هيئة السوق المالية
Capital Market Authority

KINGDOM OF SAUDI ARABIA

Capital Market Authority

PRUDENTIAL RULES

English Translation of the Official Arabic Text

Issued by the Board of the Capital Market Authority
Pursuant to its Resolution Number 1-40-2012
Dated 17/2/1434H corresponding to 30/12/2012G
Based on the Capital Market Law
issued by Royal Decree No. M/30 dated 2/6/1424H

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Arabic is the official language of the Capital Market Authority

Important Notice:

The current version of these Rules, as may be amended, can be found at the Authority website: www.cma.org.sa

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PART 1
INTRODUCTION

Article 1: Purpose and Scope

a) The purpose of these Rules is to specify the prudential requirements for the capital market institutions' financial prudence.
b) A capital market institution authorised to carry out one or more businesses of Dealing, Custody, or Managing Investments and Operating Funds, must satisfy the minimum capital adequacy requirements specified in Article (3) of these Rules and comply with the other provisions set forth in these Rules.
c) A capital market institution authorised to carry out the businesses of Managing Investments, and not authorised to carry out any of the businesses specified in Paragraph (b) of this Article must maintain at all times the capital base of not less than 50% of its expenditure-based capital requirement in accordance with Part (4) of these Rules; and comply with the other provisions set forth in Part (1), Part (2), Part (6), Part (7) and Part (8) of these Rules.
d) A capital market institution authorised to carry out only the business of Arranging or only the business of Advising or a combination of both must maintain at all times the capital base of not less than 25% of its expenditure-based capital requirement in accordance with Part (4) of these Rules; and comply with the other provisions set forth in Part (1), Part (2), Part (6), Part (7) and Part (8) of these Rules.
e) The Authority, if it deems necessary, may impose additional prudential requirements on the capital market institutions.
f) These Rules do not prejudice the provisions of the Law or its Implementing Regulations.

Article 2: Definitions

a) Any reference to the "Law" in these Rules shall mean the Capital Market Law issued by Royal Decree No. M/30 dated 2/6/1424H.
b) Expressions and terms in these Rules have the meaning which they bear in the Law and in the Glossary of Defined Terms Used in the Regulations and Rules of the Capital Market Authority, unless otherwise stated in these Rules.
c) For the purpose of implementing these Rules, the following expressions and terms shall have the meaning they bear as follows unless the contrary intention appears:
    - **Exposures:** Items reported as assets in the balance sheet, derivatives reported as assets and liabilities, or off-balance sheet items.
    - **Excess exposures:** Portion of exposures in the trading book or non-trading activities that exceed 25% of the capital market institution's Tier 1 capital.
    - **Trading book:** A ledger of all positions held for one of the reasons stated in Paragraph (a) of Article (71) of these Rules and have met the management requirements stated in Article (73) of these Rules.

- **Commodities:** Physical or energy products such as agricultural, minerals, precious metal, base metal and electricity which trade on the commodity exchanges.
- **Tier 1 capital:** The most loss-absorbing form of capital, which includes the capital items listed in Article (5) of these Rules.
- **Tier 2 capital:** A less loss-absorbing form of capital, which includes the capital items listed in Article (6) of these Rules.
- **Offsetting Transaction**: Transaction leg between the general clearing member and the CCP when the general clearing member acts on behalf of a Client Capital Market Institution.
- **Securities financing transactions or SFT:** Transactions where its value depends on market valuation of securities and the transactions are typically subject to margin agreements such as repurchase agreements, reverse repurchase agreements, and securities lending and borrowing transactions.
- **Cash transactions:** Transactions in non-derivatives financial instruments listed on the Exchange that do not give rise to counterparty credit risks.
- **Qualifying central counterparty or QCCP:** A qualifying CCP as defined in the Securities Central Counterparties Regulations issued by the Authority.
- **Capital base:** Comprises Tier 1 capital and Tier 2 capital.
- **Subordinated loans:** Fixed-term unsecured loans extended to the capital market institution as the borrower with the conditions as set out in Article (7) of these Rules.
- **Public sector entities**: A non-commercial administrative bodies responsible to the government or governmental authorities, or a non-commercial undertaking owned by or set up and sponsored by government.
- **Group of connected counterparties:** Two or more natural or legal persons who, unless otherwise shown, constitute a single risk because any of the following:
    1) One of them, directly or indirectly, has control over the other or others in the same group; or
    2) They are interconnected in a way that if one of them were experience financial problems, the other or all of the others would likely encounter repayment difficulties.
- **Financial Group:** Comprises a capital market institution and any of the following:
    1) Its local and foreign subsidiaries;
    2) Companies with which it has a joint, or essentially joint-management or exercises a significant influence over it; or
    3) Private equity investments in which it owns a majority of the voting rights.
- **Credit risks:** Risk of loss to the capital market institution resulting from the potential failure or default of the counterparties in meeting their obligations in accordance with the agreed terms.

- **Concentration risk:** Risk of loss resulting from excess exposures to a single counterparty or group of connected counterparties, or to risky assets such as real estate investments.
- **Operational risk:** Risk of loss to the capital market institution resulting from inadequate or failed internal processes, people, and systems or from any external events.
- **Market risk:** Risk of loss to the capital market institution resulting from fluctuations of market prices of assets, liabilities, and financial instruments.
- **Counterparty credit risk in derivatives transactions:** Risk of loss arising from the default of the counterparty to a derivatives transaction or portfolio of derivatives transactions before the final settlement of the transactions' cash flows in which the transaction or portfolio of transactions with the counterparty has a positive economic value at the time of default. The economic value of a derivatives transaction can vary over time with the movement of underlying market factors.
- **Clearing Member Capital Market Institution**: A capital market institution acting as a clearing member.
- **Client Capital Market Institution**: A capital market institution acting as a client of a general clearing member.
- **Risk charge:** A percentage that describes a risk level of an exposure in the trading book or other exposures subject to market risk.
- **Non-trading activities:** Exposures arising from activities that are not included in the trading book.
- **Risk weight:** A percentage that describes a risk level of an exposure under the non-trading activities which are subject to credit risk requirements.

Article 3: Minimum Capital Adequacy Requirements

a) A capital market institution authorised to carry out one or more businesses of dealing, custody or managing investments and operating funds must satisfy at all times the following minimum capital adequacy requirements:
   1) Tier 1 capital ratio of 6%, calculated as the ratio of the Tier 1 capital to risk weighted assets; and
   2) Total capital ratio of 8%, calculated as the ratio of the capital base to risk weighted assets.

b) The compositions of the capital base are set out in Article (4) of these Rules.

c) The calculation of risk weighted assets are set out in Part (3) of these Rules.

PART 2
CAPITAL BASE

Article 4: Composition of Capital Base

The capital base of a capital market institution comprises the total of:

1) Tier 1 Capital as set out in Article (5) of these Rules; and
2) Tier 2 capital as set out in Article (6) of these Rules.

Article 5: Composition of Tier 1 Capital

Tier 1 capital shall consist of the following:

1) Paid-up capital;
2) Paid-up share premium;
3) Retained earnings;
4) Accumulated other comprehensive income and other disclosed reserves;
5) Non-controlling interests; and
6) Regulatory adjustments to Tier 1 capital pursuant to Articles (10) and (11) of these Rules.

Article 6: Composition of Tier 2 Capital

a) Tier 2 capital shall consist of the instruments issued by the capital market institution that meet the criteria for inclusion in Tier 2 capital pursuant to Article (7) of these Rules. The Tier 2 capital instruments refers to the fixed-term subordinated loans or other similar fixed-term promissory notes.
b) Where the terms of the capital instrument depart from relevant criteria set out in Article (7) of these Rules, the capital market institution must not include the capital instruments in its Tier 2 capital.

Article 7: Criteria for Inclusion in Tier 2 Capital

a) To qualify as a Tier 2 capital, an instrument must satisfy the following requirements:
    1) The instrument must be directly issued by the capital market institution and fully paid-up;
    2) The instrument represents, prior to any conversion to ordinary shares capital, the most subordinated claim in liquidation of the capital market institution after the share capital;
    3) The instrument is not covered by a guarantee of the issuing capital market institution or related entity, or any other arrangements that legally or economically enhance the seniority of the holder's claim;
    4) The principal amount of the instrument has an original maturity of at least five years;
    5) The instrument may only be repayable or callable at the initiative of the capital market institution only after a minimum of one year. The capital market institution must receive prior approval from the Authority to repay the loan or exercise a call option and must not repay the loan or exercise a call unless the

capital market institution demonstrates that its capital adequacy ratios remain well above the minimum capital adequacy requirements and are deemed satisfactory in the long-term after the loan is repaid or the call option is exercised.

6) The instrument contains no step-ups or other incentives to redeem. And the interest rate, or the formulas for calculating interest payments, must be predetermined in the issue documentation. The instrument must not provide a higher interest rate if such payments are not made on time, or a reduced interest rate if such payments are made on time.
7) Neither the capital market institution, nor a related party over which the capital market institution exercises control or significant influence, can have directly or indirectly funded the instrument or the purchase of the instrument.
8) The instrument must include provisions addressing loss absorption at the point of non-viability (trigger event) that requires, at the option of the Authority, the principal amount of the instrument to be immediately and irrevocably written-off or converted into ordinary share capital. The trigger event is the issuance of a notice by the Authority to the capital market institution that includes that the conversion or write-off of the instruments is necessary, without which the capital market institution would become non-viable. The aggregate amount of the Tier 2 capital instruments required to be converted or written down must be to the extent necessary, enabling the Authority to conclude that the capital market institution is viable.

b) A capital market institution must notify the Authority in writing, without delay, when issuing Tier 2 capital instruments. The notice must be associated with a copy of the documents related to that issuance.

Article 8: Conversion and Write-Off of Tier 2 Capital Instruments

a) In relation to the conversion of Tier 2 capital instrument into ordinary share capital, as referred to in Sub-paragraph (8) of Paragraph (a) of Article (7) of these Rules, the capital market institution must ensure that:
    1) The issue documentation of this instrument specifies the number of the ordinary shares to be received upon conversion, or its conversion formula;
    2) All necessary authorisations must be obtained at the date of issuance of the Tier 2 capital instruments and maintained at all times; and
    3) There are no procedural or legal impediments to that conversion by virtue of its incorporation or statutes or contractual arrangements.
b) In relation to the write-off of Tier 2 capital instrument as referred to in Sub-paragraph (8) of Paragraph (a) of Article (7) of these Rules, the write-off mechanism must be structured so that:
    1) The claim of the instrument in the liquidation of the capital market institution is reduced; and
    2) The distributions and payments payable on that instrument must be permanently reduced.

Article 9: Amortisation of Tier 2 Capital Instruments

a) The amount of the Tier 2 capital instrument is to be amortised on a straight-line basis at a rate of 20% per year over the last four years to maturity. The amount of instruments eligible for inclusion in Tier 2 capital is set out in Table (1) below:

Table (1)

Years to maturity	Amount of instrument included in Tier 2 capital (%)
> 4 years	100%
> 3 years, ≤ 4 years	80%
> 2 years, ≤ 3 years	60%
> 1 year, ≤ 2 years	40%
≤ 1 year	20%

b) The capital market institution may repay the amortised original amount of the instrument to the holders of Tier 2 capital instruments.

Article 10: Regulatory Adjustments to Tier 1 Capital Related to Profit

a) A capital market institution may include the profit generated in the current financial year in its Tier 1 capital if the external auditor has verified the profit of the capital market institution.

b) A capital market institution that later generates a smaller profit than what was most recently verified by the external auditor must only include that smaller profit in its Tier 1 capital.

c) A capital market institution must deduct losses from its Tier 1 capital even if the external auditor has not yet verified the losses.

d) A capital market institution must deduct from its Tier 1 capital the annual cash dividends, or any other similar allocations, upon the approval of the General Assembly on such dividends or allocations.

Article 11: Regulatory Adjustments to Tier 1 Capital Related to Other Items

a) A capital market institution must deduct from its Tier 1 capital the following other items:

1) Goodwill and intangibles, including goodwill in its investments treated using the equity method. No offsetting against the negative goodwill is allowed;
2) Deferred zakat or taxes assets on the balance sheet;
3) Defined benefit pension assets on the balance sheet; and
4) Treasury stocks, whether held directly or indirectly.

b) A capital market institution must derecognise from its Tier 1 capital the following:

1) The amount of cash flow hedge reserve related to the hedging of items that are not fair valued in the balance sheet, including projected cash flows.
2) Unrealised gains and losses due to changes in the fair value of liabilities resulting from changes in the capital market institution's own credit risk.

PART 3

RISK-WEIGHTED ASSETS

CHAPTER 1: CREDIT RISK

SECTION 1: GENERAL

Article 12: Scope

A capital market institution must calculate the risk-weighted assets for credit risk for all on-balance sheet and off-balance sheet exposures, except for the following items:

1) Exposures that are deducted from the capital base pursuant to regulatory adjustments set out in Articles (10) and (11) of these Rules; and
2) Exposures that are subject to market risk capital requirements set out in Chapter (2) of this Part, this shall not include the exposures to derivative transactions.

Article 13: Calculating Risk-Weighted Assets for Credit Risk

a) For each exposure, the risk-weighted exposure amount must be calculated by multiplying the exposure amount, calculated in accordance with Article (14) of these Rules, by the risk weight that applies to that exposure as set out in this Chapter.
b) Where a credit rating is used to determine the risk weight of the exposure, the risk weight must be assigned based on the exposure's credit quality step in accordance with the rules for using credit ratings as set out in Section (2) of this Chapter.

Article 14: Calculating Exposure Values

a) The exposure value for an item on the balance sheet must be its current book value (net of write-offs, depreciation, and specific provisions).
b) The exposure values for an off-balance sheet exposure must consist of its nominal amount multiplied by a credit conversion factor as set out in Section (4) of this Chapter.
c) The exposure values for counterparty credit risk in all derivatives transactions must be calculated in accordance with Section (5) of this Chapter.
d) The exposure values for securities financing transactions must be calculated in accordance with the Simple Approach or Comprehensive Approach in accordance with Section (7) of this Chapter.
e) When calculating an exposure value, the capital market institution may use any of the credit risk mitigations in accordance with Section (7) of this Chapter.

SECTION 2: CREDIT RATINGS

Article 15: Use of Credit Ratings

a) A capital market institution may use credit ratings provided by the credit rating agencies set out in Annexes (1) and (2) of these Rules to determine the credit quality step that corresponds to an exposure.

b) A capital market institution may use credit ratings provided by authorised credit rating agencies or credit rating agencies regulated by a foreign authority equivalent to the Authority, other than the credit rating agencies set out in Annexes (1) and (2) of these Rules, with the condition of providing the Authority with the documents that show the determination of the credit ratings used by such credit rating agencies corresponding to the credit quality steps.

c) A capital market institution must only use credit ratings from authorised credit rating agencies or credit rating agencies regulated by a foreign authority equivalent to the Authority.

d) credit ratings must be used consistently and continuously and must not be used selectively. When determining the risk weight of an exposure, a capital market institution which uses credit ratings for a particular exposure category must use these credit ratings continuously for all exposures belonging to that category.

Article 16: Multiple Ratings

If more than one credit rating is available for one exposure and they correspond to different credit quality steps, the step that corresponds to the highest risk weight must be applied.

Article 17: Issue-Specific and Issuer Ratings

a) If a credit rating exists for a specific issue to which the exposure belongs, this credit rating must be used to determine the exposure's credit quality step.

b) A credit rating for an issuer within a group may not be used as a credit rating for another issuer within the same group.

Article 18: Domestic and Foreign Currency Ratings

A credit rating for an exposure denominated in the issuer's domestic currency may not be used to determine the credit quality step for another exposure to the same issuer that is denominated in another currency.

Article 19: Short-term Ratings

a) Short-term credit ratings may be used only for short-term exposures to banks, capital market institutions, and corporates with an original maturity of three months or less.

b) A short-term credit rating may be used only for the specific exposure to which it refers. The credit rating may not be used to derive the credit quality step of other exposures.

SECTION 3: EXPOSURE CLASSES AND RISK WEIGHTS

Article 20: Exposures Classes

Each non-trading activities exposure must be assigned to one of the following exposure classes:

1) Governments or central banks;
2) Public sector entities;
3) Banks or capital market institutions;
4) Corporates;
5) Retail;
6) Past due items;
7) High-risk items;
8) Securitisation and resecuritisation positions;
9) Investment funds;
10) Real estate investments; or
11) Other items.

Article 21: Exposures to Governments or Central Banks

a) Exposures to the governments or central banks include all forms of securities issued or fully guaranteed by the governments or central banks.
b) Exposures to the government of the Kingdom or SAMA must be assigned a 0% risk weight.
c) Exposures to other governments or central banks must be assigned a risk weight, as set out in Table (2) below.

Table (2)

Credit quality step	1	2	3	4	5	6	Unrated
Risk weight	0%	20%	50%	100%	100%	150%	150%

Article 22: Exposures to Public Sector Entities

a) Exposures to local public sector entities must be assigned a risk weight of 20%.
b) Exposures to public sector entities outside the Kingdom must be assigned a risk weight based on the credit quality step of the government of the country in which it was established, as set out in Table (3) below.

Table (3)

Credit quality step	1	2	3	4	5	6	Unrated
Risk weight	20%	50%	100%	100%	100%	150%	150%

c) Exposures to public sector entities may, with the approval of the Authority, be assigned the same risk weights as exposures to governments or central banks set out in Table (2) of these Rules.

Article 23: Exposures to Banks or Capital Market Institutions

a) Exposures to banks or capital market institutions and their equivalent foreign entities must be assigned a risk weight as set out in Table (4) below.

Table (4)

Credit quality step	1	2	3	4	5	6	Unrated
Risk weight	20%	50%	50%	100%	100%	150%	100%

b) Exposures to banks or capital market institutions and their equivalent foreign entities with an original maturity of three months or less must be assigned a risk weight as set out in Table (5) below.

Table (5)

Credit quality step	1	2	3	4	5	6	Unrated
Risk weight	20%	20%	20%	50%	50%	150%	50%

c) Cash on deposit with the local banks must be assigned a risk weight of 0%.

d) Exposures to banks or capital market institutions and their equivalent foreign entities in countries where credit ratings for the government are not available must be assigned a risk weight of 100%.

Article 24: Exposures to Corporates

a) Exposures to corporates refer to exposures to the companies incorporated under the Companies Law of the Kingdom or any other similar laws of other jurisdictions, excluding entities treated under Articles (21), (22), and (23) of these Rules.

b) Exposures to corporates must be assigned a risk weight, as set out in Table (6) below.

Table (6)

Credit quality step	1	2	3	4	5	6	Unrated
Risk weight	20%	50%	100%	100%	150%	150%	150%

Article 25: Exposures to Retail

Exposures to retail refer to exposures to natural persons and any other entities not deemed as corporate in accordance with Article (24) of these Rules. Such exposures must be assigned a risk weight of 300%.

Article 26: Exposures to Past Due Items

Past due items refer to exposures which passed the maturity date for more than ninety days as calculated from the original agreed payment date. Such exposures must be assigned a risk weight of 400%.

Article 27: Exposures to High-risk Items

a) Exposures associated with high risks, such as private equity, venture capital and hedge funds investments must be assigned a risk weight of 400%.

b) Other unlisted equity investments must be assigned a risk weight of 250%.

Article 28: Exposures to Securitisation and Re-securitisation Positions

The risk weight for securitisation positions and resecuritisation positions must be determined based on the credit quality step of the position, as set out in Table (7) below.

Table (7)

Credit quality step	1	2	3	4	5	6	Unrated
Securitisation	20%	50%	100%	350%	1250%	1250%	1250%
Resecuritisation	40%	100%	225%	650%	1250%	1250%	1250%

Article 29: Exposures to Investment Funds

a) Exposures to listed investment funds such as REIT, Exchange Traded Funds, or Closed-Ended Investment Traded Funds must be assigned a risk weight of 150%.

b) Exposures to non-listed open-ended investment funds must be assigned a risk weight of 150% or treated using one of the approaches in accordance with Article (30) or Article (31) of these Rules.

c) Exposures to non-listed closed-ended investment funds must be assigned a risk weight of 300%.

Article 30: Look-Through Approach

a) Where the capital market institution is aware of all the underlying exposures of an investment fund, exposures to the investment fund may be treated using the look-through approach, in which each underlying exposure is assigned a risk weight as if it were directly held by the capital market institution.

b) To assign a risk weight for the investment fund, as set out in Paragraph (a) of this Article, the following conditions must be met:

   1) The investment fund is administered by a bank, capital market institution, or equivalent foreign entity subject to the supervision of a competent authority; and

   2) The reporting by the investment fund or the fund manager of the investment fund to the capital market institution complies with the following:

      a. The exposures in the investment fund are reported at least as frequently as those of the capital market institution; and

      b. The granularity of the financial information is sufficient to allow the capital market institution to calculate the investment fund's risk-weighted exposure amount.

Article 31: Mandate-Based Approach

a) Where the capital market institution does not have sufficient information about the underlying exposures of an investment fund to use the look-through approach, the exposures to the investment fund may be treated using the mandate-based approach, in which the underlying exposures of the investment fund are determined in accordance with the limits set out in the investment fund's mandate and relevant laws provided that the capital market institution has access to daily price quotes of the investment fund and knowledge of the mandate of the investment fund and relevant laws.

b) Under this approach, the investment fund incurs exposures to the maximum extent allowed under its mandate and the relevant laws. In the exposure class, attracting first the highest risk weight. Then it continues incurring exposures in descending order in the remaining exposure classes until the maximum total exposure limit is reached. The investment fund applies leverage to the maximum extent allowed under its mandate and the relevant laws, where applicable.

Article 32: Exposures to Real Estate Investments

a) Real estate investments refer to direct investments in real estate (lands and buildings) to earn rentals and capital appreciation. This excludes the holding of lands and buildings for operational needs that are deemed as tangible assets as provided in Paragraph (a) of Article (33) of these Rules.

b) Exposures to Real estate investments must be assigned a risk weight of 400%.

Article 33: Exposures to Other Items

a) Tangible assets, other than real estate investments set out in Article (32) of these Rules, must be assigned a risk weight of 100%.

b) Prepayments and accrued income for which a capital market institution is unable, or if it would be unreasonably burdensome for a capital market institution to determine the counterparty, must be assigned a risk weight of 300%.

c) Holdings of listed equity must be assigned a risk weight of 150%.

d) Cash in handheld by a capital market institution must be assigned a risk weight of 0%.

e) Exposures to the CCP, other than for the trade exposures, collaterals, and default fund contribution for which their treatments are set out in Section (6) of this Chapter, must be assigned a risk weight as follows:

    1) A risk weight for exposures to banks and capital market institutions in accordance with Article (23) of these Rules for exposures to a QCCP; and

    2) A risk weight for exposures to corporates in accordance with Article (24) of these Rules for exposures to a non-QCCP.

f) Exposures to the recognised exchanges and depositories must be assigned the same risk weight as exposures to corporates in accordance with Article (24) of these Rules.

g) Exposures in any other form of items for which rules regarding risk-weighted exposure values are not provided in this Chapter must be assigned a risk weight of 400%.

SECTION 4: OFF-BALANCE SHEET ITEMS

Article 34: Calculating Exposure Values and Risk-Weighted Assets

a) To determine the credit exposure equivalent values for off-balance sheet items, such items must be multiplied by the appropriate credit conversion factor set out in Article (35) of these Rules.

b) The resulting credit exposure equivalent values set out in Paragraph (a) of this Article must be assigned relevant risk weights as set out in Section (3) of this Chapter.

Article 35: Credit Conversion Factor

a) A credit conversion factor of 100% applies to the following off-balance sheet items:
   1) Guarantees;
   2) Commitments with certain drawdown (e.g., book-building bidding participation and partly-paid securities) must be risk-weighted according to the type of asset; and
   3) Lending of securities or posting of securities as collateral.
   4) Other items that are direct credit substitutes not explicitly included in Paragraphs (b) and (c) of this Article.

b) A credit conversion factor of 50% applies to the following off-balance sheet items:
   1) Transaction-related contingent items (e.g., performance bonds, bid bonds, warranties, indemnities and standby letters of credit); and
   2) Commitments with an original maturity of more than one year, excluding commitments mentioned in Sub-paragraph (2) of Paragraph (a) of this Article.

c) A conversion factor of 20% applies to the off-balance sheet commitments with an original maturity of up to one year, excluding the commitments mentioned in Sub-paragraph (2) of Paragraph (a) of this Article.

d) A conversion factor of 10% applies to the off-balance sheet commitments that are unconditionally cancellable at any time by the capital market institution or without prior notice.

SECTION 5: COUNTERPARTY CREDIT RISKS

Article 36: General Provisions

a) A capital market institution must calculate the exposure value for counterparty credit risk in all derivatives transactions held in both the trading book or the non-trading activities in accordance with this Section.

b) A capital market institution may calculate a single exposure value at a netting set level for all OTC derivatives transactions covered by a bilateral netting agreement where the capital market institution fulfils the requirements for bilateral netting agreements set out in Articles (63), (64) and (65) of these Rules. Where the requirements are not met, the capital market institution must treat each derivatives transaction as if it was its own netting set.

Article 37: Exposure Values for Derivatives

a) With the exception to the derivatives types mentioned in Paragraph (b) of this Article, the exposure value (E) for all derivatives transactions within a netting set with a counterparty must be calculated using the following formula:

$$E = 1.4 \times (RC + PFE)$$

Where:

1) RC: Replacement cost, calculated in accordance with Article (38) of these Rules; and
2) PFE: Potential future exposure, calculated in accordance with Article (39) of these Rules.

b) The exposure values for the following derivatives types must be calculated as follows:

1) For interest rate swaps where both legs are denominated in the same currency and are based on floating rates, the exposure value must only constitute replacement cost multiplied by 1.4.
2) For sold options that are not in any netting or margin agreements, the exposure value may be set to zero, provided that all the options' premiums have been received upfront.
3) For credit derivatives where the capital market institution is the protection seller, and the derivatives transaction are not in any netting or margin agreements, the exposure value may be set to the amount of unpaid premium.

Article 38: Replacement Cost

a) The replacement cost (RC) for a netting set or single derivatives transaction must be calculated as follows:

$$RC = \max\{CMV – VM - NICA; 0\}$$

Where:

1) CMV: Net current market value of derivatives transactions in the netting set.
2) VM: Volatility-adjusted value of net variation margin received from and posted to the counterparty.
3) NICA: Volatility-adjusted value of net independent collateral amount received from and posted to the counterparty other than the variation margin or the collateral posted to the counterparty and held in a bankruptcy-remote manner.

b) The current market value for a derivatives transaction must be its current market price if it is regularly traded on the exchange or its present value if it is not regularly traded on the exchange and its current market price is not available. The present value of a derivatives transaction must be calculated using current market interest rates and exchange rates for the currencies and maturities of the transaction.

c) VM and NICA shall be adjusted for volatility using the volatility factors in accordance with Articles (60) and (61) of these Rules.

Article 39: Potential Future Exposure (PFE)

a) The capital market institution must calculate the potential future exposure (PFE) of a netting set as the sum of the PFEs for each derivatives transaction (even for transactions that have a negative market value) by multiplying each transaction's notional amount by the risk factors set out in Table (8) below. Derivatives transactions which do not fall within the asset classes specified in Table (8) below must be treated as transactions concerning gold and other commodities.

Table (8)

Asset class	Risk factor
Interest-rate	0.2% x residual maturity (in years)
Credit	2.5% x residual maturity (in years)
Equity	14%
Foreign exchange	2%
Gold and other commodities	8%

b) For a derivatives transaction where its outstanding exposure is settled periodically so that the market value of the transaction is reset to zero on each such occasion, its residual maturity must be equal to the time until the next market value reset date.

c) When determining a transaction's notional value denominated in a foreign currency, the notional value must be calculated in accordance with the applicable spot exchange rates as at the reporting date. Where the transaction consists of two payment legs, the notional value must be higher than the two values obtained due to the translation to SAR.

SECTION 6: EXPOSURES TO CENTRAL COUNTERPARTY (CCP)

Article 40: Scope

This Section covers the counterparty credit risk requirements arising from the capital market institution's exposures to a CCP in relation to the OTC derivatives and exchange-traded derivatives transactions cleared through the CCP.

Article 41: Calculating Exposure Values

a) A capital market institution must calculate exposure values of the derivatives transactions using the approach set out in Section (5) of this Chapter.

b) The exposure values of the collaterals posted to the CCP in relation to the derivatives transactions are determined based on the market value of the collaterals.

c) The exposure values of the contribution to the default fund are the pre-funded amount (for the exposures to a QCCP) and both the pre-funded and unfunded amounts (for exposures to a non-QCCP).

Article 42: Exposures to Derivatives Transactions Cleared Through A QCCP

a) A Clearing Member Capital Market Institution must apply the following risk weights to the derivatives transactions cleared through a QCCP to calculate the risk-weighted exposure values:
   1) A risk weight of 2% to its own trades exposures as principal, and clients' trade exposures where the Clearing Member Capital Market Institution is required to reimburse the client for any losses suffered due to changes in the value of that transaction in the event that the QCCP defaults.
   2) A risk weight of 0% to the clients' trade exposure where the Clearing Member Capital Market Institution is not required to reimburse the client for any losses suffered due to changes in the value of that transaction in the event that the QCCP defaults.

b) A Client Capital Market Institution must apply a risk weight of 2% to its derivatives transactions cleared through a QCCP to calculate the risk-weighted exposure values when all the following conditions are met:
   1) The general clearing member's Offsetting Transactions with the QCCP are identified by the QCCP as Client Capital Market Institution's transactions;
   2) Collateral is held by QCCP and general clearing member under legally binding arrangements that prevent any losses to the Client Capital Market Institution due to the default or insolvency of the general clearing member or its clients or both of them;
   3) The Client Capital Market Institution must have conducted a sufficient legal review (and undertake such further review as necessary to ensure continuing enforceability) and have a well-founded basis to conclude that the arrangements referred to in Sub-paragraphs (1) and (2) of Paragraph (b) of this Article, are legal, valid, binding and enforceable under the relevant laws of the relevant jurisdictions; and
   4) The relevant laws, regulations, rules, contractual, or administrative arrangements provide that the offsetting transactions with the defaulted or insolvent general clearing member are highly likely to continue to be indirectly transacted through the QCCP or the QCCP if the general clearing member defaults or becomes insolvent. In such circumstances, the Client Capital Market Institution's positions and collateral with the QCCP will be transferred at market value unless the Client Capital Market Institution requests to close out the positions at market value.

c) Where any of the conditions in Sub-paragraphs (1), (2) and (3) of Paragraph (b) of this Article are not satisfied, the Client Capital Market Institution must apply a risk weight of 4% to its derivatives transactions.

d) In all other cases, the Client Capital Market Institution must apply the risk weights applicable for exposures to banks or capital market institutions set out in Section (3) of this Chapter to its derivatives transactions.

Article 43: Collateral Posted to A QCCP

a) The collateral posted by a capital market institution to the QCCP are cash and securities, including the initial margin and variation margin, but excludes default fund contribution.

b) Further to the calculation requirements of the credit risks and market risks as set out in this Chapter and Chapter (2) of these Rules, the Clearing Member Capital Market Institution and Client Capital Market Institution must also account for counterparty credit risks on the collateral posted to a QCCP.

c) A Clearing Member Capital Market Institution must apply the following risk weights to calculate the risk-weighted exposure values for the collateral posted to the QCCP:

1) A risk weight of 0% to the posted collateral that is held by a QCCP where that collateral is held in a bankruptcy-remote manner from the QCCP; and
2) A risk weight of 2% to the posted collateral held by a QCCP where that collateral is not held in a bankruptcy-remote manner from the QCCP.

d) A Client Capital Market Institution must apply the following risk weights to calculate the risk-weighted exposure values for its collateral posted to a general clearing member or QCCP:

1) A risk weight of 0% to the posted collateral that is held by a QCCP and/or general clearing member where that collateral is held in a bankruptcy-remote manner from the QCCP, general clearing member, and its clients;
2) A risk weight of 2% to the posted collateral held by a QCCP and/or general clearing member where all conditions in Paragraph (b) of Article (42) of these Rules are satisfied;
3) A risk weight of 4% to the posted collateral held by the QCCP and/or general clearing member where any of the conditions in Sub-paragraphs (1), (2) or (3) of Paragraph (b) of Article (42) of these Rules are not satisfied; and
4) In all other cases, the Client Capital Market Institution must apply the risk weights applicable for exposures to banks or capital market institutions set out in Section (3) of this Chapter to its posted collateral.

Article 44: Contribution to The Default Fund of A QCCP

a) A contribution to the default fund of a QCCP covering only cash transactions must be assigned a risk weight of 0%.

b) A contribution to a default fund of a QCCP covering derivatives transactions (including such contribution covering both cash transactions and derivatives transactions) must satisfy the requirements set out in Paragraphs (c), (d), and (e) of this Article.

c) A capital market institution must calculate the risk-weighted assets on its funded contribution to the default fund of a QCCP as follows:

$$K_{\mathrm{df}} = \max\left\{\left(K_{\mathrm{ccp}} * \mathbf{12.5} * \frac{DF_{\mathrm{i}}}{DF_{\mathrm{ccp}} + DF_{\mathrm{cm}}}\right);\ (\mathbf{2}\% * DF_{\mathrm{i}})\right\}$$

Where:

1) K_{df} : Risk-weighted assets for funded default fund contribution;
2) K_{CCP} = Hypothetical capital of the QCCP communicated to the clearing members by the QCCP in accordance with the QCCP rules and procedures;
3) DF_i : Funded contribution of the capital market institution to the default fund of a QCCP;
4) DF_{CCP}: Funded contribution of the QCCP to the default fund communicated to the clearing members by the QCCP in accordance with the QCCP rules and procedures; and
5) DF_{CM}: Sum of funded default fund contributions of all clearing members of the QCCP communicated to the clearing members by the QCCP in accordance with the QCCP rules and procedures.

d) The DF_i mentioned in Paragraph (c) of this Article must be the amount paid in or the market value of the assets delivered by that capital market institution reduced by any amount that the QCCP has already used to absorb its losses following the default of one or more of the clearing members.
e) A capital market institution must apply a 0% risk weight to its unfunded contribution to the default fund of a QCCP.

Article 45: Exposures to A Non-QCCP

a) With regards to the exposures to derivatives transactions cleared through a non-QCCP and collateral posted to a non-QCCP, a capital market institution must treat such exposures as exposures to the corporate and assign the risk weights as set out in Article (24) of these Rules to calculate the risk-weighted exposure values.
b) With regards to the default fund contribution to a non-QCCP covering derivatives transactions (including such contribution covering both cash transactions and derivatives transactions), a capital market institution must apply a risk weight of 1250% to both its pre-funded contribution and unfunded contribution, which is liable to be paid if the non-QCCP so requires.

SECTION 7: CREDIT RISK MITIGATION

Article 46: Recognising the Effect of Credit Risk Mitigations

a) When calculating a risk-weighted exposure amount, a capital market institution may only consider the effect of recognisable credit risk mitigations.
b) A credit risk mitigation is recognisable if the type of credit protection is eligible and if the capital market institution meets the specific requirements related to the management of each respective type of credit protection.
c) Where an individual exposure has more than one type of recognisable credit protection, the capital market institution must distribute the exposure among the different types of

credit protection. A risk-weighted exposure amount must be calculated separately for each component.

d) The protected portion of an exposure must be assigned the same risk weight of the protection provider, while the uncovered portion of the exposure must be assigned the risk weight of the underlying counterparty.

e) The amount of credit protection must be reduced by the adjustments specified in Article (49) of these Rules.

Article 47: Legal Certainties

a) A capital market institution must fulfil any contractual and statutory requirements in respects of, and take all steps necessary to ensure, the enforceability of its credit protection arrangements under the laws applicable to the credit protection.

b) A capital market institution must have conducted sufficient legal review confirming the enforceability of its credit protection in all relevant jurisdictions and repeat such review as necessary to ensure continuing enforceability.

Article 48: Maturity Mismatches

a) The residual maturity of the credit protection must not be less than that of the protected exposure.

b) The residual maturities for the protected exposures and credit protections are determined as follows:

   1) For the protected exposure, it refers to the time until the obligor is scheduled to fulfil its obligations.
   2) For the credit protection, it refers to the remaining time to the earliest date at which the protection expires or may be terminated based on the termination rights stipulated in the agreement.

Article 49: Currency Mismatches

a) Where there is a currency mismatch, that is when the credit protection is denominated in a currency other than in which the exposure is denominated, the capital market institution must reduce the value of credit protection using the following expression:

$$\boldsymbol{Ga = G \times (1 - Hfx)}$$

Where:

1) *Ga*: Value of credit protection after applying the exchange rate volatility factor.
2) *G*: Value of credit protection before applying the exchange rate volatility factor.
3) *Hfx*: Exchange rate volatility factor as referred to in Paragraph (b) of this Article.

b) The (*Hfx)* that applies to the collateral, which are subject to the daily mark-to-market, is set out in Table (9) below.

Table (9)

Transaction type	Hfx (%)
Securities financing transaction	5.7
Margin lending and derivatives	8.0
Secured lending	11.3

c) The *Hfx* must be adjusted for the frequency of the market revaluation or remargining according to Article (61) of these Rules if the capital market institution does not mark-to-market its collateral daily.

Article 50: Guarantees and Credit Derivatives

a) Guarantees and credit derivatives are recognisable if they are issued by an eligible protection provider in accordance with Article (51) of these Rules and if the capital market institution meets the relevant requirements set out in Articles (52), (53), and (54) of these Rules.

b) When a recognisable credit derivative or guarantee is available for an exposure, the obligor's risk weight may be replaced by the protection provider's risk weight for the protected exposure.

c) When a capital market institution has guarantees or credit derivatives for off-balance sheet commitments, the effect of these recognisable guarantees or credit protection must be used before the capital market institution applies the relevant conversion factor.

Article 51: Entities Eligible to Issue Guarantees and Credit Derivatives

Eligible issuers of guarantees and credit derivatives are the following entities with a lower risk weight than the obligor:

1) Governments and central banks;
2) Public sector entities;
3) Banks and capital market institutions;
4) QCCP; or
5) Corporates with a credit quality step (2) or better.

Article 52: Requirements Common to Guarantees and Credit Derivatives

a) In order for a guarantee or credit derivative to provide eligible credit protection, the following requirements must be met:
   1) The credit protection is direct;
   2) The extent of the credit protection is clearly defined and incontrovertible;
   3) The credit protection agreement is legally effective and enforceable in all relevant jurisdictions.
   4) The credit protection agreement does not contain any clause, the fulfilment of which is outside the direct control of the capital market institution, that entails that:

a. The issuer of the guarantee or credit derivative has a unilateral right to revoke the protection;
b. The cost of the protection increases due to the deteriorating quality of the protected exposure;
c. The issuer of the guarantee or credit derivative is not obliged to pay out in a timely manner in the event the obligor fails to make any payments due; or
d. It is possible for the issuer of the guarantee or credit derivative to reduce the maturity of the guarantee or credit derivative.

b) A capital market institution must have set guidelines regarding the use of guarantees and credit derivatives related to its overall risk management strategy.

c) A capital market institution must have procedures and systems to manage potential concentrations of credit risk arising from its use of guarantees and credit derivatives.

Article 53: Specific Operational Requirements for Guarantees

In addition to the requirements in Article (52) of these Rules, in order for a guarantee to be recognised, the following conditions must be satisfied:

1) In the event of a qualifying default or failure to pay by the obligor, the capital market institution must have the right to, without undue delay, make a claim for any monies outstanding under the documentation governing the transaction against the guarantor without first being required to take legal actions or make a claim against the obligor; and
2) The guarantee explicitly documents the obligations assumed by the guarantor.

Article 54: Specific Operational Requirements for Credit Derivatives

In addition to the requirements in Article (52) of these Rules, in order for a credit derivative to be recognised, the credit derivative must be one of the following types:

1) Credit default swap;
2) Total return swap; or
3) Cash-funded credit linked note.

Article 55: Financial Collateral

a) Collateral is recognisable if it is eligible as set out in Article (56) of these Rules, and if the capital market institution fulfils the management requirements in accordance with Article (57) of these Rules.
b) When determining risk-weighted exposure values, the capital market institution may use recognisable financial collateral by using either the Simple Method pursuant to Article (58) of these Rules or the Comprehensive Method pursuant to Articles (59), (60) and (61) of these Rules.

Article 56: Eligible Financial Collateral

The following financial collaterals are eligible:

1) Cash on deposit with the local banks;

2) Cash equivalent instruments (certificates of deposits or other money market instruments) issued by local banks or capital market institutions;
3) The following debt instruments:
   a. Issued by governments and central banks, which securities have a credit rating corresponding to credit quality step (4) or better, or issued by public sector entities which are treated as governments in accordance with Paragraph (c) of Article (22).
   b. Issued by other legal entities which securities have a credit rating corresponding to credit quality step (3) or better;
4) Equities, investment funds and convertible bonds listed on the exchange;
5) Non-listed open-ended investment funds that have met the following conditions:
   a. The prices of units in investment funds are publicly quoted daily; and
   b. The investment funds are limited by their terms and conditions to investing in the instruments specified in Paragraphs (1), (2), (3), and (4) of this Article.

Article 57: Management Requirements for Financial Collateral

A financial collateral is an eligible credit protection where the following requirements are met:

1) The creditworthiness of the counterparty and the value of the collateral do not have a material positive correlation. Securities issued by the counterparty or by other companies within the same group as the counterparty do not qualify as eligible financial collateral; and
2) There is a formal written contractual agreement regarding the grant of collateral between the capital market institution and the counterparty lodging the collateral, which establishes the capital market institution's direct, explicit, irrevocable, and unconditional recourse to the collateral, and this agreement must be legally binding in all relevant jurisdictions. Where a third party holds the collateral, the capital market institution must take all necessary steps to ensure that the third party has been notified of the grant of collateral to the capital market institution and the third party segregates the collateral from its own assets.

Article 58: Simple Method – Collateral Value and Risk Weights

a) Under the Simple Method, the value of the financial collateral must be the market value. If the published market price is not available, the collateral must be revalued with a minimum frequency of six months or whenever the capital market institution or Authority has reason to believe that a significant decrease in the market value of the collateral has occurred.
b) When an exposure has recognisable financial collateral, the risk weight of the counterparty may be replaced by the risk weight of the collateral instrument for the portion that the collateral covers.
c) When the capital market institution has financial collateral for off-balance sheet commitments, the effect of this recognisable financial collateral must be used before the capital market institution applies the relevant conversion factor.

d) The remainder of the exposure that is not covered by the collateral values must be assigned the risk weight of the counterparty.

Article 59: Comprehensive Method – Calculating Adjusted Net Exposure Value (E_{unsec})

a) Under the Comprehensive Method, the capital market institution must calculate the adjusted net exposure value (E_{unsec}) to determine the exposure value not considered protected by the collateral after applying the volatility factors to the exposures and collateral using the following formula:

$$E_{unsec} = \max\{\mathbf{0}. (E_{VA} - C_{VA})\}$$

Where:

1) E_{unsec}: Adjusted net exposure value after applying the volatility factors on the exposures and collateral.
2) E_{VA}: E x $(1 + H_E)$ = Volatility-adjusted exposure value.
3) C_{VA}: C x $(1 - H_C - H_{fx})$ = Volatility-adjusted value of the collateral.
4) *E*: Original exposure value.
5) H_E: Volatility factor for the exposure with regard to changes in market prices as set out in Article (60) of these Rules.
6) *C*: Market value of the collateral.
7) H_C: Volatility factor for the collateral with regard to changes in market prices, as set out in Article (60) of these Rules.
8) H_{fx}: Volatility factor for the collateral with regard to currency mismatch, as set out in Article (49) of these Rules.

b) The (E_{unsec}) must be risk-weighted according to the risk weight of the original counterparty to obtain the risk-weighted exposure value for the collateralised transaction.

Article 60: Comprehensive Method – Volatility Factors

a) The volatility factors set out in Paragraphs (b), (c), and (d) of this Article apply to the exposures and collateral for which their mark-to-market revaluation or remargining are conducted daily.

b) The values of exposures and collateral in the form of eligible debt instruments referred to in Sub-paragraph (a) of Paragraph (3) of Article (56) of these Rules must be adjusted for market prices volatility by applying the volatility factors set out in Table (10) below.

Table (10)

Credit quality step of debt instrument		Volatility factor (%) for transaction type of:		
	Residual maturity	Secured lending	Margin lending and derivatives	Securities financing transaction
1	≤ 1 year	0.7	0.5	0.4
1	> 1 ≤ 5 years	2.8	2.0	1.4
1	> 5 years	5.7	4.0	2.8

2 and 3	≤ 1 year	1.4	1.0	0.7
2 and 3	> 1 ≤ 5 years	4.2	3.0	2.1
2 and 3	> 5 years	8.5	6.0	4.2
4		21.2	15.0	10.6

c) The values of exposures and collateral in the form of eligible debt instruments, referred to in Sub-paragraph (b) of Paragraph (3) of Article (56) of these Rules, must be adjusted for market prices volatility by applying the volatility factors set out in Table (11) below.

Table (11)

Credit quality step of debt instrument		Volatility factor (%) for transaction type of:		
	Residual maturity	Secured lending	Margin lending and derivatives	Securities financing transaction
1	≤ 1 year	1.4	1.0	0.7
1	> 1 ≤ 5 years	5.7	4.0	2.8
1	> 5 years	8.5	6.0	4.2
2 and 3	≤ 1 year	2.8	2.0	1.4
2 and 3	> 1 ≤ 5 years	8.5	6.0	4.2
2 and 3	> 5 years	17.0	12.0	8.5

d) The values of other recognisable collateral referred to in Article (56) of these Rules, and other exposures must be adjusted for market prices volatility by applying the volatility factors set out in Table (12) below.

Table (12)

Type of exposure or collateral	Volatility factors (%) for transaction type of:		
	Secured lending	Margin lending and derivatives	Securities financing transaction
Cash on deposit with the local banks and cash equivalent items issued by local banks or capital market institutions	0	0	0
Equities, investment funds, and convertible bonds listed on the exchange	21.2	15.0	10.6
Non-listed investment funds and other exposures	35.4	25.0	17.7

e) If a netting set includes items of different transaction types, the highest volatility factors for each respective type of exposures or collateral must be used.

f) With regard to OTC derivatives transactions, the volatility factor for changes in exchange rates (H_{fx}) must be applied if the collateral currency is different from the settlement currency. If the capital market institution has recognisable netting agreements, only a single volatility adjustment must be applied, even if the netting agreement includes transactions in multiple currencies.

Article 61: Comprehensive Method – Adjustment to Volatility Factors

a) If the marking-to-market of the exposures and collateral is not conducted daily, the volatility factors specified in Paragraphs (b), (c), and (d) of Article (60) of these Rules must be scaled up for the frequency of the revaluation or remargining according to the following formula:

$$Ha = HM\sqrt{\frac{NR + (Tm - 1)}{Tm}}$$

Where:

1) *Ha*: Adjusted volatility factor after adjustment for the frequency of the revaluation or remargining.
2) *HM*: Volatility factor assuming daily revaluation or remargining specified in Paragraphs (b), (c), and (d) of Article (60) of these Rules.
3) *NR*: Number of days from the last revaluation or remargining.
4) *Tm*: Holding period in days for the relevant transaction in accordance with Paragraph (b) of this Article.

b) For the purpose of the formula referred to in Paragraph (a) of this Article, the (*Tm*) (holding period in days) for the different transaction types are set out in Table (13) below:

Table (13)

Transaction type	Tm
Securities financing transaction	5
Margin lending and derivatives	10
Secured lending	20

Article 62: Bilateral Netting Agreements

a) Bilateral netting agreements are recognisable if they are eligible in accordance with Article (65) of these Rules, and if the capital market institution fulfills the requirements for managing them as contained in Article (64) of these Rules.

b) The use of netting agreements for securities financing transactions is set out in Article (66) of these Rules. The use of netting agreements for derivatives is set out in Section (5) of this Chapter.

Article 63: Legal Opinions for Bilateral Netting Agreements

a) A capital market institution must have independent, written, and reasoned legal opinions in its possession that demonstrate that the agreed netting would be recognised by the relevant courts and administrative authorities in the relevant jurisdictions.

b) The legal opinions must show that even if a netting agreement is terminated as a result of an event of default by the counterparty, including insolvency or bankruptcy, a legal review by the relevant courts and administrative authorities would, in all reasonable probability, find that the bilateral netting agreement creates a single legal obligation covering all included contracts, transactions, assets and liabilities such that the capital market institution would be entitled to receive, or obliged to pay only the net sum of the positive and negative mark-to-market values of all the contracts, transactions, assets, and liabilities included in the agreement and covered by netting.

c) The conclusion of the legal review must be based on the following:
   1) Governing laws in the jurisdictions in which the parties have their respective registered offices and, if the commitments of the counterparty or capital market institution were entered into through a foreign branch office, governing law applied in the jurisdiction in which the branch office is situated;
   2) Governing law which regulates the individual contracts, transactions, assets and, liabilities covered by the agreement; and
   3) Governing law regulating every contract, transaction, or agreement necessary to effect the netting agreement.

d) A legal opinion must include the following:
   1) A judgment that states that the netting agreement and the contracts, transactions, assets and liabilities covered by the agreement do not breach laws or court judgments in the relevant jurisdictions;
   2) References to existing netting agreements and the netting provisions contained in each such agreement; and
   3) A judgment that states that the netting agreement will be deemed legally binding in the event of default, including insolvency or bankruptcy in the relevant jurisdictions if action is taken by an administrator, liquidator, receiver, or the equivalent in other jurisdictions.

e) The legal opinion must be issued by an independent licensed lawyer, or law firm, with considerable experience in the field. The legal opinion can be either given directly to the capital market institution or to the entity that represents the other party in the netting agreement that the capital market institution has utilised. The legal opinion can also be a common legal opinion for a specific netting agreement for several capital market institutions together or an entity representing the capital market institution. The legal opinion can be drawn up for different types of netting agreements.

Article 64: Managing Requirements for Bilateral Netting Agreements

a) Before a bilateral netting agreement can influence the calculation of a risk-weighted amount for the first time, the capital market institution must notify the Authority in writing that a legally binding netting agreement exists.

b) The capital market institution must certify to the Authority in writing that:
   1) All conditions for eligibility requirements pursuant to Article (65) of these Rules are met;
   2) It has legal opinions pursuant to Article (63) of these Rules;

3) It has a netting policy approved by its governing body;
4) It has the necessary systems and controls to monitor and report netted transactions on the gross and net basis and to calculate the risk arising when the counterparty's contracts or liabilities cease.

c) A capital market institution must continuously verify that:
1) Its netting agreements have legal standing; and
2) The conclusions of the legal opinions obtained are legally valid and no older than one year.

Article 65: Eligibility Requirements for Bilateral Netting Agreements

For the effects of bilateral netting agreements to be recognised, the following conditions must be satisfied:

1) The netting agreement must be legally effective and binding in all relevant jurisdictions;
2) The netting agreement must provide the non-defaulting party the rights to terminate and close-out all transactions covered by the netting agreement in a timely manner upon an event of default, including insolvency or bankruptcy of the counterparty;
3) The netting agreement must provide for the netting of gains and losses on transactions (including the value of the collaterals) terminated and closed out under it so that a single net amount is owed by one party to the other; and
4) The netting agreement allows for the prompt liquidation or netting of collateral upon the event of default, including in the event of insolvency or bankruptcy of the counterparty.

Article 66: Securities Financing Transactions Covered by Bilateral Master Netting Agreement

a) A capital market institution that treats financial collateral according to the comprehensive method may calculate the adjusted net exposure value for securities financing transactions in accordance with Paragraph (b) of this Article, provided that the netting agreement has met the management requirements set out in Article (64) of these Rules, the eligibility criteria set out in Article (65) of these Rules and the collateral is eligible in accordance with Article (56) of these Rules.

b) The adjusted net exposure value (E*) for the securities financing transactions must be calculated for a netting set according to the following formula:

$$E^* = \max\left\{\mathbf{0}.\Sigma \mathrm{E} - \Sigma \mathrm{C} + \Sigma(E_S \times H_S) + \Sigma(E_{fx} \times H_{fx})\right\}$$

Where:

1) E^*: Adjusted net exposure value after netting and volatility factors.
2) E: Current value of exposure (i.e. current fair values of each instrument, gold and cash that the capital market institution has lent, sold subject to repurchase, or posted as collateral to the counterparty under the transaction or netting set).

3) *C:* Current value of collateral (i.e. current fair values of each type of instrument, gold and cash that the capital market institution has borrowed, purchased subject to resale, or taken as collateral from the counterparty under the transaction or netting set).
4) *Es:* Absolute value of the net position in each type of instrument or gold (i.e., the current value of exposure minus the current value of collateral).
5) *Hs*: Volatility factor appropriate to each type of instrument or gold in accordance with Article (60) of these Rules.
6) E_{fx}: Absolute value of the net positions in each currency other than the settlement currency (i.e., the current value of exposure minus the current value of collateral).
7) H_{fx}: Volatility factor for currency mismatch in accordance with Article (49) of these Rules.

c) For the purpose of Sub-paragraph (4) of Paragraph (b) of this Article, type of instrument refers to the instruments which are issued by the same entity, have the same issue date and maturity, and are subject to the same terms and conditions and liquidation period.

SECTION 8: SETTLEMENT RISKS

Article 67: Scope

a) The capital requirement for settlement risks is the account for the risk of losses to the capital market institution for cash transactions that are not entirely settled on the due settlement date, and the calculation process must include cash transactions positions in both the trading book and non-trading, in addition to the existing market risk or credit risk capital requirements that apply to those positions.
b) Where the cash transaction positions do not appear on the balance sheet of the capital market institution due to its use of settlement date accounting, the transactions that are not completed on the due settlement date must assigned a 100% credit conversion factor to determine its credit equivalent amount.
c) Transactions that are subject to the counterparty credit risks (i.e., derivatives and securities financing transactions) are exempted from the requirements of this Section.

Article 68: Risk-Weighted Exposure for DvP Transactions

a) With regard to a delivery-versus-payment (DvP) cash transaction which is not settled on the due settlement date, the capital market institution must calculate the positive current exposure of the transaction, which is the risk of loss to the capital market institution calculated based on the difference between the transaction's agreed settlement price and current market value.
b) If an instrument is purchased, a positive current exposure arises if the current market value of the instrument exceeds its agreed settlement price. If an instrument is sold, a

positive current exposure arises if the current market value of the instrument is less than its agreed settlement price.

c) The risk-weighted asset for settlement risk is calculated by applying the risk weight in accordance with Table (14) below to the value of the positive current exposure.

Table (14)

Number of days after the due settlement date	Risk weight (%)
0 to 4	0
5 to 15	100
16 to 30	625
31 to 45	937.5
46 or more	1250

Article 69: Risk-Weighted Exposures for Non-DvP Transactions (Free Deliveries)

a) With regards to the non-DvP cash transactions, the capital market institution must treat the exposure as a loan if the capital market institution has paid for the transactions before receiving them or if the capital market institution has delivered the securities before receiving payment for them.

b) As of the date the capital market institution has made its payment or delivery, and up to and including the fourth day after the due settlement date for the counterparty's payment or delivery, a risk-weighted exposure must be calculated for the transaction which the counterparty has not fulfilled its delivery or payment by applying the relevant risk weight of the counterparty set out in Section (3) of this Chapter to the payment made or value delivered to the counterparty. With regard to cross-border transactions, an exposure begins a day after the date the capital market institution has made its payment or delivery.

c) As of the fifth day after the due settlement date for the counterparty's delivery or payment and until the transaction terminates, the capital market institution must apply 1250% risk weight to the payment made or value delivered to the counterparty plus the positive current exposure, if any.

CHAPTER 2: MARKET RISK

SECTION 1: GENERAL

Article 70: Scope

a) A capital market institution must calculate the capital requirements as the sum of the following:
   1) Interest rate risk capital requirements for exposures to interest rate-linked financial instruments included in the trading book referred to in Section (2) of this Chapter;
   2) Equity price risk capital requirements for exposures to equity-linked financial instruments included in the trading book referred to in Section (3) of this Chapter;
   3) Underwriting risk capital requirements referred to in Section (5) of this Chapter;
   4) Foreign exchange risk capital requirements referred to in Section (6) of this Chapter for trading book positions and non-trading activities; and
   5) Commodity risk capital requirements referred to in Section (7) of this Chapter for trading book positions and non-trading activities.

b) A capital market institution must calculate the risk-weighted exposure amount for market risk by multiplying the capital requirement referred to in Paragraph (a) of this Article by 12.5.

c) A capital market institution must also calculate the counterparty credit risk for its trading book exposures in derivatives in accordance with Section (5) of Chapter (1) of this Part of these Rules, in addition to the relevant market risk capital requirements mentioned in Paragraph (a) of this Article.

Article 71: Standards for Assigning Instruments to The Trading Book

a) Except for the exposures listed in Paragraph (b) of this Article, a capital market institution must designate any exposure it holds for one or more of the following purposes as belonging to the trading book:
   1) Short term resale;
   2) Locking in arbitrage profit in two or more markets for the same exposure; and/or
   3) Hedging risks that arise from the exposures meeting any of the purposes mentioned in Sub-paragraphs (1) and (2) of Paragraph (a) of this Article.

b) Any exposures not assigned to the trading book according to the provisions set out in Paragraph (a) of this Article must be classified as non-trading activity exposures in addition to the following:
   1) Unlisted equities;
   2) Instruments designated for securitisation warehousing;
   3) Direct holdings of real estate;
   4) Retail credits;
   5) Non-listed closed-ended investment funds;

6) Non-listed open-ended investment funds in which the capital market institution is not able to use the look-through approach set out in Article (30) of these Rules, or mandate-based approach set out in Article (31) of these Rules;
7) Derivatives that have the exposures in Sub-paragraphs (1), (2), (3), (4), (5), and (6) of this Paragraph as underlying assets; and
8) Instruments held for the purpose of hedging a particular risk of exposures in Sub-paragraphs (1), (2), (3), (4), (5), (6) and (7) of this Paragraph.

c) An individual financial instrument or a commodity cannot be assigned to both the trading book and non-trading activities at the same time. However, the same types of financial instruments or commodities may appear in both the trading book and non-trading activities.

Article 72: Assigning Exposures to Trading Book or Non-Trading Activities

A capital market institution must have clearly defined written policies and procedures approved by its governing body to determine the exposures to be assigned to the trading book and non-trading activities respectively.

Article 73: Policies for Trading Book

a) A capital market institution must have written policies for its trading book operations including the trading strategy and valuation process for trading book positions.
b) The governing body of the capital market institutions is responsible for approving the written policies for trading book operations referred to in this Article.

SECTION 2: INTEREST RATE RISK

Article 74: General Provisions

a) Interest rate risks must be calculated for positions in interest rate-linked financial instruments included in a capital market institution's trading book.
b) A capital market institution must calculate capital requirements for specific and general interest rate risks that must be carried out on the net positions in interest rate-linked financial instruments in accordance with this Section, except for options which are dealt with under Section (4) of this Chapter.
c) A capital market institution must calculate capital requirements for specific and general interest rate risk separately for each individual currency the capital market institution has positioned. Positions in foreign currency must be converted to SAR before the capital requirement is calculated.

Article 75: Net Interest Rate Positions

a) A net position in an interest rate-linked financial instrument refers to the difference between the long and short positions in an identical financial instrument.

b) Identical financial instruments refer to instruments of the same type and issued by the same issuer, as follows:
   1) Same issuer refers to the same legal entity.
   2) Same type refers to financial instruments that are denominated in the same currency and have the same coupon rates and maturities.

c) A capital market institution may offset a matched position in futures or forward and its corresponding underlying securities and exclude it from the calculation of specific and general interest rate risks. A matched position refers to the transactions that are denominated in the same currency and have the same underlying instrument, coupon rates, and maturities.

d) In the case of cheapest-to-deliver futures or forward, a capital market institution may offset its short notional position in the cheapest to deliver security, arising from a short future or forward where the selling capital market institution has a choice of which debt security it may use to settle its obligations, against a long position in the security of the same currency.

Article 76: Specific Risk for Debt Securities

a) The capital requirement for specific interest rate risk of a debt security in the trading book is calculated by assigning the applied risk charge to the absolute value of its net positions.

b) The applicable risk charge for a debt security corresponds to its category of issuer, residual maturity, and credit quality step (where relevant), as set out in Table (15) below.

Table (15)

Category of issuer	Credit quality step	Residual term to maturity	Risk charge (%)
Governments and central banks	1		0
	2 and 3	< 6 months	0.25
		> 6, ≤ 24 months	1
		> 24 months	1.6
	4, 5 and unrated		8
	6		12
Qualifying	See Paragraph (d) of this Article	< 6 months	0.25
		> 6, ≤ 24 months	1
		> 24 months	1.6
Other	4 or unrated		8
	5 and 6		12

c) The ‘‘Governments and central banks” category in Table (15) above includes all forms of financial securities issued or fully guaranteed by governments or central banks. Any financial securities that are issued or fully guaranteed by the government of the Kingdom or SAMA must be assigned a 0% risk charge.

d) The ‘‘Qualifying” category includes securities issued by local public sector entities and other securities with a credit quality step of (3) or better based on rating by at least two credit rating agencies recognised by the Authority.
e) The ‘‘Other” category includes securities that do not meet the criteria for inclusion in the categories mentioned in Paragraphs (c) and (d) of this Article.

Article 77: Specific Risk for Securitisation and Re-securitisation Positions

The risk charge for a securitisation or re-securitisation positions must be determined based on the credit quality step of the position as set out in Table (16) below.

Table (16)

Credit quality step	1	2	3	4	5, 6, and unrated
Securitisation	1.6%	4%	8%	28%	100%
Re-securitisation	3.2%	8%	18%	52%	100%

Article 78: General Interest Rate Risk

a) A capital market institution must calculate the capital requirement for general interest rate risk for debt securities and other interest rate-linked financial instruments (excluding securitisation and re securitisation positions) as described in Paragraph (b) of this Article.
b) The capital market institution must allocate the net interest rate positions across the interest rate maturity bands and perform the following steps:
    1) Allocate net positions in each individual interest rate-linked financial instrument (both long and short net positions) to one of the maturity bands in Table (17) below based on the instrument’s residual maturity.
    For financial instruments with variable interest rates, residual maturity refers to the time remaining until their next interest rate adjustment date.

Table (17)

Maturity band	Residual maturity	Weight (%)
1	$\leq$ 1 month	0
2	> 1, $\leq$ 3 month	0.20
3	> 3, $\leq$ 6 months	0.40
4	> 6, $\leq$ 12 months	0.70
5	> 1, $\leq$ 2 year	1.25
6	> 2, $\leq$ 3 years	1.75
7	> 3, $\leq$ 4 years	2.25
8	> 4, $\leq$ 5 years	2.75
9	> 5, $\leq$ 7 years	3.25
10	> 7, $\leq$ 9 years	3.75
11	> 9, $\leq$ 11 years	4.50
12	> 11, $\leq$ 13 years	5.25

Maturity band	Residual maturity	Weight (%)
13	> 13, ≤ 15 years	6.00
14	>15, ≤ 20 years	8.00
15	> 20 years	12.50

2) Weight separately the long and short net positions in each individual financial instrument (i.e., no offsetting between the long and short net positions of different instruments) by the weight that applies to the maturity band as set out in Table (17) above.

3) Aggregate separately the weighted long and short positions within each maturity band (i.e. no offsetting of the long and short net positions of different financial instruments) to derive the sum of the weighted net long positions and the sum of the weighted net short position in each maturity band.

4) Calculate the matched net positions within each maturity band, which is the portion of the sum of the weighted long net positions that correspond to the sum of the weighted short net positions within each maturity band.

5) Calculate the capital requirement for the matched weighted positions within each maturity band by assigning a risk charge of 10%.

6) Calculate the capital requirement for the sum of the remaining unmatched weighted net positions of all maturity group by assigning a risk charge of 100%.

c) A capital market institution must match the weighted net positions and calculate the capital requirement for interest rate-linked financial instruments described in Paragraph (b) of this Article separately for each individual currency.

Article 79: Specific Risk for Interest Rate Derivatives

a) The calculations of specific interest rate risks for options in the trading book are dealt with under Section (4) of this Chapter.
b) The calculations of specific interest rate risks are exempted for the following derivatives exposures in the trading book:
   1) Futures on interest rate and interest rate index;
   2) Forward rate agreements (FRAs);
   3) Interest rate swaps, debt swaps, and cross-currency swaps; and
   4) Currency forward.
c) The futures and forward on debt securities and the futures on bond indices must be partitioned into the notional long and short positions as described in Article (81) of these Rules, and the calculation of the specific risk capital requirements for the partitioned positions must be as follows:
   1) The risk charge for the underlying debt security is determined based on the issuer of the underlying security; and

2) The risk charge for the zero coupon government security is 0%.

Article 80: General Risk for Interest Rate Derivatives

a) All positions in interest rate derivatives are subject to the general interest rate risk capital requirement set out in Article (78) of these Rules, except for the following:
   1) Matched positions in identical derivatives transactions pursuant to Paragraphs (c) and (d) of Article (75) of these Rules; and
   2) Interest rate options and associated underlying instruments which must be treated in accordance with Section (4) of this Chapter.
b) For the purpose of measuring the general interest rate risks, interest rate derivatives must be partitioned into positions in the relevant underlying securities in accordance with Articles (81), (82) and (83) of these Rules.
c) The exposure values for the underlying securities must be the market value of its principal amount or notional amount.

Article 81: Futures and Forward

a) A long (purchased) position in the futures or forward on the interest rate (including forward rate agreements or "FRA") must be treated as a combination of the following:
   1) A long position in a zero coupon government security with a maturity corresponding to the period until the expiry date of the derivative plus the life of the underlying contract; and
   2) A short position in a zero coupon government security with a maturity date equal to the expiry date of the derivative.
b) A short (sold) position in the futures or forward on the interest rate (including FRA) must be treated as a combination of the following:
   1) A short position in a zero coupon government security with a maturity corresponding to the period until the expiry date of the derivative plus the life of the underlying contract; and
   2) A long position in a zero coupon government security with a maturity date equal to the expiry date of the derivative.
c) The exposure value for the zero coupon government security referred to in Sub-paragraph (1) of Paragraph (a) and Sub-paragraph (1) of Paragraph (b) of this Article must be comprised of the derivative's sum of the notional amount plus the agreed amount of interest.
d) The exposure value for the zero coupon government security referred to in Sub-paragraph (2) of Paragraph (a) and Sub-paragraph (2) of Paragraph (b) of this Article must be comprised of the derivative's notional amount.
e) A long (purchased) position in the futures or forward on the debt security must be treated as a combination of:
   1) A notional long position in the underlying debt security or cheapest to deliver security (after taking into account the conversion factor) where the derivative can be satisfied by delivery of one from a range of securities with a maturity

corresponding to the period until the expiry date of the derivative plus the life of the underlying contract; and

2) A notional short position in a zero coupon government security with a maturity date equal to the expiry date of the derivative.

f) A short (sold) position in the futures or forward on the debt security must be treated as a combination of:

1) A notional short position in the underlying debt security or the cheapest to deliver security (after taking into account the conversion factor) where the derivative can be satisfied by delivery of one from a range of securities with a maturity corresponding to the period until the expiry date of the derivative plus the life of the underlying contract; and

2) A notional long position in a zero coupon government security with a maturity date equal to the expiry date of the derivative.

g) The positions which arise from the partitioning of the futures or forward into long and short positions described in Paragraphs (a), (b), (e), and (f) of this Article must be included in the calculation of specific and general interest rate risk unless otherwise exempted pursuant to Paragraph (b) of Article (79) and Paragraph (a) of Article (80) of these Rules.

h) The futures on a bond index must be treated as a combination of long and short positions in the same way that applies to other derivatives and must be treated as a single financial instrument.

i) A currency forward must be treated as a combination of a notional long position and a notional short position in a zero coupon government security in each currency. These notional positions would be recorded in the respective maturity ladder of the relevant currency for calculation of general interest rate risk in accordance with Article (78) of these Rules.

Article 82: Swaps

a) An interest rate swap must be treated as a combination of a notional short position and a notional long position in government securities. For example, an interest rate swap designed to give its holder variable interest while paying fixed interest must be treated as a combination of the following:

a) A notional long position in a financial instrument with a variable interest rate maturing on the next interest rate adjustment date; and

b) A notional short position in a financial instrument with a fixed interest rate has the same maturity of the swap.

b) A currency swap must be considered as a combination of a notional short position and a notional long position in each currency. The separate legs of a currency swap must be reported in the relevant maturity ladders for the currencies concerned for the calculation of general interest rate risk. The capital requirements for foreign exchange risks must be calculated in accordance with the methods set out in Section (6) of this Chapter.

c) For the purpose of calculating general interest rate risks for swaps that pay or receive a fixed or floating interest rate against the reference price other than the interest rate-linked financial instrument, (i.e., a stock index), the interest rate component must be entered into the maturity ladder set out in Article (78) of these Rules while the equity component must be entered into its relevant category as set out in Article (87) of these Rules.

Article 83: Credit Derivatives

a) The credit derivatives that may be included in the trading book include credit default swaps, total return swaps, and cash-funded credit linked notes.

b) The capital market institutions that transact in credit derivatives must notify the Authority in writing prior to the execution of the credit derivatives transactions.

SECTION 3: EQUITY PRICE RISK

Article 84: General Provisions

a) Equity price risks must be calculated for positions in equity and equity-linked financial instruments included in a capital market institution's trading book.

b) Capital requirements for equity price risks must be calculated based on both the gross and net positions as they are defined in accordance with Articles (86) and (87) of these Rules.

c) A capital market institution must calculate capital requirements for specific and general equity risk separately for each individual currency in which the capital market institution has positioned. Positions in foreign currency must be converted into SAR before the capital requirement is calculated. With regard to the depository receipts, the underlying instruments must be assigned to the currency in which the instruments were issued.

Article 85: Net Equity Positions

a) Netting of the capital market institution's long and short positions in equity and equity-linked financial instruments in the trading book may be carried out within each country if they are issued by the same legal entity, resulting in a single net short or long position to which the specific and general market risk charges will apply.

b) For netting purposes, the positions in equity derivatives must first be converted into positions in the underlying financial instruments in accordance with Article (89) of these Rules.

c) With regard to netting equity financial instruments and their underlying instruments, (e.g., depository receipt), the underlying instruments must be issued in the same currency of the financial instruments.

Article 86: Specific Equity Price Risk

a) For the gross positions in each exposure type of the equity, listed investment fund, and non-listed open-ended investment fund, the risk charge for specific risk must be set at 8%.
b) For the gross positions in the equity index contracts, the risk charge for specific risk must be set at 2%.
c) The gross positions mentioned in Paragraphs (a) and (b) of this Article refers to the sum of the value of the net long positions and the absolute value of net short positions for each exposure type.

Article 87: General Equity Price Risk

a) For the net positions in each exposure type of the equity, listed investment fund, non-listed open-ended investment fund, and equity index contracts in the trading book, the risk charge for general risk must be set at 8%.
b) The net positions mentioned in Paragraph (a) of this Article refers to the absolute value of the difference between the sum of long positions and the sum of short positions for each exposure type.

Article 88: Alternative Treatments for Non-Listed Open-Ended Investment Funds

a) For the non-listed open-ended investment funds that satisfy the look-through approach conditions stipulated in Paragraph (b) of Article (30) of these Rules, the positions in these investment funds may be treated using the look-through approach and assigned capital requirements as if the underlying exposures were directly held by the capital market institution.
b) For the non-listed open-ended investment funds that do not satisfy the conditions for the look-through approach stipulated in Paragraph (b) of Article (30) of these Rules but satisfy the conditions for the mandate-based approach stipulated in Paragraph (a) of Article (31) of these Rules, the positions in these funds may be treated using the mandate-based approach and the capital requirements calculated in accordance with the limits set in the incorporation documents of the investment fund and the relevant laws.

Article 89: Equity Derivatives

a) A capital market institution must convert equity derivatives into notional positions in the relevant underlying transaction for the calculation of specific and general equity price risk, with the exception to equity options which are treated in accordance with Section (4) of this Chapter.
b) Where the equity forms one leg of a derivatives transaction, any interest rate or foreign currency exposure from the other leg of the transaction must be reported for the calculation of capital requirements in accordance with Section (2) or Section (6) of this Chapter, respectively.
c) A capital market institution must treat a long (purchased) position in the equity futures or forward as a combination of:

1) A notional long position comprised of the underlying equity in the derivatives transaction; and
2) A notional short position in a zero coupon government security with a maturity date equal to the expiry date of the derivatives transaction.

d) A capital market institution must treat a short (sold) position in the equity futures or forward contract as a combination of:
   1) A notional short position comprised of the underlying equity in the derivatives transaction; and
   2) A notional long position in a zero coupon government security with a maturity date equal to the expiry date of the derivatives transaction.
e) An equity index futures or forward contract must be treated as an individual share and partitioned into long and short positions, in the same way that applies to other equity derivatives.
f) In calculating capital requirements for specific equity price risk, the following must be applicable:
   1) A risk charge of 0% is assigned for zero coupon government security deriving from the partitioning of equity futures or forwards; and
   2) The notional underlying equity position must be incorporated into the calculation of respective gross equity positions described in Article (86) of these Rules.
g) In calculating capital requirements for general equity price risk, the following must be applicable:
   1) The zero coupon government security deriving from the partitioning of equity futures or forwards must be included in the interest rate maturity ladder in accordance with Article (78) of these Rules; and
   2) The notional underlying equity position must be incorporated into the calculation of respective net equity positions described in Article (87) of these Rules.

SECTION 4: TREATMENT OF OPTIONS

Article 90: Approaches for Options in The Trading Book

A capital market institution must use either of the following approaches for calculating the market risks for the options in the trading book:

a) Simplified Approach as set out in Article (91) of these Rules where the capital market institution:
   1) Has exposures solely to the purchased options in its trading book; and/or
   2) Writes options and all its written options are perfectly hedged by perfectly matched long positions in its trading book; or

b) Delta Plus Approach in accordance with the standards issued by the Basel Committee on Banking Supervision, where the capital market institution also writes options, and such option positions are not fully hedged.

Article 91: Simplified Approach

a) Under the Simplified Approach, the capital market institution must calculate the capital requirements on the purchased option positions by applying the general risk charges and specific risk charge as set out in Paragraph (b) of this Article. The calculated capital requirements are then added to the relevant category of market risk, i.e. interest rate risks, equity price risks, foreign exchange risks, or commodities risks.

b) The capital requirements for the exposures to the options under the Simplified Approach are set out in Table (18) below:

Table (18)

Options positions	Capital requirement
Long call or Long put.	The lesser of: a) The market value of the underlying security multiplied by the sum of specific and general market risk charges for the underlying security; or b) The market value of the option (or book value for the option on specific foreign exchange or commodity positions). For item (a) above, the risk charges for options on foreign exchange and commodity will be 8% and 15% respectively.
Combination of the long underlying security and long in-the-money put; Or combination of the short underlying security and long in-the-money call.	The market value of the underlying security multiplied by the sum of specific and general market risk charges for the underlying security, less the market value of the option (or book value for an option on specific foreign exchange or commodity) that is in the money, bounded at zero.

c) The underlying security for options positions such as foreign exchange shall be the asset which would be received if the option were exercised.

d) For the options where the underlying's market value could be zero, e.g., caps, floors, swaptions, etc., its market value shall be replaced with the nominal value.

SECTION 5: UNDERWRITING

Article 92: Scope

A capital market institution that underwrites an issue or offer for the sale of securities or that commits to another capital market institution to sub-underwrite an issue or offer for the sale of securities must calculate the capital requirement for the underwriting risks following the same principles which would apply if the securities were part of its trading book pursuant to Sections (2) and (3) of this Chapter.

Article 93: Net Underwriting Positions

A capital market institution may deduct the portions of the issue or offer for sale of securities sub-underwritten or subscribed by third parties pursuant to written agreements from the portion of the issue or offer for sale underwritten by the capital market institution. In order for an issue or offer for sale underwritten by a third party to be eligible for the deduction, the written agreement must contain the third party's irrevocable and unconditional liability for the issue or offer for the sale of the securities.

Article 94: Capital Requirement for Underwriting Risks

The capital market institution must calculate the capital requirement for underwriting risks as the product of the following:

1) Net underwriting position;
2) Applicable risk charges for the underwritten security as prescribed under Sections (2) and (3) of this Chapter; and
3) Underwriting risk factor of 50% to cover an initial public offering for securities or an underwriting risk factor of 100% to cover rights issue in securities.

Article 95: Underwriting Notification

a) A capital market institution must notify the Authority in writing of its potential underwriting commitment for an issue or offer for the sale of securities prior to signing the irrevocable written agreement with the issuer or main underwriter to underwrite or sub-underwrite respectively any issue or offer for the sale of securities.
b) In its written underwriting notification mentioned in Paragraph (a) of this Article, the capital market institution must describe how the underwriting will affect its capital adequacy ratio and confirm that the underwriting exposures arising from its underwriting commitment will not cause its capital adequacy ratio to fall below the minimum required level described in Article (3) of these Rules.

SECTION 6: FOREIGN EXCHANGE RISKS

Article 96: General Provisions

a) A capital market institution must calculate the capital requirement for foreign exchange risks to measure the risk of holding or taking positions in foreign currencies and gold in both the trading book and non-trading activity in accordance with Article (98) of these Rules.
b) The foreign exchange exposures must include all assets, liabilities, provisions, and off-balance sheet commitments in every individual currency other than SAR.
c) The capital market institution must measure the exposure in a single foreign currency or gold in accordance with Article (97) of these Rules.
d) Exposures to foreign currencies positions that have been deducted in full from the capital base or subject to 100% capital requirements must be excluded from the calculation of capital requirements for foreign exchange risks.

Article 97: Net Positions in Foreign Currencies and Gold

a) A capital market institution must include the following items in its measurement of a net open position in each foreign currency:
    1) Net spot position, i.e. all asset items less all liability items denominated in the currency in question;
    2) Net forward position, i.e. all amounts to be received less all amounts to be paid under forward foreign exchange transactions, including currency futures, the principal on currency swaps not included in the spot position, and interest rate transactions such as futures and swaps denominated in a foreign currency;
    3) Guarantees and similar instruments that are certain to be called and likely to be irrecoverable;
    4) Expected future interest and anticipated expenses not yet accrued but already fully hedged (application must be carried out consistently without selecting only those expected future flows which reduce the position);
    5) Net delta-weighted position of the total holding in foreign currency options; and
    6) Any other items represent a profit or loss in foreign currencies.
b) A capital market institution must measure positions in gold (including gold derivatives) in terms of the standard unit of measurement (kilos, grams, etc.).
c) Net positions (long or short) in each foreign currency and gold must be valued at their current market value.
d) Net position (long or short) in each foreign currency and gold must be converted into SAR using the spot rates at the reporting date.

Article 98: Capital Requirement for Foreign Exchange Risks

a) For the positions in USD and each GCC currency, the sum of net short or long positions in these currencies, whichever is greater, must be assigned with a risk charge of 2%.
b) For positions in each other foreign currencies, the sum of net short or long positions in these currencies, whichever is greater, must be assigned with a risk charge of 8%.
c) The absolute value of the net position in gold must be assigned with a risk charge of 8%.

SECTION 7: COMMODITIES RISKS

Article 99: General Provisions

a) The capital market institution must calculate the capital requirements for commodities risks for positions in commodities and commodity derivatives (excluding gold and gold derivatives) for positions in both the trading book and non-trading activities in accordance with Article (101) of these Rules, except for certain treatments for options on commodities which are set out in Section (4) of this Chapter.
b) Capital requirements for positions in gold and gold derivatives must be calculated in accordance with Section (6) of this Chapter.

Article 100: Net Positions in Commodities

a) Each position in commodities or commodity derivatives must be expressed in terms of the standard units of measurement (e.g., barrel, MWh, kg, etc.). Positions in commodity derivatives must first be converted into notional commodities positions.
b) Capital requirements for commodities risks must be calculated based on each commodity's net long and net short positions.
c) When determining each commodity's net long and net short positions, positions in identical commodities can be netted. Positions in identical commodities refer to the commodity contracts that are deliverable against each other or close substitutes for each other with a minimum correlation of (0.9) between price movements that can be clearly established over a minimum period of one year.
d) The net positions in each commodity must be converted at current spot rates into SAR.

Article 101: Commodity Derivatives

a) Futures and forwards transactions on commodities must be partitioned as follows:
    1) A long (purchased) position must be treated as a combination of:
        a. A long position in the underlying commodity; and
        b. A short position in a zero coupon government security assigned a risk charge of 0% with a maturity date equal to the delivery date of the contract.
    2) A short (sold) position must be treated as a combination of:
        a. A short position in the underlying commodity; and

b. A long position in a zero coupon government security assigned a risk charge of 0% with a maturity date equal to the delivery date of the contract.

b) A commodity swap where one leg of the transaction is a fixed price and the other leg is the current market price must be partitioned as a long position if the capital market institution pays a fixed price and receives a floating price or as a short position if the capital market institution receives a fixed price and pays a floating price.
c) The options on commodities shall be treated in accordance with Section (4) of this Chapter.

Article 102: Capital Requirements for Commodity Risks

A capital market institution must calculate the capital requirements for commodity risks as follows:

1) A risk charge of 15% is assigned to the net positions in each identical commodity as described in Article (100) of these Rules; and
2) A risk charge of 3% is assigned to the gross positions in each identical commodity. The gross position in each commodity equals the sum of the long positions and the absolute values of the short positions in each identical commodity.

CHAPTER 3: OPERATIONAL RISKS

Article 103: Scope

a) The capital market institution must calculate the capital requirement for operational risks as the higher of the capital requirements calculated under the income-based approach set out in Article (104) of these Rules or the expenditure-based approach set out in Article (105) of these Rules.

b) The risk-weighted exposure amount for operational risk is determined by multiplying the capital requirement referred to in Paragraph (a) of this Article by (12.5).

Article 104: Income-Based Approach

a) The capital market institution may calculate the capital requirement for operational risks using the income-based approach, whether by the basic indicator approach or the standardised approach. If the basic indicator approach is used, the capital requirement is equal to 15% of the income indicator calculated in accordance with Paragraphs (b), (c), (d), and (e) of this Article. If the standardised approach is used, the capital requirement must be based on the risk charges applicable to each type of activity in accordance with Paragraph (f) of this Article, which are calculated by multiplying the risk charge that applies to each activity by its income indicator calculated in accordance with Paragraphs (b), (c), (d), and (e) of this Article.

b) The income indicator must consist of the average positive annual adjusted gross income of the capital market institution's annual audited financial statements for the last three financial years, calculated as the sum of the adjusted gross income of the positive financial years divided by the number of positive financial years.

c) If any of the last three financial years did not represent a twelve months accounting period, the adjusted gross income of the affected financial year must be recalculated on a pro-rata basis so as to produce an equivalent annual amount.

d) If a capital market institution has been in business for less than twelve months, the income indicator must correspond to the projected adjusted gross income as provided in the capital market institution's business plan for the first year of operation as submitted with its application for authorisation.

e) The adjusted gross income refers to the operating income that:
   1) Must be gross of any provisions (e.g., provision for unpaid interest);
   2) Must be gross of operating expenses (e.g., fees paid to outsourcing service providers). However, fees received for the provision of outsourcing services must be included in adjusted gross income; and
   3) May exclude non-recurring income from non-ordinary activities.
   4) May exclude income from discontinued operations.

f) The risk charge applicable to each type of activity using the standardised approach are in accordance with Table (19) below.

Table (19)

Activity Type	Risk Charge
Corporate financing	18%
Research and advice	18%
Trading and sales	18%
Custody	15%
Asset management	12%

Article 105: Expenditure-Based Approach

a) The capital requirements for operational risks under the expenditure-based approach is equal to 25% of the adjusted annual audited expenditure of the capital market institution's most recent audited financial statement.

b) The adjusted annual audited expenditure refers to the total expenditures that arise in the normal course of business, which may exclude the following:

   1) Bonuses, shares in profits, and other variable remuneration paid to the employees, directors, or partners, where applicable, to the extent that the payments are made at the discretion of the capital market institution;
   2) Fees, brokerage expenses, and other expenses paid to the CCPs, exchanges, other trading venues, and intermediate brokers for the purposes of executing, registering, or clearing transactions, only where they are directly passed on and charged to customer (these exclude fees and expenses that are related to the provision of services and the revenues generated from them, such as necessary fees and expenses to maintain membership with the CCPs, exchanges and other trading venues);
   3) Non-recurring expenses from non-ordinary activities; and
   4) Expenditure from taxes and zakat where they fall due in relation to the annual profits of the capital market institution.

c) If the capital market institution's most recent audited financial statements do not represent a 12-month accounting period, its adjusted annual audited expenditure must be calculated based on a pro-rata basis so as to produce an equivalent annual amount.

d) If a capital market institution has been in business for less than twelve months, its adjusted annual audited expenditure must be recalculated based on the projected expenditure as reflected in its business plan for the first year of operation as submitted with its application for authorisation.

CHAPTER 4: CONCENTRATION RISKS

Article 106: Excess Exposures

a) A capital market institution must calculate the capital requirements for concentration risks for the excess exposures in both trading-book and non-trading activities.
b) The excess exposures refer to the values of a capital market institution's exposures to a single counterparty or group of connected counterparties that exceed the concentration risk limit of 25% of the capital market institution's Tier 1 capital.
c) A capital market institution may carry excess exposures in the non-trading activities provided that such exposures are exempted as set out in Article (107) of these Rules, or the capital market institution fulfils the concentration risks capital requirements for non-trading activities exposures set out in Paragraph (b) of Article (111) of these Rules.
d) A capital market institution may carry excess exposures in the trading book provided that such exposures are exempted as set out in Article (107) of these Rules, or the capital market institution fulfils the concentration risk capital requirements for trading book exposures set out in Paragraph (c) of Article (111) of these Rules.
e) A capital market institution must immediately submit a notification in writing to the Authority upon carrying the excess exposure that is not exempted under Article (107) of these Rules to describe the excess exposure, including how and when it arose.

Article 107: Exempted Exposures

The following exposures are exempted from the concentration risk limit stated in Paragraph (b) of Article (106) of these Rules:

1) Exposures to the government of the Kingdom and SAMA, or exposures carrying the explicit guarantees of the government of the Kingdom or SAMA;
2) Exposures which, in the case of foreign exchange transactions, arise in connection with the ordinary course of settlement of a transaction during the two days following the payment;
3) Exposures which, in the case of transactions for the purchase or sale of securities or commodities, arise in connection with the ordinary course of settlement of a transaction during the five days following the payment or delivery of the securities or commodities, whichever is earlier;
4) Exposures which arise in connection with an underwriting of securities;
5) Exposures in the form of cash on deposit with the local banks;
6) Exposures that are deducted from the capital base; and
7) Exposures to QCCPs related to clearing activities.

Article 108: Management Requirements

A capital market institution must have sound administrative and accounting procedures and adequate systems and controls in place for the purpose of identifying, measuring, monitoring, and reporting all its excess exposures in a timely manner.

Article 109: Determining Concentrated Exposures in The Non-Trading Activities

a) When determining concentrated exposures in non-trading activities, the capital market institution must use the following exposure values:
   1) For on-balance sheet non-derivatives items, the exposure values are calculated based on the accounting value that is net of specific provisions;
   2) For off-balance sheet commitments, the exposure values are calculated based on the on-balance sheet equivalent values, which are obtained from applying the credit conversion factors;
   3) For derivatives, the exposure values are calculated in accordance with Article (37) of these Rules; and
   4) For securities financing transactions, the exposure values are calculated in accordance with Article (59) or Article (66) of these Rules.

b) In calculating the value of exposures, a capital market institution may use the risk-mitigating effect of credit protection as follows:
   1) The portion of the exposure that is covered by a recognisable collateral may be treated as an exposure to the issuer of the collateral;
   2) The portion of the exposure that is covered by a recognisable guarantee or credit derivative may be treated as an exposure to the guarantor or the protection seller, respectively.
   3) The capital market institution may use the effect of any recognisable netting agreements.
   4) A capital market institution must analyse, to the extent possible, their exposures to collateral issuers, guarantors, and protection sellers for possible concentrations beyond the limit referred to in Paragraph (b) of Article (106) of these Rules, and where appropriate, take action and report any significant findings to the Authority.

Article 110: Determining Concentrated Exposures in The Trading Book

a) A capital market institution must calculate concentrated exposures amounts to an individual counterparty in the trading book by aggregating the sum, if it is positive, of its net positions in interest rate-linked and equity-linked financial instruments issued by the counterparty.

b) For the purpose of calculating the net positions referred to in Paragraph (a) of this Article, the capital market institution must use the following exposure values:
   1) For non-derivatives interest rate, debt, and equity instruments, the exposure values are the accounting value that is net of specific provisions.
   2) For swaps, futures, forwards, and credit derivatives, the derivatives transactions must first be partitioned into their individual legs in accordance with Section (2), (3) and (4) of Chapter (2) of Part (3) of these Rules, and only transaction legs representing exposures in the scope of the concentration risks framework need to be considered.

3) For credit derivatives that represent sold protection, the exposure to the referenced entity is the amount due in the case that the referenced entity triggers the credit derivative minus the market value of the credit protection.
4) For a call option, the exposure value is the market value (positive for a long call and negative for a short call). For a put option, the exposure value is the strike price minus market value (positive for a long put and negative for a short put). The resulting option exposures to each underlying counterparty must be aggregated. If there is a negative net exposure after aggregation of all option exposures, the option exposure must be set to zero.
5) The exposures to various investment funds do not need to be aggregated even if they are administered by the same fund manager.

Article 111: Capital Requirements for Concentration Risks

a) A capital market institution must calculate the capital requirements for concentration risks in the non-trading activities and trading book in accordance with Paragraphs (b) and (c) of this Article.
b) The excess exposures in the non-trading activities must be assigned a risk weight of 1250%.
c) The excess exposures in the trading book must be comprised of the exposures that attract the highest specific risk capital requirements and treated as follows:
    1) If the excess exposure has existed for less than ten days, the concentration risk capital requirement must be 200% of the specific risk capital requirements that apply to the excess exposure, and the results must be multiplied by 12.5 to arrive at its risk-weighted exposure amount.
    2) If the excess exposure has existed for ten days or longer, the excess exposure must be allocated to the excess exposure bands shown in Column (1) of Table (20) below in ascending order of specific risk capital requirements. The concentration risk capital requirement must be calculated as the aggregate sum of the existing specific risk capital requirements within each excess exposure band multiplied by its corresponding factor in Column (2) of Table (20) below. The results must be multiplied by 12.5 to arrive at its risk-weighted exposure amount.

Table (20)

Excess exposure band (exposure as a percentage of Tier-1 capital)	Factor
25% to 40%	200%
> 40% to ≤ 60%	300%
> 60% to ≤ 80%	400%
> 80% to ≤ 100%	500%
> 100% to ≤ 250%	600%
Over 250%	900%

PART 4

EXPENDITURE-BASED CAPITAL REQUIREMENT

Article 112: General Provisions

a) The expenditure-based capital requirements are the prudential requirements for the capital market institutions referred to in Paragraphs (c) and (d) of Article (1) of these Rules.

b) The expenditure-based capital requirements must be calculated based on the capital market institution's adjusted annual audited expenditure of the most recent audited financial statements, calculated in accordance with Article (113) of these Rules.

c) If the capital market institution's most recent audited financial statements do not represent a 12-month accounting period, its adjusted annual audited expenditure must be recalculated on a pro-rata basis so as to produce an equivalent annual amount.

d) If a capital market institution has been in business for less than one year, its adjusted annual audited expenditure must be based on the projected adjusted annual expenditure as reflected in its business plan for the first year of operation that was submitted with its application for authorisation.

e) If a capital market institution has a material change that leads to an increase of 50% or more in its expected adjusted expenditure during the current financial year, it must recalculate its adjusted annual expenditure and expenditure-based capital requirement accordingly and submit a written notification to the Authority immediately of such recalculation.

Article 113: Adjusted Annual Audited Expenditure

The adjusted annual audited expenditure must be calculated in accordance with Paragraph (b) of Article (105) of these Rules.

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PART 5
LIQUIDITY RISK

Article 114: General Provisions

a) A capital market institution must maintain a liquidity risk management framework commensurate with the level and extent of liquidity risk to which the capital market institution is exposed from its activities.

b) The liquidity risk management framework of a capital market institution must be reviewed by its senior management and approved by its governing body on a periodic basis.

PART 6

REPORTING

Article 115: Reporting Obligations

a) The reporting obligations in this Part must be in addition to any notification requirements that a capital market institution has under the Capital Market Institutions Regulations and other Implementing Regulations issued by the Authority.
b) Where stated in these Rules that a capital market institution must submit information to the Authority, the submitted information must be based on its own information and the financial group’s information.
c) A capital market institution must keep and preserve all financial and non-financial records and documents in accordance with the relevant provisions provided in the Capital Market Institutions Regulations.
d) A capital market institution must report all deviations from these Rules together with its plan to rectify the deviations to the Authority immediately.

Article 116: Capital Adequacy Model

a) A capital market institution must submit its capital adequacy model (comprising the balance sheet, income statement, and risk calculations) to the Authority using the capital adequacy model template issued by the Authority.
b) For the periodic reporting, a capital market institution must submit the capital adequacy model within ten days after the end of each month.
c) As an exception to the provision of Paragraph (b) of this Article, a capital market institution authorised to carry out only the businesses of Advising must submit the capital adequacy model within ten days after the end of each quarter.
d) For the annual reporting in conjunction with the submission of the capital market institution’s annual audited financial statements, the capital adequacy model must be submitted within three months after its financial year end.

Article 117: Audited Financial Statements

a) A capital market institution must submit its annual audited financial statements to the Authority within three months after the financial year end.
b) The annual audited financial statements must be prepared in accordance with the Saudi Organisation for Chartered and Professional Accountants (SOCPA)’s accounting and auditing standards, or after obtaining an approval from the Authority, internationally accepted accounting and auditing standards where appropriate. Annual financial statements must be audited by an audit firm who is registered with the Authority according to the Rules for Registering Auditors of Entities Subject to the Authority's Supervision.

PART 7

FINANCIAL GROUPS

Article 118: Reporting on Consolidated Basis

a) Consolidated accounts must be prepared for a capital market institution as a financial group by applying relevant accounting rules applicable to the preparation of consolidated statements of financial positions (balance sheets) and consolidated profit and loss statements in accordance with Article (117) of these Rules. The Authority may allow consolidation by other methods where exceptional grounds exist.

b) On a need basis, the Authority may decide whether any entity that is part of the capital market institution's financial group must be excluded from its consolidated accounts.

c) The capital market institution may submit an application to the Authority to exclude from its consolidated accounts any entity that is part of its financial group where:

   1) The entity is located in a country where there are legal obstacles to the transfer of necessary information;
   2) The entity is of negligible significance in light of the purpose of the supervision; or
   3) A compilation of the financial position of the entity would be inappropriate or misleading in light of the purpose of the supervision.

d) A capital market institution's consolidated accounts may if there are exceptional grounds and with the approval of the Authority, be prepared on the basis of financial statements referring to another point in time than the reporting date.

e) A capital market institution must, on the dates and for the accounting periods determined by the Authority for each individual case, provide to the Authority with the following consolidated information:

   1) Financial group's consolidated financial position;
   2) Purchases and sales of assets between the capital market institution and any entity that is part of its financial group;
   3) Receivables and liabilities between the capital market institution and any entity that is part of its financial group;
   4) Agreements between the capital market institution and any entity that is part of its financial group; and
   5) Commitments and contingent liabilities between the capital market institution and any entity that is part of its financial group.

PART 8

CLOSING PROVISIONS

Article 119: Entry into Force

These Rules shall be effective in accordance to its approval resolution.

ANNEX 1

CREDIT QUALITY STEPS FOR LONG-TERM RATINGS

Credit quality Step	Credit Rating				
	S & P	**Fitch**	**Moody's**	**Capital Intelligence**	**Simah Rating**
1	AAA to AA-	AAA to AA-	Aaa to Aa3	AAA	AAA to AA-
2	A+ to A-	A+ to A-	A1 to A3	AA to A	A+ to A-
3	BBB+ to BBB-	BBB+ to BBB-	Baa1 to Baa3	BBB	BBB+ to BBB-
4	BB+ to BB-	BB+ to BB-	Ba1 to Ba3	BB	BB+ to BB-
5	B+ to B-	B+ to B-	B1 to B3	B	B+ to B-
6	CCC+ and below	CCC+ and below	Caa1 and below	C and below	CCC+ and below

ANNEX 2

CREDIT QUALITY STEPS FOR SHORT-TERM RATINGS

Credit quality step	Credit Rating				
	S & P	**Fitch**	**Moody's**	**Capital Intelligence**	**Simah Rating**
1	A-1+, A-1	F1+, F1	P-1	A1	A-1+, A-1
2	A-2	F2	P-2	A2	A-2
3	A-3	F3	P-3	A3	A-3
4	Below A-3	Below F3	Not Prime	Below A3	Below A-3