thousands JD**

No.		Zone 1				Zone 2			Zone 3								
	Time-band	0-1	1-3	3-6	6-12	1-1.9	1.9-2.8	2.8-3.6	3.6-4.3	4.3-5.7	5.7-7.3	7.3-9.3	9.3-10.6	10.6-12	12-20	Over 20	
	Open positions	**Months**				**Years**			**Years**								
	Total																
	Total of long positions	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0	
	Total of short positions	**0**	**0**	**0**	**0**	**0**	**0**	**0**	**0**	**0**	**0**	**0**	**0**	0	0	**0**	
	Weight	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0	
1	long positions*Weight (A)	**0**	**0.2%**	**0.4%**	**0.7%**	**1.25%**	**1.75%**	**2.25%**	**2.75%**	**3.25%**	**3.75%**	**4.5%**	**5.25%**	**6%**	**8%**	**12.5%**	
	Short positions*Weight (B)	**0**	**0**	**0**	**0**	**0**	**0**	**0**	**0**	**0**	**0**	**0**	**0**	**0**	**0**	**0**	
2	(A) + (B)	**0**	**0**	**0**	**0**	**0**	**0**	**0**	**0**	**0**	**0**	**0**	**0**	**0**	**0**	**0**	0
3	Vertical disallowances (matched position within time-band *10%)	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0	**0**
4	horizontal disallowances: matched position within the zones * (40%,30%)	**0**				**0**			**0**								**0**
	horizontal disallowances: matched position between adjacent zones*40%																**0**
	horizontal disallowances: matched position between zones 1and3 * 100%																**0**
5	**The capital required for general risk of *Sukūk* subject to return rate risk equal:**																**0**
6	**The market general risk for return rate = the required capital * 12.5**																0

Annex (18) Market risk for foreign exchange rate and gold/ silver

currency	**Net positions**	
	long	short
Dollar		
Euro		
Japanese Yen		
Swiss franc		
Swedish krona		
Canadian Dollar		
Danish Krone		
pound		
Other currencies		
Total of net open positions (long and short)	0	0
a. The greatest open positions	0	
b. Net open position in gold (Long or short)		
c. Net open position in silver (Long or short)		
a+b +c	0	
Capital charge for foreign exchange risk and gold/silver (a+b+c)*8%	0	
Market risk for foreign exchange rate and gold/silver = Capital * 12.5	0	

Annex (19) Simplified approach used to calculate commodities risk

Commodity type	Long position	Short positon	Net of position	Total of positions	The required capital
			(1)-(2)	(1)+(2)	{(4)*3%}+{15%*(3)}
	1	**2**	**3**	**4**	**5**
			0	0	0
			0	0	0
			0	0	0
			0	0	0
			0	0	0
			0	0	0
			0	0	0
Total					**0**
Market risk of commodities = required capital * 12.5					**0**

Annex (20) Leverage Ratio

No.	Exposures	Amount (own funds)	CCF	Amount after CCF	Amount (commingled)	CCF	Amount after CCF	Amount after alpha	total
A	**The numerator**								
	T1 after deductions [1]		100%			100%			
B	**The denominator**								
1	Cash and balances with central banks		100%			100%			
2	Balances with banks and financial institutions		100%			100%			
3	Securities portfolio [2]		100%			100%			
4	Other sales receivables, deferred receivables, financing, *Ijārah Muntahia Bittamlīk* and good loans [3]		100%			100%			
5	Net fair value of derivatives [4]								
6	Net fixed assets		100%			100%			
7	Real Estate Investments		100%			100%			
8	Other assets		100%			100%			
	Total On-balance sheet items [5]								
9	**Irrevocable obligations**								
9/a	Guarantees		100%			100%			
9/b	Letters of credit		100%			100%			
9/c	Sight letters of credit		100%			100%			
9/d	Acceptances		100%			100%			
9/e	Unutilized facilities [6]		100%			100%			
9/f	Underwriting		100%			100%			
9/g	Liquidity facility		100%			100%			
9/h	Any other obligations, including alternatives repurchase agreements and securities financing transactions according to *Shariah*		100%			100%			
10	**Cancelable obligations [7]**								
10/a	Guarantees		10%			10%			
10/b	Letters of credit		10%			10%			
10/c	Sight letters of credit		10%			10%			
10/d	Unutilized credit facilities (Non-binding credit ceilings)		10%			10%			
10/e	Liquidity facility (credit lines)		10%			10%			
10/f	Others		10%			10%			
	Total off-balance sheet items (9 + 10) [8]								
	Leverage ratio (A/B)								

[1] All deductions from the capital will be from the T1, and the items are full deducted from T1 will be excluded from the denominator of the ratio.

[2] Net of securities portfolio.

[3] The credit facilities will be after deducting the provision for impairment and suspending returns.

[4] Off-balance sheet credit derivatives represent the positive net fair value after excluding the negative value.

[5] All assets within on-balance sheet must be without deduction of any financial or tangible guarantees and without taking credit risk mitigations (including physical or financial collateral, guarantees, *Urbun*, *Hamish Jiddiyah*, etc.). Also, it is not allowed to netting between financing exposures items and profit-sharing investment account or deposits.

[6] The unutilized facilities include direct and indirect.

[7] Obligations that the bank may cancel without referring to the customer and without prior notice, and their maturity is usually less than a year.

[8] The off-balance sheet items will be net after excluding cash collaterals.