# EQUITY RISK IN THE BANKING BOOK

**Page no.**

**EQUITY RISK IN THE BANKING BOOK** **BA 340**

(Confidential and not available for inspection by the public) Monthly

Name of bank………………………………………………..

Month ended………………………………………....(yyyy-mm-dd)

(All amounts to be rounded off to the nearest R'000)

| **Standardised approach for credit risk[1]** | **Line no.** | **Exposure value** | **Risk weighting** | **Risk weighted exposure** | **Capital requirement** |
|---|---|---|---|---|---|
| | | **1** | **2** | **3** | **4** |
| Equities - listed and unlisted | 1 | | 100% | | |
| Private equity and venture capital | 2 | | 150% | | |

**1. Including the simplified standardised approach for credit risk.**

(All amounts to be rounded off to the nearest R'000)

| **IRB approach for credit risk**<br>**Market based approach** | **Line no.** | **Exposure value** | **Risk weighting** | **Risk weighted exposure[1]** | **Capital requirement** | |
|---|---|---|---|---|---|---|
| | | **1** | **2** | **3** | **4** | |
| **Simple risk weight method** (total of items 4 and 5) | 3 | | | | | |
| Equities - listed | 4 | | 300% | | | |
| Equities - unlisted | 5 | | 400% | | | |
| | | **Exposure value** | **Risk weighting floor** | **Risk weighted exposure[1]** | | **Capital requirement** |
| | | | | **Without limit[2]** | **With limit[3]** | |
| | | **1** | **2** | **3** | **4** | **5** |
| **Internal models approach** (total of items 7 and 8) | 6 | | | | | |
| Equities - listed | 7 | | 200% | | | |
| Equities - unlisted | 8 | | 300% | | | |
| ***Memorandum item:***<br>Diversified amount | 9 | | | | | |

1. **After the application of a scaling factor of 1.06.**
2. **Means the relevant risk weighted exposure amount prior to the application of the specified risk weighting floor, if relevant.**
3. **Means the relevant risk weighted exposure amount after the application of the specified risk weighting floor, when relevant.**

(All amounts to be rounded off to the nearest R'000)

| IRB approach for credit risk<br>PD/LGD approach<br>Internal obligor grade[1] | Line no. | Internal rating: PD ratio | | | Exposure value | | Risk weighted exposure[2] | Capital requirement |
|---|---|---|---|---|---|---|---|---|
| | | PD range | | Average PD assigned to the obligor grade (%) | | In respect of which the 1,5 scaling factor applies | | |
| | | Lower bound (%) | Upper bound (%) | | | | | |
| | | 1 | 2 | 3 | 4 | 5 | 6 | 7 |
| 01 | 10 | 0.0001 | 0.0120 | | | | | |
| 02 | 11 | 0.0121 | 0.0170 | | | | | |
| 03 | 12 | 0.0171 | 0.0240 | | | | | |
| 04 | 13 | 0.0241 | 0.0340 | | | | | |
| 05 | 14 | 0.0341 | 0.0480 | | | | | |
| 06 | 15 | 0.0481 | 0.0670 | | | | | |
| 07 | 16 | 0.0671 | 0.0950 | | | | | |
| 08 | 17 | 0.0951 | 0.1350 | | | | | |
| 09 | 18 | 0.1351 | 0.1900 | | | | | |
| 10 | 19 | 0.1901 | 0.2690 | | | | | |
| 11 | 20 | 0.2691 | 0.3810 | | | | | |
| 12 | 21 | 0.3811 | 0.5380 | | | | | |
| 13 | 22 | 0.5381 | 0.7610 | | | | | |
| 14 | 23 | 0.7611 | 1.0760 | | | | | |
| 15 | 24 | 1.0761 | 1.5220 | | | | | |
| 16 | 25 | 1.5221 | 2.1530 | | | | | |
| 17 | 26 | 2.1531 | 3.0440 | | | | | |
| 18 | 27 | 3.0441 | 4.3050 | | | | | |
| 19 | 28 | 4.3051 | 6.0890 | | | | | |
| 20 | 29 | 6.0891 | 8.6110 | | | | | |
| 21 | 30 | 8.6111 | 12.1770 | | | | | |
| 22 | 31 | 12.1771 | 17.2220 | | | | | |
| 23 | 32 | 17.2221 | 24.3550 | | | | | |
| 24 | 33 | 24.3551 | 34.4430 | | | | | |
| 25 | 34 | 34.4431 | 99.9999 | | | | | |
| Default | 35 | 100.0000 | 100.0000 | | | | | |
| Total (of items 10 to 35) | 36 | | | | | | | |

**1. In ascending order, based on exposure weighted average PD.**
**2. After the application of a scaling factor of 1.06.**

(All amounts to be rounded off to the nearest R'000)

| **Memorandum items:** | **Line no.** | **Exposure amount** |
|---|---|---|
| | | **1** |
| Equity exposures exempt from the market based and PD/LGD approaches | 37 | |
| Deductions against capital and reserve funds in respect of investments in related entities | 38 | |
| Investments in unconsolidated majority owned banking, securities and other financial subsidiaries | 39 | |
| Significant minority investments in banking, securities and other financial entities | 40 | |
| Investments in insurance subsidiaries and significant minority investments in insurance entities | 41 | |
| Significant minority and majority investments in commercial entities that exceed the specified materiality levels | 42 | |
| Other investments in related entities, which entities are included in the consolidation of the reporting banking group's accounts, such as significant minority- and majority-owned commercial entities below the specified materiality level | 43 | |

**31. Equity risk in the banking book – Directives and interpretations for completion of monthly return concerning equity risk in the banking book (Form BA 340)**

(1) The content of the relevant return is confidential and not available for inspection by the public.

(2) The purpose of the return, amongst other things, is to determine the nature and extent of the reporting bank's exposure to investment risk arising from equity positions and other relevant investments or instruments held in its banking book.

(3) *Criteria relating to categorisation of equity exposures held in a bank's banking book*

Based on the economic substance and not the legal form of an instrument, and irrespective whether or not the said instrument makes provision for a voting right, for the purposes of these Regulations equity exposures held in a bank's banking book-

(a) shall include-

(i) any direct ownership interest in the assets and income of a commercial or financial institution;

(ii) any indirect ownership interest in the assets and income of a commercial or financial institution, including-

(A) a derivative instrument held, which derivative instrument is linked to an equity interest;

(B) any instrument or interest held in a corporation, partnership, limited liability company or other type of enterprise that issue ownership interests and which in turn principally is engaged in the business of investing in equity instruments;

(iii) any instrument that-

(A) is not redeemable, that is, the return of invested funds can be achieved only by way of the sale of the relevant instrument, the sale of the rights to the relevant investment or the liquidation of the issuer of the relevant instrument;

(B) does not constitute an obligation of the issuer of the instrument;

(C) entitles the holder of or investor in the said instrument to a residual claim in respect of the assets or income of the issuer of the said instrument;

(D) exhibits or contains characteristics similar to an instrument that qualifies as common equity tier 1 capital of a bank, as defined in section 1 of the Act;

(E) constitutes an obligation of the issuer of the instrument and the said obligation or instrument makes provision for any one of the conditions or circumstances specified below:

(i) The issuer of the said instrument has the right indefinitely to defer the settlement of the said obligation.

(ii) The obligation specifies that settlement will, or at the discretion of the issuer may, take place by way of the issuance of a fixed number of equity shares of the obligor.

(iii) The obligation specifies that settlement will, or at the discretion of the issuer may, take place by way of the issuance of a variable number of the issuer's equity shares and any change in the value of the obligation is related to, and in the same direction as, the change in the value of a fixed number of the issuer's equity shares.

(iv) The holder of the instrument has the option to require that the obligation be settled in equity shares.

(b) shall exclude any instrument-

(i) held in any institution or entity of which the assets and liabilities are consolidated with the assets and the liabilities of the reporting bank or controlling company;

(ii) that constitutes a deduction against the common equity tier 1 capital and reserve funds or additional tier 1 capital and reserve funds or tier 2 capital and reserve funds of the reporting bank;

(iii) specified in writing by the Registrar, which instrument or any part thereof, in the discretion of and subject to the conditions specified in writing by the Registrar, should be treated as debt instead of equity.

(4) Based on-

(a) the relevant requirements specified in regulation 23, including in particular regulations 23(6)(j), 23(8)(j), 23(11)(b)(vii), 23(11)(c)(v) and/or 23(11)(d)(v), as the case may be;

(b) the relevant requirements specified in this regulation 31; and

(c) the relevant requirements specified in regulation 38, including in particular regulations 38(2)(a) and/or 38(8), as the case may be,

a bank shall calculate and report, among other things, its relevant specified exposure amounts, risk weighted exposure amounts and/or required amount of capital and reserve funds.

(5) Once a bank adopts the IRB approach as envisaged in regulation 23(10) for all or part of any of its corporate, bank, sovereign, or retail asset classes, the bank shall simultaneously adopt the IRB approach for its equity exposures, subject only to materiality levels as may be specified in writing by the Registrar from time to time, provided that the Registrar may require a bank to implement one of the IRB equity approaches specified in subregulation (6) below when the bank's equity exposures constitute a significant part of its business, even though the bank may not adopt an IRB approach in respect of other asset classes, business units or activities.

(6) *Calculation of risk weighted exposure in respect of equity instruments held in the banking book of a bank that adopted the IRB approach for the measurement of the bank's exposure to credit risk*

(a) Subject to the provisions of regulation 38(2)(a), a bank that adopted the IRB approach for the measurement of the bank's exposure to credit risk shall calculate its risk-weighted assets and related required amount of capital and reserve funds in respect of equity exposures held in its banking book in accordance with the market-based approach or PD/LGD approach specified below, or, subject to the prior written approval of and such conditions as may be specified in writing by the Registrar, a combination of the said approaches, provided that-

(i) the bank shall apply a selected approach in a consistent manner;

(ii) each relevant risk category shall be assessed using a single approach;

(iii) all relevant elements of the reporting bank's exposure to equity risk in the banking book shall be subject to the bank's risk management policies, processes and procedures, and the relevant requirements specified in this subregulation (6);

(iv) no bank shall be allowed to apply a combination of approaches-

(A) within a specific risk category; or

(B) in respect of the same type of risk, across different risk centres;

(v) any relevant equity exposure that constitutes a deduction against the reporting bank's capital and reserve funds in terms of the provisions of regulations 23(6), 23(8), 23(11), 23(13) or 38(5) shall be included in the form BA 340, and the relevant amount shall be deducted from the bank's capital and reserve funds in accordance with the relevant requirements specified in section 70 of the Act read with the provisions of the aforesaid regulations;

(vi) a bank that adopted the market-based approach-

(A) shall continuously comply with the relevant minimum requirements specified in regulation 23(11)(b)(vii) if the bank wishes to apply the internal model market-based approach specified in paragraph (b)(ii) below;

(B) shall calculate its risk weighted exposure in terms of the simple risk-weight method when the bank is unable to comply with the said minimum requirements relating to the internal model market-based approach specified in regulation 23(11)(b)(vii);

(C) may in the calculation of the bank's risk-weighted exposure recognise the effects of guarantees, but not collateral, obtained in respect of a particular equity position;

(vii) a bank that adopted the PD/LGD approach shall in addition to the requirements specified in paragraph (c) below, comply with the relevant minimum requirements relating to corporate exposure specified in regulations 23(11)(b)(v)(A), 23(11)(b)(v)(B), 23(11)(b)(vi)(A) and 23(11)(d)(ii);

(viii) no investment in a significant minority owned or majority owned or controlled commercial entity, which investment amounts to less than 15 per cent of the sum of the bank's issued common equity tier 1 capital and reserve funds, additional tier 1 capital and reserve funds and tier 2 capital and reserve funds of the reporting bank, as reported in items 41, 65 and 78 of the form BA 700, shall be assigned a risk weight of less than 100 per cent;

(ix) based on such conditions, requirements or criteria as may be specified in writing by the Registrar, the Registrar may exempt from the provisions of this subregulation (6) specified types of equity exposure;

(x) any investment in an equity instrument shall be valued in accordance with the relevant provisions of Financial Reporting Standards issued from time to time, which value shall also be applied by the reporting bank in the calculation of the bank's relevant risk weighted exposure amount and the related required amount of capital and reserve funds;

(xi) when the bank invests in instruments issued by a fund, which fund invests in equity and non-equity instruments, the bank shall base its calculations on the assumption that the fund firstly invests, to the maximum extent allowed in terms of the mandate of the fund, in the asset classes attracting the highest capital requirement, and then continues to make investments in descending order until the maximum total investment level is reached;

(xii) the bank's total risk weighted exposure amount relating to equity instruments held in the bank's banking book, and the related required amount of capital and reserve funds, shall be equal to the sum of amounts calculated in accordance with the relevant requirements specified in this subregulation (6).

(b) Market-based approach

A bank that adopted the market based approach for the calculation of its capital requirements relating to equity positions held in the bank's banking book shall apply one or both of the methods specified below in respect of the bank's various equity portfolios provided that the method selected by the bank shall be consistent with the complexity of the bank's equity holdings and shall be applied in a consistent manner.

(i) Simple risk weight method

A bank that adopted the simple risk weight method-

(A) shall assign to the appropriate categories specified in table 1 below the bank's relevant net equity positions, calculated in accordance with the relevant definition of a long or short position.

**Table 1**

| Description | Risk weight |
|---|---|
| Publicly traded equity, that is, any equity instrument traded on a licensed exchange[1] | 300% |
| Other equity positions[1] | 400% |

1. **Including the absolute values of net short positions.**

(B) may net short cash positions and positions relating to derivative instruments held in its banking book against long positions held in respect of the same instrument, provided that-

(i) the said instrument shall explicitly be designated as a hedge in respect of that particular equity instrument; and

(ii) both instruments shall have remaining maturities of no less than one year;

(C) shall treat any maturity mismatched positions in accordance with the relevant requirements relating to corporate exposures specified in regulation 23(11)(d)(ii) read with the relevant requirements specified in regulation 23(12)(f).

(ii) Internal models approach

A bank that adopted or has been directed by the Registrar to apply the internal models approach shall calculate its risk-weighted exposure relating to its equity positions through the application of the formula specified below:

RWA = K x 12,5

where:

**RWA** is the relevant risk-weighted exposure amount

**K** is the capital requirement, which capital requirement-

(A) shall be equal to the potential loss that may arise from the bank's equity positions held in its banking book, derived from the bank's internal value-at-risk model;

(B) shall be based on a 99$^{th}$ percentile, one-tailed confidence interval of the difference between quarterly returns and an appropriate risk-free rate computed over a long-term sample period, provided that the said capital requirement-

(i) shall not be less than the capital requirement calculated in terms of the simple risk-weight method specified in sub-paragraph (i) above, applying a risk weight of 200 per cent in respect of publicly traded equity and a risk weight of 300 per cent in respect of all other equity positions;

(ii) shall be calculated in respect of individual instruments and not at a portfolio level.

(c) PD/LGD approach

A bank that adopted the PD/LGD approach shall calculate its risk-weighted exposure amount in respect of equity positions held in the bank's banking book in accordance with the relevant requirements relating to corporate exposure specified in regulation 23(11)(d)(ii), provided that-

(i) the bank's estimate of the PD ratio of a corporate institution in which the bank holds an equity position shall be based on the same requirements as the bank's estimate of the PD ratio of a corporate institution in respect of which the bank has a debt exposure.

When the bank has no debt exposure in respect of a corporate institution in which the bank holds an equity instrument and the bank has insufficient information in respect of the said corporate institution to adhere to the definition of default, but the bank complies with the other relevant standards, the bank shall apply a scaling factor of 1.5 to the relevant risk weight derived from the relevant corporate risk-weight function;

(ii) when a default event occurs in respect of a debt obligation of a particular corporate institution in which the reporting bank holds an equity position, it shall for purposes of these Regulations be deemed that a simultaneous default event occurred in respect of the said equity position held by the bank;

(iii) the bank shall in respect of each relevant equity exposure apply-

(A) a LGD ratio of 90 per cent, and

(B) a five year maturity adjustment;

(iv) the bank shall apply a minimum risk weight of 100 per cent in respect of-

(A) public equities, provided that-

(i) the bank's investment forms part of a long-term customer relationship;

(ii) capital gains are not expected to be realised in the short term;

(iii) the bank has lending and/or general banking relationships with the portfolio company in order to estimate or obtain the probability of default;

(B) private equities, provided that-

(i) the bank's return on the investment is based on regular and periodic cash flows, which cash flows are not derived from capital gains;

(ii) the bank has no expectation of any abnormal future capital gain or realising any existing gain in respect of the said investment;

(v) in the case of all equity positions other than the equity positions referred to in subparagraph (iv) above, including any net short positions, the bank's capital requirement shall not be less than the capital requirement calculated in terms of the simple risk weight method, based on a risk weight of 200 per cent in respect of publicly traded equity and a risk weight of 300 per cent in respect of other equity exposures;

(vi) the bank shall include in its calculation any equity instruments held in respect of companies that are included in one of the bank's retail portfolios;

(vii) when the sum of a bank's unexpected loss (UL) and expected loss (EL) associated with a relevant equity exposure held in the bank's banking book results in a lower amount of required capital and reserve funds than what would be the case when the relevant aforesaid specified minimum risk weights are applied, the bank shall apply the relevant aforesaid specified minimum risk weights to that relevant equity position held;

(viii) the maximum risk weight in respect of any equity exposure, including any relevant expected loss amount, shall be 1250 per cent;

(ix) when the bank obtained a hedge in respect of the equity exposure, the bank shall apply-

(A) an LGD ratio of 90 per cent in respect of the exposure to the protection provider; and

(B) a five-year maturity in respect of the said equity exposure.

(7) Instructions relating to the completion of the return are furnished with reference to certain item descriptions and line items appearing on the form BA 340, as follows:

*Line item:*

1 **Equity, listed and unlisted**

Based on the relevant requirements specified in regulations 23(6)(j) and 23(8)(j), this item shall reflect the relevant aggregate amount of the reporting bank's equity investments other than private equity investments or investment in venture capital.

2 **Private equity and venture capital**

Based on the relevant requirements specified in regulations 23(6)(j) and 23(8)(j), this item shall reflect the relevant aggregate amount of the reporting bank's investments in private equity and venture capital.

4 **Publicly traded equity or listed equity**

This item shall reflect the aggregate amount of publicly traded equity instruments, which instruments are included in items 27 and 35 of the form BA 100.

5 **Other equity or unlisted equity**

This item shall reflect the aggregate amount of equity instruments other than publicly traded equity instruments, including any unlisted equity instrument and investments in subsidiaries and associates, which instruments are included in items 28, 36 and 39 to 41 of the form BA 100.

43 **Other investments in related entities**

This item shall reflect the aggregate amount of investments in subsidiaries and associates other than subsidiaries and associates reported in items 40 to 42, which subsidiaries and associates are included in the consolidation of the banking group's accounts.