



# **BANK OF MAURITIUS**

## **Guideline on Standardised Approach to Credit Risk**

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## INTRODUCTION

Under the Basel II framework banks are allowed to choose between two broad methodologies for calculating their capital requirements for credit risk. One alternative is to measure credit risk in a standardised manner, supported by external credit assessments. The other alternative, which is subject to the explicit approval of the regulator, allows banks to use their internal rating systems to measure credit risk.

### Purpose

The *Guideline on Standardised Approach to Credit Risk* (Guideline) provides a framework for banks to apply a uniform approach to the measurement of risks relating to their on- and off-balance sheet credit exposures for capital adequacy purposes. Banks shall be required to use the Standardised Approach to Credit Risk for capital adequacy purposes unless they have obtained approval from the Bank of Mauritius (Bank) to use an internal ratings-based approach.

This Guideline also sets out the methodology for determining the appropriate risk weight for an exposure secured by eligible collateral, guarantee and/or credit derivative.

### Authority

This Guideline is issued under the authority of Section 100 of the Banking Act 2004 and section 50 of the Bank of Mauritius Act 2004.

### Scope of application

This Guideline applies to all banks licensed under the Banking Act 2004.

### Effective date

The revised Guideline shall come into effect on 1 April 2022.

### Structure of the Guideline

The Guideline is divided into three parts:

**PART I** – TREATMENT OF ON-BALANCE SHEET EXPOSURES;

**PART II** – TREATMENT OF OFF-BALANCE SHEET EXPOSURES; and

**PART III** – TREATMENT OF CREDIT RISK MITIGATION TECHNIQUES.

## PART I – TREATMENT OF ON-BALANCE SHEET EXPOSURES

*This section sets out the methodology for calculating the risk-weighted amount of a bank's on-balance sheet exposures under the Standardised Approach to Credit Risk. The methodology applies to a bank's exposures in the banking book.*

*The risk weights are based on the credit assessments of external rating agencies and are determined according to the category of borrowers, namely sovereign, bank, corporate, and others, with each category of borrower having a specific risk weight structure.*

### Recognition of External Credit Assessment Institutions (ECAIs)

1. The ratings of S&P Global Ratings, Moody's Investors Service and Fitch Ratings shall be recognised for the purpose of allocating risk-weights to claims on counterparties and exposures. The ratings of other ECAIs may be recognised subject to the requirements of the *Guideline on the Recognition and Use of External Credit Assessment Institutions*.
2. **Table A1** and **Table A2** show the mapping of the long-term and short-term ratings of these agencies respectively to the external rating grades as envisaged by the Bank.

### Risk-weighted amount

3. A bank's total risk-weighted on-balance sheet credit exposures equal the sum of the risk-weighted amount of each on-balance sheet asset it holds.
4. The risk-weighted amount of an on-balance sheet asset is determined by multiplying its current book value (including accrued interest or revaluations, and net of any specific provision or associated depreciation) by the relevant risk weight specified in **Table A10**.
5. Where an on-balance sheet claim on a counterparty is secured against qualifying collateral, qualifying guarantee or credit derivative, a bank may use the credit risk mitigation techniques as detailed in **Part III** of this Guideline to reduce the risk-weighted amount of its credit exposure to a counterparty when calculating its capital requirements.

### Treatment of on-balance sheet assets by category of borrower

#### *Claims on sovereigns*

6. Claims on Government of Mauritius denominated and funded in Mauritian rupees shall be assigned a preferential risk weight of 0%<sup>1</sup>. Claims on other sovereigns denominated and funded in their local currency may be assigned a preferential risk weight as determined by the supervisory authority of the sovereign, subject to the prior written approval of the Bank. In the absence of prior written approval of the Bank, claims on other sovereigns in their local currency shall be assigned risk weights as specified in **Table A3**.

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<sup>1</sup> The preferential risk weight of 0% may be extended to the risk weighting of collateral and guarantees. Refer to **paragraphs 127 and 128**.



7. Claims on other sovereigns in currency other than their local currency, and claims on Government of Mauritius denominated in currency other than the Mauritian rupee shall be assigned risk weights as specified in **Table A3**.
8. Claims on the European Union, the European Stability Mechanism and the European Financial Stability Facility shall receive a 0% risk weight.<sup>2</sup>

*Recognition of Export Credit Agencies (ECAs)*

9. In cases where countries are not rated by eligible ECAs, banks may use the consensus risk scores of ECAs participating in the “Arrangement on Officially Supported Export Credits”, provided the ECAs publish their risk scores and subscribe to the OECD agreed methodology.
10. **Table A4** shows the ECA risk scores as established by the OECD agreed methodology and the corresponding risk weight categories.

*Claims on central banks (and international institutions)*

11. Claims on Bank of Mauritius denominated and funded in Mauritian rupees shall be assigned a preferential risk weight of 0%<sup>1</sup> above. Claims on other central banks denominated and funded in their local currency may be assigned a preferential risk weight as determined by the supervisory authority of the sovereign, subject to the prior written approval of the Bank. In the absence of prior written approval of the Bank, claims on other central banks denominated and funded in their local currency shall be assigned risk weights as specified in **Table A5**.
12. Claims on Bank of Mauritius denominated in currency other than the Mauritian rupee shall be risk-weighted at 0%.<sup>3</sup> Claims on other central banks in currency other than their local currency shall be risk-weighted based on the credit assessment of ECAs, and the rating of the sovereign of the central bank shall apply, according to the risk weight structure shown at **Table A5**.
13. Claims on the Bank for International Settlements (BIS), the International Monetary Fund (IMF) and the European Central Bank (ECB) shall receive a 0% risk weight.

*Claims on Multilateral Development Banks (MDBs)*

14. A risk weight of 0% shall be assigned to claims on highly rated MDBs<sup>4</sup> that fulfil the criteria set out by the Basel Committee on Banking Supervision (BCBS)<sup>5</sup>.

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<sup>2</sup> Inserted on 1 April 2022

<sup>3</sup> Effective as from 31 March 2020: *COVID-19 measures*

<sup>4</sup> (Amended on 1 April 2022) MDBs currently eligible for a 0% risk weight are: The World Bank Group comprising the International Bank for Reconstruction and Development (IBRD); the International Finance Corporation (IFC); the Multilateral Investment Guarantee Agency (MIGA); and the International Development Association (IDA), Asian Development Bank (ADB), African Development Bank (AfDB), European Bank for Reconstruction and Development (EBRD), Inter-American Development Bank (IADB), European Investment Bank (EIB), European Investment Fund (EIF), Nordic Investment Bank (NIB), Caribbean Development Bank (CDB), Islamic Development Bank (IDB), Council of Europe Development Bank (CEDB), International Finance Facility for Immunization and Asian Infrastructure Investment Bank (IFFI/IIIB).

<sup>5</sup> The eligibility criteria for MDBs risk-weighted at 0% is listed at **Table A9**.

15. Claims on other MDBs shall be attributed risk weights based on their external credit assessments as set out for claims on banks, without the possibility of using the preferential treatment for short-term claims. The risk weight structure shall be as specified in **Table A6**.

#### *Claims on banks*

16. Claims on banks shall be assigned risk weights based on the external credit assessments of the banks, with claims on unrated banks being risk-weighted at 50%, subject to the requirement at **paragraph 17**. The risk weight structure is shown at **Table A7**.
17. No claim on an unrated bank shall receive a risk weight lower than that applied to claims on its sovereign of incorporation.<sup>6</sup>
18. Banks shall be allowed to apply a preferential risk weight that is one category more favourable in respect of their short-term<sup>7</sup> foreign currency lending to banks licensed under the Banking Act 2004, subject to a floor of 20%. This treatment shall be available to both rated and unrated banks, but not to banks risk-weighted at 150%. Subsidiaries of foreign banks may, subject to the prior written approval of the Bank, apply a preferential risk-weight of 0% to intragroup bank balances, provided that:
- (a) the subsidiary demonstrates that it is managed as an integrated part of the banking group;
  - (b) the subsidiary establishes to the satisfaction of the Bank that its parent bank is subjected to consolidated supervision and to similar capital requirements as in Mauritius; and
  - (c) capital resources are freely transferable between the subsidiary and its parent bank.
19. Short-term claims<sup>7</sup> <sup>above</sup> denominated and funded in Mauritian rupees on banks licensed under the Banking Act 2004 shall be risk-weighted at 20%. This treatment shall be available to both rated and unrated banks, but not to banks risk-weighted at 150%.

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<sup>6</sup> (Effective December 2015) - This rule shall not apply to claims of the confirming bank on the issuing bank in the context of short-term self-liquidating letters of credit originating from low-income countries classified as such by the World Bank.

<sup>7</sup> Short-term claims are defined as having an original maturity of 3 months or less. Claims with (contractual) original maturity of less than 3 months, which are expected to be rolled over (i.e. where the effective maturity is longer than 3 months), shall not qualify for this preferential treatment.

## *Claims on non-central government public sector entities (PSEs)*

### *Domestic PSEs*

#### *Claims on domestic PSEs guaranteed by Government of Mauritius*

20. Claims on domestic PSEs, denominated and funded in Mauritian rupees, that are guaranteed by Government of Mauritius shall be assigned a risk weight of 0%, provided they meet the requirements of **paragraphs 117 and 118** of this Guideline.
21. Claims on domestic PSEs, denominated in currency other than Mauritian rupees and guaranteed by Government of Mauritius shall be assigned a risk weight similar to claims on sovereigns in currency other than their local currency, as specified in **Table A3**.

#### *Claims on domestic PSEs treated as claims on banks*

22. Claims on domestic PSEs<sup>8</sup> which are not guaranteed by Government of Mauritius shall be treated as claims on banks provided they satisfy the following essential criteria<sup>9</sup>:
  - (a) the PSE has specific revenue raising powers and specific institutional arrangements the effect of which is to reduce the risk of default;
  - (b) the PSE is operating in monopolistic market and providing essential services; and
  - (c) a declaration of bankruptcy is not possible due to its special public status, unless an Act of Parliament is passed for this purpose.
23. As part of the supervisory review process, the Bank would evaluate whether banks have applied the criteria consistently to assess the eligibility of PSEs.
24. Claims on domestic PSEs that are treated as claims on banks shall be risk-weighted as specified in **Table A6**.

### *Foreign PSEs*

#### *Claims on foreign PSEs treated as claims on sovereigns*

25. Claims on PSEs in other jurisdictions shall be treated as claims on sovereigns in whose jurisdictions they are established, provided the claims are guaranteed by the sovereign.

#### *Claims on foreign PSEs treated as claims on banks*

26. In the case where a foreign supervisor has issued a directive whereby claims on PSEs to which a locally incorporated bank has an exposure should be treated as a claim on banks, the Bank may consider the lower risk weight, upon representation by that bank.

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<sup>8</sup> Examples of eligible PSEs are: Central Electricity Board, Central Water Authority, Wastewater Management Authority, State Trading Corporation, Road Development Authority, Airports of Mauritius Ltd., Cargo Handling Corporation Ltd., Agricultural Marketing Board, Financial Services Commission and Mauritius Broadcasting Corporation.

<sup>9</sup> The Bank may set additional criteria, if necessary.

*Claims on PSEs treated as claims on corporates*

27. Claims on PSEs other than those defined under **paragraphs 20 to 26** shall be treated as claims on corporates. The applicable risk weights shall be as specified in **Table A8**.

*Claims on securities firms*

*Claims on securities firms treated as claims on banks*

28. Claims on securities firms<sup>10</sup> may be treated as claims on banks provided to these firms are subject to supervisory and regulatory arrangements comparable to those applicable under the new framework (including, in particular, risk-based capital requirements). These claims shall be risk-weighted as specified in **Table A6**.

*Claims on securities firms treated as claims on corporates*

29. Claims on securities firms that do not meet the above criteria shall be treated as claims on corporates. The applicable risk weights shall be as specified in **Table A8**.

*Claims on corporates*

30. Claims on corporates including claims on insurance companies shall be risk-weighted as specified in **Table A8**.
31. Claims on an unrated corporate shall not be given a risk weight preferential to that assigned to its sovereign of incorporation.
32. All claims on corporates may be risk-weighted at 100% without regard to external ratings, subject to the prior written approval of the Bank. As part of the supervisory review process, the Bank would consider whether the credit quality of unrated corporate claims should warrant a risk weight higher than 100%.

*Claims included in the regulatory retail portfolio*

33. Claims included in the regulatory retail portfolio shall be assigned a risk weight of 75%, except as set out in **paragraph 45** for past due loans, provided they meet the following criteria:
- (a) **orientation criterion** - the exposure is to an individual person or persons or to a small business.
  - (b) **product criterion** - the exposure takes the form of any of the following<sup>11</sup>: revolving credits and lines of credit (including credit cards and overdrafts), personal term loans and leases and small business facilities and commitments.

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<sup>10</sup> A securities firm is an institution which engages in some or all of the activities of brokers, dealers, market makers, researchers and traders.

<sup>11</sup> Mortgage loans are excluded to the extent that they qualify for treatment as claims secured by residential property. Securities (such as bonds and equities) whether listed or not, are specifically excluded from this category.

- (c) **granularity criterion** - the regulatory retail portfolio should be sufficiently diversified to a degree that reduces the risks in the portfolio, warranting the 75% risk weight. One way of achieving this is that no aggregate exposure to one counterpart<sup>12</sup> must exceed 0.2% of the overall regulatory retail portfolio.
  - (d) **low value of individual exposures** - the maximum aggregated retail exposure to one counterpart and connected counterparties<sup>13</sup> must not exceed an absolute threshold of Rs20 million.<sup>14</sup>
34. The Bank would evaluate at periodic intervals the risk weight assigned to the regulatory retail portfolio with reference to the default experience for these exposures. As part of the supervisory review process, the Bank would consider whether the credit quality of regulatory retail claims held by individual banks should warrant a risk weight higher than 75%.

#### *Claims secured by residential property*

35. **Claims secured by residential property for purchase/construction in Mauritius [excluding loans granted under the Property Development Scheme (PDS) – comprising the Integrated Resort Scheme (IRS) and the Real Estate Scheme (RES)], except as set out in paragraph 46 for past due loans, shall be risk-weighted as follows:**<sup>15</sup>

- i. 35% risk weight for the portion of loans up to Rs10 million;
- ii. 75% risk weight for the portion of loans greater than Rs10 million up to Rs20 million;
- iii. 100% risk weight for the portion of loans exceeding Rs20 million,

subject to the following requirements:

- (a) lending must be fully secured by mortgages on residential property;
- (b) the residential property must be occupied by the borrower or rented by the borrower to a third party;
- (c) the residential property must be valued according to strict valuation rules<sup>16</sup>;
- (d) the bank must be satisfied that the risk of the borrower is not dependent solely on the performance of the underlying property serving as collateral but rather on the capacity of the borrower to repay the debt from other sources;

<sup>12</sup> Aggregate exposure means gross amount (i.e. not taking any credit risk mitigation into account) of all forms of debt exposures (e.g. loans or commitments) that individually satisfy the three other criteria. In addition, 'to one counterpart' means one or several entities that may be considered as a single beneficiary (e.g. in the case of a small business that is affiliated to another small business, the limit would apply to the bank's aggregate exposure on both businesses).

<sup>13</sup> (Amended on 1 April 2022) 'Connected counterparties' means persons who are regarded as constituting a single risk because they are so interconnected that, if one of them, were to experience financial problems, the other or all of the others would be likely to encounter repayment difficulties.

<sup>14</sup> Effective as from 31 March 2020: *COVID-19 measures*

<sup>15</sup> Effective as from 31 March 2020: *COVID-19 measures*

<sup>16</sup> The valuation should be carried out by a person who possesses the necessary qualifications, ability and experience and who is independent from the credit decision process.

- (e) the value of the property must be monitored on an on-going basis, and the bank must revalue any property offered as security for such loans when there is sufficient indication of a material change in the market value of property; in the case of past due loans, the valuation of property should be carried out every two years or at such lesser intervals as may be warranted<sup>17</sup>; and
  - (f) the property must be adequately insured.
- 36. Claims secured by residential property for purchase/construction in Mauritius under the PDS (comprising IRS/RES), except as set out in paragraph 46 for past due loans, that meet all the criteria in paragraph 35(a)-(f) shall be risk-weighted as follows:<sup>18</sup>**
- i. 35% risk weight for the portion of loans up Rs5 million;
  - ii. 100% risk weight for the portion of loans greater than Rs5 million up to Rs12 million;
  - iii. 125% risk weight for the portion of loans exceeding Rs12 million.
- 37. Claims secured by residential property for purchase/construction in Mauritius that do not satisfy all the criteria in paragraph 35(a)-(f) shall be risk-weighted at 125%, except as set out in paragraph 46 for past due loans.**
- 38. Claims secured by residential property for purposes other than purchase/construction in Mauritius, up to Rs10 million<sup>19</sup>, shall be risk-weighted at 35%, except as set out in paragraph 49 for past due loans, subject to the following requirements:**
- (a) lending must be fully secured by mortgages on residential property;
  - (b) the loan-to-value (LTV) ratio<sup>20</sup> must not exceed 80%;
  - (c) the mortgage must be enforceable in all jurisdictions which are relevant at the time of conclusion of the credit agreement and the mortgage must be properly filed on a timely basis;
  - (d) the residential property must be occupied by the borrower or rented by the borrower to a third party;
  - (e) the residential property must be valued according to strict valuation rules<sup>16 above</sup>;
  - (f) the bank must be satisfied that the risk of the borrower is not dependent solely on the performance of the underlying property serving as collateral but rather on the capacity of the borrower to repay the debt from other sources;

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<sup>17</sup> Amended in October 2016

<sup>18</sup> Inserted on 1 April 2022 (*Ref: COVID-19 measures 31.03.2020*)

<sup>19</sup> Effective as from 31 March 2020: *COVID-19 measures*

<sup>20</sup> The LTV ratio is defined as follows: (Outstanding principal amount of the residential mortgage loan + senior mortgages and liens)/ (Appraised value of the residential property).

(g) the value of the property must be monitored on an on-going basis, and the bank must revalue any property offered as security for such loans when there is sufficient indication of a material change in the market value of property; in the case of past due loans, the valuation of property should be carried out every two years or at such lesser intervals as may be warranted<sup>17</sup> above; and

(h) the property must be adequately insured.

39. The portion of claims secured by residential property for purposes other than purchase/construction in Mauritius in excess of the 80% LTV ratio and/or that does not satisfy all the criteria at **paragraphs 35, 36, 37 and 38** shall be risk-weighted at 75%.
40. Claims secured by residential property for purposes other than purchase/construction in Mauritius, above Rs10 million and up to Rs20 million<sup>21</sup>, shall be risk-weighted at 75%.
41. All other claims secured by residential property for purposes other than purchase/construction in Mauritius shall be risk-weighted at 100%.
42. The Bank would evaluate at periodic intervals the risk weights assigned to claims secured by residential property with reference to the default experience for these exposures, and the evolution of the property market. As part of the supervisory review process, the Bank would consider whether the credit quality of such claims held by individual banks should warrant risk weights higher than prescribed hereunder.

#### *Claims secured by commercial real estate*

43. Claims secured by commercial real estate<sup>22</sup> for purchase/construction in Mauritius, except as set out in **paragraph 47** for past due loans, shall be risk-weighted as follows:
- (a) 100% risk weight for loans up to Rs75 million;
- (b) 125% risk weight for loans exceeding Rs75 million.
44. Claims secured by commercial real estate<sup>22</sup> for purposes other than purchase/construction in Mauritius, except as set out in **paragraph 45** for past due loans, shall be risk-weighted at 100%.

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<sup>21</sup> Effective as from 31 March 2020: *COVID-19 measures*

<sup>22</sup> Includes loans extended for financing the buying and selling of residential properties with a view to making a profit in the transaction or for property development purposes.

### *Past due claims*

- 45.** The unsecured portion of any loan (other than loans secured by residential property for purchase/construction in Mauritius as set out in **paragraph 46**, loans secured by residential property for purposes other than for purchase/construction in Mauritius as set out in **paragraph 49** and loans secured by commercial real estate for purchase/construction in Mauritius as set out in **paragraph 47**) that is past due for more than 90 days, net of specific provisions (including partial write-offs), shall be risk-weighted as follows:
- (a) 150% risk weight when specific provisions are less than 20% of the outstanding amount of the loan;
  - (b) 100% risk weight when specific provisions are no less than 20% of the outstanding amount of the loan;
  - (c) 50% risk weight when specific provisions are no less than 50% of the outstanding amount of the loan.
- 46.** In the case of loans secured by residential property for purchase/construction in Mauritius, when such loans are past due for more than 90 days, these loans (net of specific provisions) shall be risk-weighted as follows:
- (a) 100% risk weight for loans up to Rs5 million;
  - (b) 125% risk weight for loans greater than Rs5 million up to Rs12 million;
  - (c) 150% risk weight for loans exceeding Rs12 million.
- 47.** In the case of loans secured by commercial real estate for purchase/construction in Mauritius, when such loans are past due for more than 90 days, these loans (net of specific provisions) shall be risk-weighted as follows:
- (a) 125% risk weight for loans up to Rs75 million;
  - (b) 150% risk weight for loans exceeding Rs75 million.
- 48.** For the purpose of defining the secured portion of the past due loan, eligible collateral and guarantees<sup>23</sup> shall be the same as for credit risk mitigation purposes. Past due retail loans shall be excluded from the regulatory retail portfolio when assessing the granularity criterion specified in **paragraph 33** for risk-weighting purposes.
- 49.** In the case of loans secured by residential property, other than purchase/construction in Mauritius, when such loans are past due for more than 90 days they shall be risk-weighted at 100%, net of specific provisions. If such loans are past due but specific provisions are no less than 20% of their outstanding amount, the risk weight applicable to the remainder of the loan shall be reduced to 50%.

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<sup>23</sup> The list of eligible collaterals and guarantees is provided **Part III** of this Guideline.



***Other assets***

- 50.** The standard risk weight for all other assets shall be 100%, except for cash items in the process of collection, which shall be risk-weighted at 20%.
- 51.** Investment in equity or regulatory capital instruments issued by banks or securities firms shall be risk-weighted at 100%, unless deducted from the capital base of the bank.

## PART II – TREATMENT OF OFF-BALANCE SHEET EXPOSURES

*This section sets out the procedures and requirements for calculating the risk-weighted amounts of a bank's off-balance sheet credit exposures under the standardised approach. The process covers all off-balance sheet business including both market-related transactions held in the banking and trading books, and non-market-related transactions.*

### **Risk-weighted amount**

- 52.** A bank's total risk-weighted off-balance sheet credit exposure is calculated as the sum of the risk-weighted amounts of all its market-related and non-market related transactions.
- 53.** A two-step approach is used in order to derive the risk-weighted amounts of off-balance sheet items as follows:
- (a) the nominal principal amounts of off-balance sheet items are multiplied by the credit conversion factors (CCFs); and
  - (b) the resulting credit equivalent amounts are multiplied by the risk weights applicable to the counterparty.
- 54.** Where the transaction is secured by eligible collateral, guarantee or credit derivative, the credit risk mitigation techniques detailed in **Part III** of this Guideline shall be used to reduce the regulatory capital charge of the exposure.

### **Non-market-related off-balance sheet transactions**

- 55.** The non-market-related off-balance sheet transactions should be broadly classified into the following categories:
- (a) direct credit substitutes;
  - (b) trade- and performance-related contingent items; and
  - (c) other commitments.
- 56.** The credit equivalent amount in relation to a non-market-related off-balance sheet transaction shall be determined by multiplying the contracted amount of that particular transaction by the relevant CCF specified in **Table B1**.
- 57.** Where the non-market-related off-balance sheet transaction is an undrawn or partially undrawn facility, the amount of undrawn commitment to be included in calculating a bank's off-balance sheet non-market-related credit exposures shall be the maximum unused portion of the commitment that could be drawn during the remaining period to maturity. Any drawn portion of a commitment shall form part of a bank's on-balance sheet credit exposures.

58. Where there is an undertaking to provide a commitment on an off-balance sheet item, the CCF applicable to the commitment shall be the lower<sup>24</sup> of:
- (a) the CCF applicable to the commitment based on its original maturity and whether it can be cancelled at any time unconditionally; or
  - (b) the CCF applicable to the off-balance sheet exposure arising from the drawdown of the commitment.
59. With regard to irrevocable commitments to provide off-balance sheet facilities, the maturity of commitments shall be determined as specified in **Table B2**.

### ***Sale and repurchase agreements***

60. Loans or other assets sold under a sale and repurchase agreement (repo)<sup>25</sup> shall continue to be reported on the balance sheet, and the repo shall be reported as an off-balance sheet item.
61. The bank that has purchased instruments such as reverse repos shall for the duration of the agreement, report the transaction as a collateralised loan.

### ***Other commitments***

62. Other commitments include the undrawn portion of any binding arrangement that obligates a bank to provide funds at some future date. These should be classified according to:
- (a) an original maturity of up to one year;
  - (b) an original maturity of over one year; and
  - (c) whether they can be unconditionally cancelled at any time.
63. A commitment is regarded as being created on the date the customer accepts the facility in writing regardless of whether the commitment is revocable or irrevocable, conditional or unconditional, and in particular whether or not the facility contains a 'material adverse change' clause.
64. If a commitment is in the form of a general banking facility, consisting of two or more credit lines (including lines for entering into OTC derivative/credit derivative contracts), the bank shall assign a CCF to the commitment based on its original maturity and whether it can be unconditionally cancelled at any time.

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<sup>24</sup> For example, an irrevocable commitment with an original maturity of 15 months (50% - CCF) to issue a 6-month documentary letter of credit (20% - CCF) would attract the lower of the CCF i.e. the CCF applicable to the documentary letter of credit - 20% CCF.

<sup>25</sup> A sale and repurchase agreement (repo) is an arrangement whereby a bank sells an instrument to a third party with a commitment to repurchase the asset for an agreed price on demand, or after a stated time, or in the event of a particular contingency. It represents an irrevocable commitment and should be reported as an off-balance sheet item.

65. Rolling or undated/open-ended commitments (e.g. overdrafts or unused credit card lines) shall be included under **paragraph 62(c)** provided they are unconditionally cancellable at any time without notice - other than where the only reason for cancellation is '*force majeure*' - and subject to credit review at least annually. Other rolling or undated commitments shall be reported under either **paragraph 62(a) or 62(b)**.

#### **Market-related off-balance sheet transactions**

66. In calculating a bank's risk-weighted off-balance sheet credit exposures arising from market-related transactions for capital adequacy purposes, the bank shall include all its market-related transactions held in the banking and trading books which give rise to off-balance sheet credit risk<sup>26</sup>.
67. Market-related transactions include the following:
- (a) **interest rate contracts** - these include single currency interest rate swaps, basis swaps, forward rate agreements, interest rate futures, interest rate options purchased and any other instruments of a similar nature;
  - (b) **foreign exchange contracts<sup>27</sup> (including contracts involving gold)** - these include cross currency swaps (including cross currency interest rate swaps), forward foreign exchange contracts, currency futures, currency options purchased, hedge contracts and any other instruments of a similar nature;
  - (c) **equity contracts** - these include swaps, forwards, purchased options and similar derivative contracts based on individual equities or equity indices;
  - (d) **precious metal contracts (other than gold)** - these include swaps, forwards, purchased options and similar derivative contracts based on precious metals such as silver, platinum and palladium;
  - (e) **other commodity contracts (other than precious metals)** - these include swaps, forwards, purchased options and similar derivative contracts based on energy contracts, agricultural contracts, base metals (such as aluminium, copper and zinc) and any other non-precious metal commodity contracts; and
  - (f) **other market-related contracts** - these include any contracts covering other items giving rise to credit risk.
68. A bank may, for capital adequacy purposes, net off-balance sheet claims and obligations arising from market-related contracts with a single counterparty across both the banking and trading books, where the relevant obligations are covered by eligible bilateral netting agreements.

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<sup>26</sup> The credit risk on off-balance sheet market-related transactions is the cost to a bank of replacing the cash flow specified by the contract in the event of counterparty default. This will depend, among other things, on the maturity of the contract and on the volatility of rates underlying that type of instrument.

<sup>27</sup> Foreign exchange rate contracts with an original maturity of 14 calendar days or less may be excluded from market-related transactions for capital adequacy purposes.

69. The credit equivalent amounts of off-balance sheet market-related transactions, whether held in the banking or trading book, must be determined as follows:
- (a) in the case of foreign exchange rate and interest rate related contracts:
    - (i) by the *Original Exposure Method*, for banks with a small volume of business i.e. business representing less than 5% of total on-balance sheet assets in the trading book, in such contracts; or
    - (ii) by the *Current Exposure Method* (or *Replacement Cost Method*), in the case of banks which actively trade these contracts or where such contracts form a significant part of their treasury operations;
  - (b) in all other cases, by the *Current Exposure Method*.

#### ***Original Exposure Method***

70. The credit equivalent amount of an off-balance sheet market-related contract shall be determined by multiplying the notional principal amount of the contract by the appropriate CCF according to the nature of the contract and its maturity, as specified in **Table B3**.

#### ***Current Exposure (or Replacement Cost) Method***

71. The credit equivalent amount of exchange rate and interest rate contracts under this method, shall be the sum of:
- (a) current exposure, which is the total replacement cost (obtained by marking-to-market) of all its contracts with positive value; and
  - (b) potential exposure, which is derived by applying the CCF, according to residual maturity, to the principal amount or face value of the contracts, as specified in **Table B4**.
72. No potential exposure shall be calculated for single currency floating/floating interest rate swaps; the credit equivalent amount of these contracts shall be evaluated solely on the basis of their current exposures, i.e. replacement cost.
73. Once the credit equivalent amount for an exchange rate or interest rate contract has been determined using either of the methods, that amount shall then be weighted according to the risk weight of the counterparty, or if relevant, that of the guarantor or the collateral.

## **PART III – TREATMENT OF CREDIT RISK MITIGATION TECHNIQUES**

*Banks use a number of techniques to mitigate the credit risks to which they are exposed, e.g. exposures may be collateralised by first priority claims, in whole or in part with cash or securities, a loan exposure may be guaranteed by a third party, or a bank may buy a credit derivative to offset various forms of credit risk. Additionally, banks may agree to net loans owed to them against deposits from the same counterparty.*

*The use of credit risk mitigation (CRM) techniques reduces or transfers credit risks but it may simultaneously increase other risks (residual risks). Banks should employ robust procedures and processes to control these risks. When these risks are not adequately controlled, the Bank may impose additional capital charges or take other supervisory actions. The Pillar 3 requirements must also be observed for banks to obtain capital relief in respect of any CRM technique.*

*This section sets out the principles for the recognition of CRM techniques that a bank may use under the Standardised Approach to Credit Risk for the purpose of calculating its capital requirements.*

### **CRM approaches**

- 74.** A bank shall select one of the following approaches and apply that approach to all its on- and off-balance sheet banking book exposures that are subject to credit risk mitigation:
- (a) the simple approach, or
  - (b) the comprehensive approach to credit risk mitigation.
- 75.** A bank shall advise the Bank which of these CRM approaches it has chosen to use for its banking book exposures.
- 76.** A bank shall use the comprehensive approach to credit risk mitigation to calculate the counterparty risk charges for over-the-counter (OTC) derivatives and repo-style transactions booked in the trading book.
- 77.** Partial collateralisation shall be recognised under both approaches. Mismatches in the maturity of the underlying exposure and the collateral shall only be allowed under the comprehensive approach.
- 78.** The CRM techniques covered in this section are as follows:
- (a) collateralised financial transactions;
  - (b) financial guarantees;
  - (c) credit derivatives; and
  - (d) on-balance sheet netting.

## **Treatment of collateral**

- 79.** Under the simple approach, where a claim on a counterparty is secured against eligible collateral<sup>28</sup>, the secured portion of the claim shall be weighted according to the risk weight appropriate to the collateral. The unsecured portion of the claim shall be weighted according to the risk weight applicable to the original counterparty.
- 80.** The comprehensive approach incorporates a system of haircuts or discounts that are applied to the value of the pledged collateral<sup>29</sup> and to the value of a bank's exposure in order to reduce risks<sup>30</sup> associated with the use of collateral. The process is detailed at **paragraphs 90 to 99**.
- 81.** A capital requirement shall be applied to a bank on both sides of a collateralised transaction, e.g. both repo and reverse repo agreements shall be subject to capital requirements.

## **Treatment of guarantees**

- 82.** Under both approaches, where a claim on a counterparty is secured by a guarantee from an eligible guarantor<sup>31</sup>, the portion of the claim that is supported by the guarantee, shall be weighted according to the risk weight of the guarantor (unless the risk weight of the original counterparty is lower). The unsecured portion of the claim shall be weighted according to the risk weight applicable to the original counterparty.

## **Treatment of pools of credit risk mitigation techniques**

- 83.** Where a bank has multiple CRM techniques covering a single exposure (e.g. where both eligible collateral and guarantee partially cover an exposure), the bank shall be required to subdivide the exposure into portions covered by each type of CRM technique. The risk-weighted assets of each portion of the claim shall be calculated separately. Where credit protection provided by a single guarantor has different maturities, these shall also be divided into separate portions.

## **Minimum requirements for recognition of CRM techniques**

- 84.** In order for a bank to obtain capital relief for use of any CRM technique, the following conditions shall be met under both the simple and comprehensive approaches:
- (a) All documentation used in collateralised transactions and for documenting on-balance sheet netting and guarantees must be binding on all parties and legally enforceable in all relevant jurisdictions. A bank must have undertaken sufficient legal review to be satisfied with the legal enforceability of the documentation and shall be expected to undertake periodic reviews to ensure ongoing enforceability;

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<sup>28</sup> The list of eligible collateral under the simple approach is at **Table C1**.

<sup>29</sup> The collateral instruments that are eligible for recognition under the comprehensive approach are at **Table C2**.

<sup>30</sup> The two main risks associated with the use of collateral are: (i) the value of the collateral and of the underlying exposure may fluctuate over time; and (ii) the bank may not be able to effectively seize and liquidate the collateral in a timely manner.

<sup>31</sup> The range of eligible guarantors /protection providers is at **Table C3**.

- (b) The legal mechanism by which collateral is pledged or transferred must ensure that the bank has the right to liquidate or take legal possession of it, in a timely manner, in the event of the default, insolvency or bankruptcy<sup>32</sup> of the counterparty (and, where applicable, of the custodian holding the collateral). A bank shall take all steps necessary to fulfill requirements under the law applicable to the bank's interest in the collateral for obtaining and maintaining an enforceable security interest, i.e. by registering, or for exercising a right to net or set off in relation to title transfer collateral;
- (c) The credit quality of the counterparty and the value of the collateral must not have a material positive correlation, e.g. securities issued by the counterparty of the credit exposure (or by any person or entity related or associated with the counterparty) would provide little protection and would therefore not be eligible collateral;
- (d) Banks must have clear and robust procedures for the timely liquidation of collateral to ensure that any legal conditions required for declaring the default of the counterparty and liquidating the collateral are observed and that the collateral can be liquidated promptly;
- (e) With the exception of cash collateral, collateral must be held by an independent custodian, or an equally independent third party, or by the bank. Where the collateral is held by an independent custodian or an equally independent third party, the bank must take reasonable steps to ensure that the custodian segregates the collateral from its own assets. Deposits held with banks other than the lending bank shall be recognised as eligible collateral if they are openly pledged or assigned to the lending bank and such pledge or assignment is legally effective and enforceable in all relevant jurisdictions;
- (f) Where a bank, acting as an agent, arranges a repo-style transaction (i.e. repurchase/reverse repurchase and securities lending/borrowing transactions) between a customer and a third party and provides a guarantee to the customer that the third party will perform on its obligations, then the risk to the bank is the same as if the bank had entered into the transaction as a principal. In such circumstances, a bank shall be required to calculate capital requirements as if it were itself the principal.

### **The simple approach**

**85.** For collateral to be recognised under the simple approach, it must be

- (a) pledged for at least the life of the exposure;
- (b) marked to market; and
- (c) revalued every six months at a minimum.

**86.** The portion of claims collateralised by the market value of eligible collateral shall receive the risk weight attributable to the collateral, subject to a floor of 20% except under the conditions specified in **paragraph 87**. The remainder of the claim shall be assigned the risk weight appropriate to the counterparty.

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<sup>32</sup> Other relevant credit events permitting enforcement may also be set out in the transaction documentation.



### ***Exceptions to the 20% risk-weight floor***

87. A risk weight of 0% may be assigned to collateralised transactions where the exposure and the collateral are denominated in the same currency, and either:
- (a) the collateral is cash on deposit; or
  - (b) the collateral is in the form of sovereign securities and central bank's securities eligible for a risk weight of 0% and the market value of the collateral has been discounted by 20%.
88. OTC derivative transactions subject to daily mark-to-market, collateralised by cash and where there is no currency mismatch shall receive a risk weight of 0%. Such transactions collateralised by sovereign securities qualifying for a risk weight of 0% in the standardised approach shall receive a risk weight of 10%.
89. Repo and reverse repo transactions that are carried out with a core market participant and satisfy the criteria outlined in **paragraph 111** shall receive a risk weight of 0%. If the counterparty to the transaction is not a core market participant and satisfies the criteria in **paragraph 111**, the transaction shall receive a risk weight of 10%.

### **The comprehensive approach**

90. Under this approach, a bank calculates an adjusted exposure amount after risk mitigation for a collateralised transaction by applying haircuts to both the collateral and the exposure to take into account possible price fluctuations. This will produce volatility-adjusted amounts for both exposure and collateral. Adjusted exposure amount after risk mitigation shall be weighted according to the risk weight of the counterparty to obtain the risk-weighted amount for the collateralised transaction.
91. Where the exposure and the collateral are held in different currencies, an additional downward adjustment shall be made to the volatility-adjusted collateral amount to take account of possible future fluctuations in exchange rates. The framework for calculating the exposure amount after risk mitigation is set out in **paragraphs 96 to 99**.

### ***Standard supervisory haircuts/Own-estimate haircuts***

92. A bank shall be able to use standard supervisory haircuts or, with the prior written approval of the Bank, its own-estimate haircuts based on its internal estimates for market price volatility and foreign exchange volatility, subject to the quantitative and qualitative criteria set out in **paragraphs 104 and 105** being fulfilled.
93. The standard supervisory haircuts shall apply to the security (Hc) with reference to the rating of the issuer and to the exposure (He) with reference to the rating of the counterparty.
94. The standard supervisory haircuts (assuming daily mark-to-market, daily remargining and a 10-business day holding period), expressed as percentages are provided at **Table C4**.
95. Where the use of own estimates haircuts is allowed, the estimates shall be required to cover the full range of instruments types used by the bank with the exception of immaterial portfolios where standard supervisory haircuts may be used.

### *Calculation of capital requirements*

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

$$E^* = \max \{0, [E \times (1 + H_e) - C \times (1 - H_c - H_{fx})]\}$$

where:

$E^*$	=	the exposure value after risk mitigation
$E$	=	the current value of the exposure
$H_e$	=	haircut appropriate to the exposure
$C$	=	the current value of the collateral received
$H_c$	=	haircut appropriate to the collateral
$H_{fx}$	=	haircut appropriate for currency mismatch between the collateral and exposure

- 97.** The exposure amount after risk mitigation shall be multiplied by the risk weight of the counterparty to obtain the risk-weighted asset amount for the collateralised transaction.
- 98.** In the case of OTC derivatives,  $E \times (1+H_e)$  is replaced by the credit equivalent amount of the OTC derivative calculated using the current exposure (mark-to-market) method<sup>33</sup>, i.e. replacement cost and the potential future exposure.
- 99.** Where the collateral is a basket of assets, the haircut on the basket shall be:

$$H = \sum_i a_i H_i$$

where

$a_i$  is the weight of the asset in the basket (as measured by units of currency) and  $H_i$  is the haircut applicable to that asset.

### *Own-estimate haircut categories*

- 100.** For debt securities having a credit assessment from an eligible ECAI equivalent to below investment grade and for equities that are eligible under this Guideline, the haircuts shall be calculated for each individual security.
- 101.** For debt securities having a credit assessment from an eligible ECAI equivalent to investment grade or better, a bank may calculate a volatility estimate for each category of security. In determining relevant categories, the bank shall take into account the type of issuer of the security, its rating, its residual maturity and its modified duration. Volatility estimates must be representative of the securities actually included in the category for that bank.
- 102.** A bank shall estimate individually the volatility of the collateral instrument or any foreign exchange mismatch without taking into account the correlations between unsecured exposure, collateral and exchange rates.
- 103.** A bank that calculates its own estimates for haircuts shall be required to follow the principles for maturity mismatch set out in **paragraphs 131 to 135**.

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<sup>33</sup> Refer to **Table B4** for further details.

### *Quantitative criteria*

**104.** The Bank shall not prescribe the type of model that a bank may use to estimate its own haircuts. As a minimum, the model must capture the material risks and satisfy the following quantitative criteria:

- (a) a 99<sup>th</sup> percentile, one-tailed confidence interval must be used;
- (b) the minimum holding period must be dependent on the type of transaction and the frequency of remargining or marking-to-market. The minimum holding periods for different types of transactions are detailed in **Table C5**. A bank may use haircut numbers calculated according to shorter holding periods, scaled up to the appropriate holding period by the square root of time formula, as defined in **paragraph 108**;
- (c) a bank must take into account the illiquidity of lower-quality assets. The holding period must be adjusted upwards in cases where such a holding period would be inappropriate given the liquidity of the collateral. It must also identify where historical data may understate potential volatility, e.g. a pegged currency. Such cases must be dealt with by subjecting the data to stress testing;
- (d) a bank must use a minimum of one year of historical observations (sample period) for calculating haircuts. For a bank that uses a weighting scheme or other methods for the historical observation period, the “effective” observation period must be at least one year (i.e. the weighted average time lag of the individual observations should not be less than 6 months); and
- (e) a bank must update its data sets at least once every 3 months and must also reassess them whenever market prices are subject to material changes. Accordingly, haircuts must be computed at least every three months. The Bank may also require a bank to calculate its haircuts using a shorter observation period if this is justified by a significant upsurge in price volatility.

### *Qualitative criteria*

**105.** In addition to the quantitative criteria above, a bank is required to satisfy the following qualitative criteria in order to obtain approval to use its own estimates for haircuts:

- (a) the estimated volatility data (and holding period) must be used in the day-to-day risk management process of the bank;
- (b) a bank must have robust processes in place for ensuring compliance with a documented set of internal policies, controls and procedures concerning the operation of the risk measurement system;
- (c) the risk measurement system must be used in conjunction with internal exposure limits; and
- (d) an independent review of the risk measurement system must be carried out regularly in the bank’s own internal auditing process. A review of the overall risk management process must take place at regular intervals (ideally not less than once a year) and must specifically address, at a minimum:

- (i) the integration of risk measures into daily risk management;
- (ii) the validation of any significant change in the risk measurement process;
- (iii) the accuracy and completeness of position data;
- (iv) the verification of consistency, timeliness and reliability of data sources used to run internal models, including the independence of such data sources; and
- (v) the accuracy and appropriateness of volatility assumptions.

***Adjustments for different holding periods and non-daily mark-to-market or remargining***

**106.** For some transactions, depending on the nature and frequency of the revaluation and remargining provisions, different holding periods are appropriate. The framework for collateral haircuts distinguishes between repo-style transactions, “other capital-market-driven transactions” (i.e. OTC derivatives transactions and margin lending) and secured lending.<sup>34</sup>

**107.** The minimum holding periods for various products are summarised in **Table C5**.

**108.** When the frequency of remargining or revaluation is longer than the minimum, the minimum haircut numbers must be scaled up depending on the actual number of business days between remargining or revaluation using the square root of time formula below:

$$H = H_M \sqrt{\frac{N_R + (T_M - 1)}{T_M}}$$

where

H = haircut

H<sub>M</sub> = haircut under the minimum holding period

T<sub>M</sub> = minimum holding period for the type of transaction

N<sub>R</sub> = actual number of business days between remargining for capital market transactions or revaluation for secured transactions.

**109.** When a bank calculates the volatility on a holding period (T<sub>N</sub> days) which is different from the specified minimum holding period (T<sub>M</sub>), the haircut under minimum holding period (H<sub>M</sub>) shall be calculated using the square root of time formula:

$$H_M = H_N \sqrt{\frac{T_M}{T_N}}$$

where:

T<sub>N</sub> = holding period used by the bank for deriving H<sub>N</sub>

H<sub>N</sub> = haircut based on the holding period T<sub>N</sub>

<sup>34</sup> In capital-market-driven transactions and repo-style transactions, the documentation contains remargining clauses; in secured lending transactions, it generally does not.

**110.** For a bank using the standard supervisory haircuts, the 10-business day haircuts specified in **paragraph 94** shall be the basis. The haircuts shall be scaled up or down depending on the type of transaction and the frequency of remargining or revaluation using the formula below:

$$H = \frac{H_{10} \sqrt{\{N_R + (T_M - 1)\}}}{\sqrt{10}}$$

where

H = haircut

H<sub>10</sub> = 10-business day standard supervisory haircut for instrument

N<sub>R</sub> = actual number of business days between remargining for capital market transactions or revaluation for secured transactions

T<sub>M</sub> = minimum holding period for the type of transaction

### ***Conditions for zero haircut***

**111.** A zero haircut may be applied to repo-style transactions where the counterparty is a core market participant<sup>35</sup> and the following conditions are satisfied:

- (a) both the exposure and the collateral are cash or a sovereign security or PSE security qualifying for a 0% risk weight in the standardised approach;
- (b) both the exposure and the collateral are denominated in the same currency;
- (c) either the transaction is overnight or both the exposure and the collateral are marked-to-market daily and are subject to daily remargining;
- (d) following a counterparty's failure to remargin, the time that is required between the last mark-to-market before the failure to remargin and the liquidation of the collateral is considered to be no more than 4 business days;
- (e) the transaction is settled across a settlement system proven for that type of transaction;
- (f) the documentation covering the agreement is standard market documentation for repo-style transactions in the securities concerned;
- (g) the transaction is governed by documentation specifying that if the counterparty fails to satisfy an obligation to deliver cash or securities or to deliver margin or otherwise defaults, then the transaction is immediately terminable; and
- (h) upon any default event, regardless of whether the counterparty is insolvent or bankrupt, the bank has the unfettered, legally enforceable right to immediately seize and liquidate the collateral for its benefit.

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<sup>35</sup> For the purpose of applying a zero haircut, the following entities are considered as core market participants: Government of Mauritius, Bank of Mauritius and banks.

*Treatment of repo-style transactions covered under master netting agreements*

- 112.** For certain types of repo-style transactions, where the conditions defined in **paragraph 111** are satisfied and the counterparty is a core market participant, banks may not apply standard supervisory haircuts or own-estimate haircuts in calculating the exposure amount after risk mitigation. The effects of master netting agreements covering repo-style transactions may be recognised for the calculation of capital requirements subject to the conditions in **paragraph 113**.
- 113.** The effects of bilateral netting agreements covering repo-style transactions shall be recognised on a counterparty-by-counterparty basis if the agreements are legally enforceable in each relevant jurisdiction upon the occurrence of an event of default and regardless of whether the counterparty is insolvent or bankrupt. In addition, netting agreements must:
- (a) provide the non-defaulting party the right to terminate and close-out in a timely manner all transactions under the agreement upon an event of default, including in the event of insolvency or bankruptcy of the counterparty;
  - (b) provide for the netting of gains and losses on transactions (including the value of any collateral) terminated and closed out under it so that a single net amount is owed by one party to the other;
  - (c) allow for the prompt liquidation or set-off of collateral upon the event of default; and
  - (d) be, together with the rights arising from the provisions required in (a) to (c) above, legally enforceable in each relevant jurisdiction upon the occurrence of an event of default and regardless of the counterparty's insolvency or bankruptcy.
- 114.** Netting across positions in the banking and trading books shall only be recognised when the netted transactions fulfil the following conditions:
- (a) all transactions are marked to market daily; and
  - (b) the collateral instruments used in the transactions are recognised as eligible financial collateral in the banking book.

**115.** For a bank using the standard supervisory haircuts or own-estimate haircuts, the framework below shall apply to take into account the impact of master netting agreements<sup>36</sup>:

$$E^* = \max \{0, [(\sum (E) - \sum (C)) + \sum (E_s \times H_s) + \sum (E_{fx} \times H_{fx})]\}$$

where:

$E^*$  = the exposure value after risk mitigation

$E$  = current value of the exposure

$C$  = the value of the collateral received

$E_s$  = absolute value of the net position in a given security

$H_s$  = haircut appropriate to  $E_s$

$E_{fx}$  = absolute value of the net position in a currency different  
from the settlement currency

$H_{fx}$  = haircut appropriate for currency mismatch

### ***On-balance sheet netting***

**116.** A bank may use the net exposure of loans and deposits<sup>37</sup> as the basis for calculating its capital adequacy ratio, in accordance with the formula in **paragraph 96**, subject to the following conditions:

- (a) the bank must ensure that the netting or offsetting agreement is enforceable in all relevant jurisdictions, including in the event of the insolvency or bankruptcy of a counterparty;
- (b) the bank must be able at any time to determine those assets and liabilities with the same counterparty that are subject to the on-balance sheet netting agreement;
- (c) the bank must monitor and control its risks associated with the termination of the credit protection; and
- (d) the bank must monitor and control the relevant exposures on a net basis.

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<sup>36</sup> The intention here is to obtain a net exposure amount after netting of the exposures and collateral and have an add-on amount reflecting possible price changes for the securities involved in the transactions and for foreign exchange risk if any. The net long or short position of each security included in the netting agreement will be multiplied by the appropriate haircut. All other rules regarding the calculation of haircuts stated above equivalently apply for banks using bilateral netting agreements for repo-style transactions.

<sup>37</sup> Assets (loans) are treated as exposure and liabilities (deposits) as collateral. The haircuts shall be zero except when a currency mismatch exists.

## **Guarantees and credit derivatives**

### ***Operational requirements common to guarantees and credit derivatives***

**117.** The following conditions must be met for the credit protection deriving from a guarantee (counter-guarantee) or credit derivative to be recognised:

- (a) the credit protection must be direct;
- (b) the extent of the credit protection must be clearly defined and incontrovertible;
- (c) the credit protection contract must not contain any clause, the fulfillment of which is outside the direct control of the lender, that:
  - (i) would allow the protection provider to unilaterally cancel the protection;
  - (ii) would increase the effective cost of protection as a result of deteriorating credit quality of the protected exposure;
  - (iii) would prevent the protection provider from being obliged to pay out in a timely manner in the event that the original obligor fails to make any payments due; or
  - (iv) could allow the maturity of the credit protection to be reduced by the protection provider; and
- (d) it must be legally effective and enforceable in all jurisdictions which are relevant at the time of the conclusion of the credit agreement.

### ***Additional operational requirements for guarantees***

**118.** In addition to the legal certainty requirements, for a guarantee to be recognised, the following conditions must be satisfied:

- (a) on the qualifying default/non-payment of the counterparty, the bank must have the right to pursue in a timely manner the guarantor for any monies under the claim in respect of which the guarantee is provided;
- (b) the guarantor may make one lump sum payment of all monies under the claim to the bank or the guarantor may assume the future payment obligations of the counterparty covered by the guarantee;
- (c) the bank must have the right to receive any such payments from the guarantor without first having to take legal actions in order to pursue the counterparty for payment;
- (d) the guarantee must be an explicitly documented obligation assumed by the guarantor;
- (e) the guarantee must cover all types of payments the underlying obligor is expected to make in respect of the claim; and
- (f) where a guarantee covers payment of principal only, interest and other amounts not covered by the guarantee must be treated as the uncovered portion.



### *Additional operational requirements for credit derivatives*

**119.** In order for a credit derivative contract to be recognised, the following conditions must also be satisfied:

- (a) the credit events specified by the contracting parties must, at a minimum, cover:
  - (i) failure to pay the amounts due under terms of the underlying obligation that are in effect at the time of such failure (with a grace period that is closely in line with the grace period in the underlying obligation);
  - (ii) bankruptcy, insolvency or inability of the obligor to pay its debts, or its failure or admission in writing of its inability generally to pay its debts as they become due, and analogous events; and
  - (iii) restructuring of the underlying obligation involving forgiveness or postponement of principal, interest or fees that results in a credit loss event (i.e. charge-off, specific provision or other similar debit to the profit and loss account). When restructuring is not specified as a credit event, the requirements of **paragraph 120** shall apply;
- (b) if the credit derivative covers obligations that do not include the underlying obligation, **section (g) below** governs whether the asset mismatch is permissible;
- (c) the credit derivative shall not terminate prior to expiration of any grace period required for a default on the underlying obligation to occur as a result of a failure to pay, subject to the provisions of **paragraph 131**;
- (d) in the case of credit derivatives allowing for cash settlement, a robust valuation process must be in place in order to estimate loss reliably. There must be a clearly specified period for obtaining post-credit-event valuations of the underlying obligation. If the reference obligation specified in the credit derivative for purposes of cash settlement is different from the underlying obligation, **section (g) below** governs whether the asset mismatch is permissible;
- (e) if the protection purchaser's right/ability to transfer the underlying obligation to the protection provider is required for settlement, the terms of the underlying obligation must provide that any required consent to such transfer may not be unreasonably withheld;
- (f) the identity of the parties responsible for determining whether a credit event has occurred must be clearly defined. This determination must not be the sole responsibility of the protection provider. The protection buyer must have the right/ability to inform the protection provider of the occurrence of a credit event;
- (g) a mismatch between the underlying obligation and the reference obligation under the credit derivative (i.e. the obligation used for purposes of determining cash settlement value or the deliverable obligation) or between the underlying obligation and the obligation used for purposes of determining whether a credit event has occurred, is permissible if:

- (i) the reference obligation or the obligation used for purposes of determining whether a credit event has occurred, as the case may be, ranks *pari passu* with or is junior to the underlying obligation; and
- (ii) the underlying obligation and reference obligation share the same obligor (i.e. the same legal entity) and legally enforceable cross-default or cross-acceleration clauses are in place.

**120.** When the restructuring of the underlying obligation is not covered by the credit derivative, but the other requirements in **paragraph 119** are met, partial recognition of the credit derivative shall be allowed. If the amount of the credit derivative is less than or equal to the amount of the underlying obligation, 60% of the amount of the hedge shall be recognised as covered. If the amount of the credit derivative is larger than that of the underlying obligation, then the amount of eligible hedge is capped at 60% of the amount of the underlying obligation.

**121.** Only credit default swaps and total return swaps that provide credit protection equivalent to guarantees shall be eligible for recognition subject to the operational requirements set out in **paragraph 117**.

#### ***First-to-default credit derivatives***

**122.** There are cases where a bank obtains credit protection for a basket of reference names and where the first default among the reference names triggers the credit protection and the credit event also terminates the contract. In this case, the bank may recognise regulatory capital relief for the asset within the basket with the lowest risk-weighted amount, but only if the notional amount is less than or equal to the notional amount of the credit derivative.

#### ***Second-to-default credit derivatives***

**123.** In the case where the second default among the assets within the basket triggers the credit protection, the bank obtaining credit protection through such a product shall only be able to recognise any capital relief if first-default-protection has also been obtained or when one of the assets within the basket has already defaulted.

#### ***Risk weights***

**124.** The protected portion is assigned the risk weight of the protection provider. The uncovered portion of the exposure is assigned the risk weight of the underlying counterparty.

**125.** Materiality thresholds on payments below which no payment is made in the event of loss are equivalent to retained first loss positions and must be deducted in full from the capital of the bank purchasing the credit protection.

### *Proportional cover*

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

### *Sovereign guarantees and counter-guarantees*

- 127.** The preferential risk weight of 0%, as set out in **paragraphs 6 and 11**, may be extended to portions of claims guaranteed by the Government of Mauritius or the Bank of Mauritius, where the guarantee is denominated in Mauritian rupees and the exposure is funded in that currency, and, all operational requirements for guarantees set out in **paragraphs 117 and 118** are observed.<sup>38</sup>
- 128.** Claims covered by a guarantee which is indirectly counter-guaranteed by a sovereign may be treated as covered by a sovereign guarantee provided they meet the following requirements:<sup>39</sup>
- (a) the sovereign counter-guarantee covers all credit risk elements of the claim;
  - (b) both the original guarantee and the counter-guarantee meet all operational requirements for guarantees, except that the counter-guarantee need not be direct and explicit to the original claim; and
  - (c) the bank is able to satisfy the Bank that the cover is robust and that no historical evidence suggests that the coverage of the counter-guarantee is less than effectively equivalent to that of a direct sovereign guarantee.

### *Currency mismatch*

- 129.** Where the credit protection is denominated in a currency different from that in which the exposure is denominated (i.e. there is a currency mismatch), the amount of the exposure deemed to be protected (GA) shall be reduced by the application of a haircut  $H_{FX}$  as follows:

$$G_A = G \times (1 - H_{FX})$$

where:

G = nominal amount of the credit protection

$H_{FX}$  = haircut appropriate for the currency mismatch between the credit protection and the underlying obligation

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<sup>38</sup> Amended on 1 April 2022

<sup>39</sup> Amended on 1 April 2022

### ***Maturity mismatch***

**130.** For the purposes of calculating risk-weighted assets, a maturity mismatch occurs when the residual maturity of a guarantee/collateral is less than the maturity of the underlying exposure.

### ***Definition of maturity***

**131.** Under all CRM treatments, effective maturity of the underlying exposure and of the guarantee/collateral is defined as:

- (a) the longest possible remaining time before the counterparty is scheduled to fulfil its obligation, taking into account any grace period; and
- (b) the shortest possible maturity for the guarantee/collateral, taking into account embedded options that may reduce the term of the credit protection.

**132.** A guarantee/collateral shall be recognised only when its original maturity is greater than or equal to 12 months.

**133.** The maturity of guarantee/collateral for exposures with original maturities of less than 12 months must be matched in order to be recognised.

**134.** In all cases guarantee/collateral with maturity mismatches shall not be recognised when it has a residual maturity of 3 months or less.

### ***Adjustment for maturity mismatch***

**135.** Where there is a maturity mismatch between the exposure and the credit protection, the following adjustment shall be applied:

$$P_a = P \times (t - 0.25) / (T - 0.25)$$

where:

$P_a$  = value of the credit protection adjusted for maturity mismatch

$P$  = credit protection (e.g. collateral amount, guarantee amount) adjusted for any haircuts

$t$  = min ( $T$ , residual maturity of the credit protection arrangement) expressed in years

$T$  = min (5, residual maturity of the exposure) expressed in years.

## ANNEXURES

**Table A1 - Long-term ratings**

External Rating Grade	S&P Global Ratings	Moody's Investors Service	Fitch Ratings
1	AAA to AA-	Aaa to Aa3	AAA to AA-
2	A+ to A-	A1 to A3	A+ to A-
3	BBB+ to BBB-	Baa1 to Baa3	BBB+ to BBB-
4	BB+ to BB-	Ba1 to Ba3	BB+ to BB-
5	B+ to B-	B1 to B3	B+ to B-
6	CCC+ to D	Caa1 to D	CCC+ to D

**Table A2 - Short-term ratings**

External Rating Grade	S&P Global Ratings	Moody's Investors Service	Fitch Ratings
1	A-1	P-1	F1
2	A-2	P-2	F2
3	A-3	P-3	F3
4	others	others	others

**Table A3 - Risk weights for claims on sovereigns in their local currency in the absence of prior written approval of the Bank, claims on sovereigns in currency other than their local currency, claims on Government of Mauritius<sup>40</sup> denominated in currency other than Mauritian rupees, and claims on domestic PSEs denominated in currency other than Mauritian rupees and guaranteed by Government of Mauritius**

Credit assessment of S&P Global Ratings / Fitch Ratings	AAA to AA-	A+ to A-	BBB+ to BBB-	BB+ to B-	Below B-	Unrated
Credit assessment of Moody's Investors Service	Aaa to Aa3	A1 to A3	Baa1 to Baa3	Ba1 to B3	Below B3	Unrated
Consensus risk scores of ECAs participating in the Arrangement on Officially Supported Export Credits	0 - 1	2	3	4 - 6	7	
External rating grade	1	2	3	4,5	6	Unrated
Risk weight	0%	20%	50%	100%	150%	100%

Claims on the European Union, European Stability Mechanism and European Financial Stability Facility shall be assigned a risk weight of 0%.<sup>41</sup>

**Table A4 - ECA risk scores and corresponding risk weight categories**

Consensus risk scores of ECAs participating in the Arrangement on Officially Supported Export Credits	0 - 1	2	3	4 - 6	7
Risk weight	0%	20%	50%	100%	150%

<sup>40</sup> Mauritius is presently rated Baa2 by Moody's Investors' Service, hence a risk weight of 50% shall be assigned to claims on Government of Mauritius denominated in foreign currency.

<sup>41</sup> Inserted on 1 April 2022

**Table A5 - Risk weights for claims on central banks in their local currency in the absence of prior written approval of the Bank and claims on central banks in currency other than their local currency**

Credit assessment of S&P Global Ratings / Fitch Ratings	AAA to AA-	A+ to A-	BBB+ to BBB-	BB+ to B-	Below B-	Unrated
Credit assessment of Moody's Investors Service	Aaa to Aa3	A1 to A3	Baa1 to Baa3	Ba1 to B3	Below B3	Unrated
External rating grade	1	2	3	4,5	6	Unrated
Risk weight	0%	20%	50%	100%	150%	100%

**Note:** Claims on Bank for International Settlements, International Monetary Fund and European Central Bank shall be assigned a risk weight of 0%.

**Table A6 - Risk weights for claims on other MDBs, claims on domestic PSEs treated as claims on banks and claims on other securities firms treated as claims on banks**

Credit assessment of S&P Global Ratings / Fitch Ratings	AAA to AA-	A+ to A-	BBB+ to BBB-	BB+ to B-	Below B-	Unrated
Credit assessment of Moody's Investors Service	Aaa to Aa3	A1 to A3	Baa1 to Baa3	Ba1 to B3	Below B3	Unrated
External Rating Grade	1	2	3	4,5	6	Unrated
Risk weight	20%	50%	50%	100%	150%	50%

**Note:** Claims on PSEs treated as claims on banks shall be assigned a risk weight of 50% as they are presently unrated.

**Table A7 - Risk weights for claims on banks**

Credit assessment of S&P Global Ratings / Fitch Ratings	AAA to AA-	A+ to A-	BBB+ to BBB-	BB+ to B-	Below B-	Unrated
Credit assessment of Moody's Investors Service	Aaa to Aa3	A1 to A3	Baa1 to Baa3	Ba1 to B3	Below B3	Unrated
External Rating Grade	1	2	3	4,5	6	Unrated
Risk weight	20%	50%	50%	100%	150%	50%
Risk weight for short term claims	20%	20%	20%	50%	150%	20%

**Table A8 - Risk weights for claims on PSEs treated as claims on corporates, claims on securities firms treated as claims on corporates; and claims on corporates**

Credit assessment of S&P Global Ratings/ Fitch Ratings	AAA to AA-	A+ to A-	BBB+ to BB-	Below BB-	Unrated
Credit assessment of Moody's Investors Service	Aaa to Aa3	A1 to A3	Baa1 to Ba3	Below Ba3	Unrated
External Rating Grade	1	2	3,4	5,6	Unrated
Risk weight	20%	50%	100%	150%	100%



**Table A9 - Eligibility criteria for MDBs risk-weighted at 0%**

Eligibility criteria for MDBs risk-weighted at 0%	
<b>1</b>	Very high-quality long-term issuer ratings, i.e. a majority of an MDB's external assessments must be AAA
<b>2</b>	Shareholder structure is comprised of a significant proportion of sovereigns with long-term issuer credit assessments of AA- or better, or the majority of the MDB's fund-raising are in the form of paid-in equity/capital and there is little or no leverage
<b>3</b>	Strong shareholder support demonstrated by the amount of paid-in capital contributed by the shareholders, the amount of further capital the MDBs have the right to call, if required, to repay their liabilities; and continued capital contributions and new pledges from sovereign shareholders
<b>4</b>	Adequate level of capital and liquidity (a case-by-case approach is necessary in order to assess whether each MDB's capital and liquidity are adequate)
<b>5</b>	Strict statutory lending requirements and conservative financial policies, which would include among other conditions a structured approval process, internal creditworthiness and risk concentration limits (per country, sector, and individual exposure and credit category), large exposures approval by the board or a committee of the board, fixed repayment schedules, effective monitoring of use of proceeds, status review process, and rigorous assessment of risk and provisioning to loan loss reserve

**Table A10 - Risk weight categories - on-balance sheet**

	Nature of item	External Rating Grade	Risk Weight (%)
<b>A</b>	<b>Cash items</b>		
1	Cash in hand	-	0
2	Foreign currency notes and coins	-	0
3	Cash items in the process of collection	-	20
<b>B</b>	<b>Claims on sovereigns</b>	-	
1	Claims on or guaranteed by Government of Mauritius denominated and funded in Mauritian rupees	-	0
2	Holdings of securities denominated in Mauritian rupees issued or guaranteed by Government of Mauritius, Treasury Bills and Treasury Notes	-	0
3	Holdings of securities denominated in Mauritian rupees issued by the Bank of Mauritius - Bank of Mauritius Bills	-	0
4	Claims on other sovereigns denominated and funded in their local currency	-	As determined by the supervisory authority of the sovereign, subject to the prior written approval of the Bank
5	Claims on Government of Mauritius denominated in currency other than Mauritian rupees	-	50
6	Claims on other sovereigns in currency other than their local currency	1	0
		2	20
		3	50
		4,5	100
		6	150
		unrated	100
7	Claims on the European Union, European Stability Mechanism and European Financial Stability Facility <sup>42</sup>	-	0
<b>C</b>	<b>Claims on central banks (and international institutions)</b>		
1	Claims on Bank of Mauritius denominated and funded in Mauritian rupees	-	0
2	Claims on other central banks denominated and funded in their local currency	-	As determined by the supervisory authority of the sovereign, subject to the prior written approval of the Bank
3	Claims on Bank of Mauritius denominated in currency other than Mauritian rupees <sup>43</sup>	-	0
4	Claims on other central banks denominated in currency other than their local currency <sup>44</sup>	1	0
		2	20
		3	50
		4,5	100
		6	150
		unrated	100
5	Claims on BIS, IMF and ECB	-	0

<sup>42</sup> Amended on 1 April 2022

<sup>43</sup> Effective as from 31 March 2020: *COVID-19 measures*

<sup>44</sup> Rating of the sovereign of the central bank shall apply.

	Nature of item	External Rating Grade	Risk Weight (%)
<b>D</b>	<b>Claims on Multilateral Development Banks (MDBs)</b>		
1	Claims on eligible MDBs <sup>4 above</sup>	-	0
2	Claims on other MDBs <sup>45</sup>	1	20
		2, 3	50
		4,5	100
		6	150
		unrated	50
<b>E</b>	<b>Claims on banks<sup>46</sup></b>		
1	Claims on, or claims guaranteed by banks	1	20
		2, 3	50
		4,5	100
		6	150
		unrated	50
2	Claims on banks licensed under the Banking Act 2004, with an original maturity of 3 months or less, denominated and funded in Mauritian rupees	-	20
3	Claims on banks, with an original maturity of 3 months or less, denominated and funded in foreign currency	1, 2, 3	20
		4, 5	50
		6	150
		unrated	20
4	Claims on parent bank <sup>47</sup>	-	0
<b>F</b>	<b>Claims on non-central government Public Sector Entities (PSEs)</b>		
1	Claims on domestics PSEs		
a	Claims on domestic PSEs denominated and funded in Mauritius rupees, guaranteed by Government of Mauritius	-	0
b	Claims on domestic PSEs denominated in currency other than Mauritian rupees and guaranteed by Government of Mauritius	1	0
		2	20
		3	50
		4, 5	100
		6	150
		unrated	100
c	Claims on domestic PSEs <sup>48</sup> that satisfy the criteria in <b>paragraph 22</b> (treated as claims on banks)	1	20
		2, 3	50
		4, 5	100
		6	150
		unrated	50
2	Claims on foreign PSEs		
a	Claims on foreign PSEs guaranteed by the sovereign in whose jurisdiction they are established	1	0
		2	20
		3	50
		4, 5	100
		6	150
		unrated	100

<sup>45</sup> Treated as claims on banks without the possibility of using the preferential treatment for short-term claims.

<sup>46</sup> Includes claims collateralised by cash deposits placed with a bank other than the lending bank with a legal right of set-off on the credit balances.

<sup>47</sup> Subject to conditions under **paragraph 18**.

<sup>48</sup> Examples of eligible PSEs are: Central Electricity Board, Central Water Authority, Wastewater Management Authority, State Trading Corporation, Road Development Authority, Airport of Mauritius Ltd., Cargo Handling Corporation Ltd., Agricultural Marketing Board, Financial Services Commission and Mauritius Broadcasting Corporation.

	Nature of item	External Rating Grade	Risk Weight (%)
b	Claims on foreign PSEs <sup>49</sup>	1	20
		2,3	50
		4,5	100
		6	150
		unrated	50
3	Claims on all other PSEs <sup>50</sup>	1	20
		2	50
		3,4	100
		5,6	150
		unrated	100
G	Claims on securities firms		
1	Claims on securities firms that are subject to supervisory and regulatory arrangements comparable to those applicable under the Basel II framework (treated as claims on banks)	1	20
		2,3	50
		4,5	100
		6	150
		unrated	50
2	Claims on other securities firms (treated as claims on corporates)	1	20
		2	50
		3,4	100
		5,6	150
		unrated	100
H	Claims on corporates		
1	Claims on corporates <sup>51</sup>	1	20
		2	50
		3,4	100
		5,6	150
		unrated	100
I	Claims included in the regulatory retail portfolio		
1	Claims in the regulatory retail portfolio	-	75
J	Claims secured by residential property		
1	Claims secured by residential property for purchase/construction in Mauritius [excluding loans granted under the PDS (comprising IRS/RES)], except as set out in <b>paragraph 46</b> for past due loans, that meet all the requirements of <b>paragraph 35(a)–(f)</b> where the portion of the claims is: <sup>52</sup>		
a	up to Rs10 million	-	35
b	greater than Rs10 million up to Rs20 million	-	75
c	exceeding Rs20 million	-	100
2	Claims secured by residential property for purchase/construction in Mauritius under the PDS (comprising IRS/RES), except as set out in <b>paragraph 46</b> for past due loans, that meet all criteria in <b>paragraph 35(a)–(f)</b> where the proportion of the claim is: <sup>53</sup>		
a	up to Rs5 million	-	35
b	greater than Rs5 million up to Rs12 million	-	100
c	exceeding Rs12 million	-	125
3	All other claims secured by residential property for purchase/construction in Mauritius that do not satisfy all the criteria in <b>paragraph 35(a)–(f)</b> , except as set out in <b>paragraph 46</b> for past due loans.	-	125

<sup>49</sup> As determined by foreign supervisor, subject to the prior written approval of the Bank.

<sup>50</sup> Those claims shall be treated as claims on corporates.

<sup>51</sup> All claims on corporates may be risk-weighted at 100%, subject to the prior written approval of the Bank.

<sup>52</sup> Effective as from 31 March 2020: *COVID-19 measures*

<sup>53</sup> Inserted on 1 April 2022 (*Ref: COVID-19 measures 31.03.2020*)

	Nature of item	External Rating Grade	Risk Weight (%)
4	Claims secured by residential property for purposes other than purchase/construction in Mauritius that meet all the requirements of <b>paragraph 38</b> up to Rs10 million <sup>54</sup> , except as set out in <b>paragraph 49</b> for past due loans	-	35
5	The portion of claims secured by residential property for purposes other than purchase/construction in Mauritius in excess of the 80% LTV ratio and/or that does not satisfy all the criteria at <b>paragraphs 35, 36, 37 and 38</b>	-	75
6	Claims secured by residential property for purposes other than purchase/construction in Mauritius, above Rs10 million and up to Rs20 million <sup>55</sup>	-	75
7	All other claims secured by residential property for purposes other than for purchase/construction in Mauritius	-	100
<b>K</b>	<b>Claims secured by commercial real estate</b>		
1	Claims secured by commercial real estate for purchase/construction in Mauritius		
a	up to Rs75 million	-	100
b	exceeding Rs75 million	-	125
2	Claims secured by commercial real estate for purposes other than purchase/construction in Mauritius	-	100
<b>L</b>	<b>Past due claims</b>		
1	The unsecured portion of any claim (other than loans secured by residential property for purchase/construction in Mauritius, loans secured by residential property for purposes other than for purchase/construction in Mauritius and loans secured by commercial real estate for purchase/construction in Mauritius) that is past due for more than 90 days net of specific provisions when:		
a	specific provisions are less than 20% of the outstanding amount of the past due claim or impaired asset	-	150
b	specific provisions are no less than 20% of the outstanding amount of the past due claim or impaired asset	-	100
c	specific provisions are no less than 50% of the outstanding amount of the past due claim or impaired asset	-	50
2	Loans secured by residential property for purchase/construction in Mauritius, when such loans are past due for more than 90 days:		
a	up to Rs5 million	-	100
b	greater than Rs5 million up to Rs12 million	-	125
c	exceeding Rs12 million	-	150
3	Loans secured by commercial real estate for purchase/construction in Mauritius, when such loans are past due for more than 90 days:		
a	up to Rs75 million	-	125
b	exceeding Rs75 million	-	150
4	Loans secured by residential property other than for purchase/construction in Mauritius that are past due for more than 90 days net of specific provisions when:		
a	specific provisions are less than 20% of their outstanding amount has been made	-	100
b	specific provisions no less than 20% of outstanding amount has been made	-	50

<sup>54</sup> Effective as from 31 March 2020: *COVID-19 measures*

<sup>55</sup> Effective as from 31 March 2020: *COVID-19 measures*

	Nature of item	External Rating Grade	Risk Weight (%)
<b>M</b>	<b>Other assets</b>		
1	Investment in corporate shares and securities	-	100
2	Investment in equity or regulatory capital instruments issued by banks or securities firms	-	100
3	Premises, real estate, furniture, fixtures, equipment, vehicles and other fixed assets including capital works in progress	-	100
4	All other assets not elsewhere specified	-	100

**Table B1 - Credit conversion factors - off-balance sheet items**

	<b>Instruments</b>	<b>Credit Conversion Factor (%)</b>
1	<p><b>Direct credit substitutes</b></p> <p>Any irrevocable off-balance sheet obligations which carry the same credit risk as a direct extension of credit, such as an undertaking to make a payment to a third party in the event that a counterparty fails to meet a financial obligation or an undertaking to a counterparty to acquire a potential claim on another party in the event of default by that party, constitutes a direct credit substitute (i.e. the risk of loss depends on the creditworthiness of the counterparty or the party against whom a potential claim is acquired).</p> <p>These include instruments such as:</p> <ul style="list-style-type: none"> <li>(i) Acceptances and endorsements (including per aval endorsements);</li> <li>(ii) Guarantees given on behalf of customers to stand behind the current financial obligations of a customer and to carry out these obligations in the event the customer fails to do so, e.g. a loan guarantee;</li> <li>(iii) Letters of credit issued by a bank without the provision of retaining title to the underlying shipment or where the title has passed from the bank;</li> <li>(iv) Letters of credit confirmed by the bank; and</li> <li>(v) Standby letters of credit serving as financial guarantees.</li> </ul>	100
2	<p><b>Sales and repurchase agreements and assets sales with recourse<sup>56</sup></b></p> <p>These include any asset sales (to the extent that such assets are not included on balance sheet) by a bank where the holder of the asset is entitled to “put” the asset back to the bank within an agreed period or under certain prescribed circumstances, e.g. deterioration in the value or credit quality of the asset concerned.</p>	100
3	<p><b>Lending of banks’ securities or the posting of securities as collateral</b></p> <p>These include repurchase/reverse repurchase agreements<sup>57</sup> and securities lending/securities borrowing transactions.</p>	100
4	<p><b>Forward asset purchases</b></p> <p>These include commitments to purchase at a specified future date and on pre-arranged terms, a loan, security or other asset from another party, including written put options on specified assets with the character of a credit enhancement.</p> <p>Where a bank purchasing the asset has an unequivocal right to substitute cash settlement in place of accepting delivery of the asset and the price on settlement is calculated with reference to a general market price indicator (and not to the financial condition of any specific entity), the purchase may be treated as a market-related off-balance sheet transaction. Written put options expressed in terms of market rates for currencies or financial instruments bearing no credit risk, are excluded from risk assets.</p>	100

<sup>56</sup> These transactions shall be weighted according to the type of asset or the issuer of securities (as appropriate) and not according to the counterparty with whom the transaction has been entered into, where the credit risk associated with the underlying asset which has been sold (temporarily with recourse) or purchased, remains with the bank.

<sup>57</sup> Refer to **paragraphs 57 and 58**.

	<b>Instruments</b>	<b>Credit Conversion Factor (%)</b>
5	<p><b>Placements of forward deposits</b></p> <p>These relate to any agreement between a bank and another party whereby the bank will place a deposit at an agreed rate of interest with that party at a predetermined future date.</p>	100
6	<p><b>Partly-paid shares and securities</b></p> <p>These include any amounts owing on the uncalled portion of partly paid shares and securities held by a bank which represent commitments with certain drawdown by the issuer at a future date.</p>	100
7	<p><b>Transaction-related contingent items</b></p> <p>These are contingent liabilities which involve an irrevocable obligation of a bank to pay a third party beneficiary when a customer fails to perform some contractual non-financial obligation, that is where the risk of loss to the bank depends on the likelihood of a future event which is independent of the creditworthiness of the counterparty. They are essentially guarantees which support particular obligations rather than supporting customers' general financial obligations, and include:</p> <ul style="list-style-type: none"> <li>(i) performance bonds, warranties and indemnities;</li> <li>(ii) bid or tender bonds;</li> <li>(iii) advance payment guarantees;</li> <li>(iv) customs and excise bonds; and</li> <li>(v) standby letters of credit related to particular contracts and non-financial transactions.</li> </ul>	50
8	<p><b>Note-issuance facilities (NIFs) and revolving underwriting facilities (RUFs)</b></p> <p>These involve arrangements whereby a borrower may drawdown funds up to a prescribed limit over a predefined period by making repeated note issues to the market, and where, should the issue prove unable to be placed in the market, the unplaced amount is to be taken up or funds made available by a bank being committed as an underwriter of the facility.</p>	50
9	<p><b>Trade-related contingent items</b></p> <p>Contingent liabilities arising from trade-related obligations, which are secured against an underlying shipment of goods for both issuing and confirming bank.</p> <p>These include documentary letters of credit issued by a bank which are, or are to be, collateralised by underlying shipments, i.e. where the credit provides for the bank to retain title to the underlying shipment; shipping guarantees issued by a bank; acceptances on trade bills; and any other trade-related contingencies.</p> <p>A graduated approach shall be applied to both the issuing and confirming banks in respect of self-liquidating trade letters of credit arising from the movement of goods (e.g. documentary credits collateralised by the underlying shipment), as follows:</p> <ul style="list-style-type: none"> <li>(a) <b>Maturity</b> ≤ 3 months</li> <li>(b) 3 months &lt; <b>Maturity</b> ≤ 9 months</li> <li>(c) 9 months &lt; <b>Maturity</b> ≤ 12 months</li> <li>(d) <b>Maturity</b> &gt; 12 months</li> </ul> <p>Banks shall ensure that appropriate risk mitigation measures are in place to cater for the different risks (i.e. credit risk, counterparty risk, country risk, foreign exchange risk and commodity risk, amongst others) involved in these types of transactions.</p> <p>The effective maturity shall be used in case the letters of credit are expected to, or, have been rolled over.</p>	<p>20</p> <p>50</p> <p>75</p> <p>100</p>



	Instruments	Credit Conversion Factor (%)
10	<b>Other commitments</b>	
	(i) Commitments with an original maturity up to one year	20
	(ii) Commitments with an original maturity over one year	50
	(iii) Commitments that can be unconditionally cancelled at any time by the bank without prior notice, or that effectively provide for automatic cancellation due to the deterioration in a borrower's creditworthiness	0

**Table B2 - Determination of maturity of a commitment**

	Determination of maturity of a commitment
(i)	<p><b><i>Original and remaining maturity</i></b></p> <p>The maturity of a commitment shall be measured from the date the commitment is entered into, that is based on original maturity, until the final date by which it must be drawn down in full.</p>
(ii)	<p><b><i>Renegotiation of the terms of a commitment</i></b></p> <p>In the case where the terms of a commitment have been renegotiated, the maturity shall be measured as from the date of the renegotiation until the end of the period of the renegotiated commitment provided the renegotiation involves:</p> <ul style="list-style-type: none"> <li>○ a full credit assessment of the customer; and</li> <li>○ the lender's right, without notice, to withdraw the commitment.</li> </ul> <p>Where these conditions are not met, the original starting date of the commitment shall be used to determine its maturity rather than the date of renegotiation.</p>
(iii)	<p><b><i>A commitment to provide a loan (or purchase an asset) which has a maturity of over one year but which must be drawn down within a period of up to one year</i></b></p> <p>Such commitments shall be treated as having a maturity of up to one year so long as any undrawn portion of the facility is automatically cancelled at the end of the drawdown period.</p>
(iv)	<p><b><i>A commitment to provide a loan (or purchase an asset) to be drawn down in a number of tranches, some up to one year and some over one year.</i></b></p> <p>The whole commitment shall be considered as having a maturity of over one year.</p>
(v)	<p><b><i>Commitments for fluctuating amounts</i></b></p> <p>Where a commitment provides for a customer to have a facility limit which varies during the period of the commitment, the amount of the commitment shall at all times be taken as the maximum amount that can be drawn under the commitment for the remaining period.</p>
(vi)	<p><b><i>Forward commitments</i></b></p> <p>The original maturity of a forward commitment<sup>58</sup> shall be measured from the date the commitment is entered into until the final date by which the facility must be drawn in full.</p>
(vii)	<p><b><i>Commitments for off-balance sheet transactions</i></b></p> <p>A distinction is made between a commitment to provide an off-balance sheet facility that may or may not be drawn by the customer, and a commitment to provide an off-balance sheet instrument with certain drawdown e.g.</p> <ul style="list-style-type: none"> <li>○ A commitment of over one year to provide a trade related contingent facility at a future date which may or may not be drawn down shall be given a CCF of 50% (the CCF for long-term commitments) multiplied by 20% (the CCF for trade-related contingents), that is, an effective CCF of 10%. Similarly, a long-term commitment to provide a guarantee facility shall receive a CCF of 50% multiplied by 100%, that is, an effective CCF of 50%.</li> <li>○ A commitment (short-term or long-term) to provide a trade-related contingent item, where it is certain that the drawdown will occur at some point in the future, including a range of dates, shall be given a CCF of 20%. Similarly, a commitment to issue a guarantee at a particular point in future shall receive a CCF of 100%.</li> </ul>

<sup>58</sup> A forward commitment occurs where a bank is committed to grant a facility at a future date.

**Table B3 - Conversion factors for Original Exposure Method**

Original Maturity	Exchange Rate Contracts	Interest Rate Contracts
1 year or less	2.0%	0.5%
> 1 year to 2 years	5.0% (i.e. 2% + 3%)	1.0%
For each additional year	3.0%	1.0%

**Table B4 - Conversion factors for Current Exposure (or Replacement Cost) Method**

Residual Maturity	Interest Rate Contract	Foreign Exchange Contract	Equity Contract	Precious Metal Contracts (except Gold)	Other commodities or other market related contracts
1 year or less	Nil	1.0%	6.0%	7.0%	10.0%
> 1 year to 5 years	0.5%	5.0%	8.0%	7.0%	12.0%
Over 5 years	1.5%	7.5%	10.0%	8.0%	15.0%

**Table C1 - Eligible collateral under the simple approach**

<b>Collateral instruments that are eligible under the <i>simple approach</i></b>	
1	Cash on deposit with the bank which is incurring the counterparty exposure as well as certificates of deposit or comparable instruments issued by the lending bank.
2	Gold
3	Debt securities rated by a recognised external credit assessment institution where these are rated either: <ul style="list-style-type: none"> <li>○ at least 4 when issued by sovereigns; or</li> <li>○ at least 3 when issued by other entities (including banks and securities firms); or</li> <li>○ at least 3 in the case of short-term debt instruments.</li> </ul>
4	Securities issued by: <ul style="list-style-type: none"> <li>○ Government of Mauritius <ul style="list-style-type: none"> <li>▪ Treasury Bills and Treasury Notes</li> <li>▪ Mauritius Development Loan Stocks</li> <li>▪ Bonds</li> </ul> </li> <li>○ Bank of Mauritius <ul style="list-style-type: none"> <li>▪ Bills</li> </ul> </li> </ul>
5	Debt securities not rated by a recognised external credit assessment institution where: <ul style="list-style-type: none"> <li>○ these are issued by a bank; and</li> <li>○ these are listed on a recognised exchange; and</li> <li>○ these are classified as senior debt; and</li> <li>○ all rated issues of the same seniority by the issuing bank have a long- or short-term external rating grade of at least 3; and</li> <li>○ the bank holding the debt has no information suggesting that the debt security justifies a rating below this level; and</li> </ul> <p>Banks will need to seek the approval of the Bank of Mauritius before recognising such instruments as eligible collateral.</p>
6	Equities (including convertible bonds) that are included in a main index. (These include equities in SEMDEX).
7	Undertakings for Collective Investment in Transferable Securities (UCITS) and mutual funds where: <ul style="list-style-type: none"> <li>○ a price for the units is publicly quoted; and</li> <li>○ the UCITS/mutual fund is limited to investing in instruments listed above.</li> </ul>

**Table C2 - Eligible collateral under the comprehensive approach**

<b>Collateral instruments that are eligible under the <i>comprehensive approach</i></b>	
1	All instruments eligible under the simple approach
2	Equities (including convertible bonds) that are listed on a recognised exchange
3	UCITS/mutual fund that invest in equities as per (2) above

**Table C3 - Range of eligible guarantors / protection providers**

<b>Guarantors /protection providers that are eligible for <i>credit risk mitigation</i></b>	
1	Sovereign entities, central banks, PSEs, banks, MDBs, and securities firms with a lower risk weight than that of the counterparty <sup>59</sup>
2	Other entities with an external rating grade of 2 or better.  This would include credit protection provided by parent, subsidiary and affiliate companies when they have a lower risk weight than the obligor.

**Table C4 - Standard supervisory haircuts**

<b>Issue rating for debt securities</b>	<b>Residual Maturity</b>	<b>Sovereigns<sup>60 61</sup></b>	<b>Other issuers</b>
1 (long and short term)	≤ 1 year	0.5	1
	>1 year, ≤ 5 years	2	4
	> 5 Years	4	8
2 and 3 (long and short term) and unrated bank securities	≤ 1 year	1	2
	>1 year, ≤ 5 years	3	6
	> 5 Years	6	12
4		15	N/A
Main index (including convertible bonds), gold, equities in SEM 7 and the reserve list of SEM 7		15	
Other equities (including convertible bonds) listed on a recognised exchange, equities in SEMDEX <sup>62</sup>		25	
UCITS/Mutual funds		Highest haircut applicable to any security in which the fund can invest	
Currency mismatch <sup>63</sup>		8	

**Table C5 - Minimum holding periods for various products**

<b>Transaction type</b>	<b>Minimum holding period</b>	<b>Condition</b>
Repo-style transactions	5 business days	daily remargining
Other capital market transactions	10 business days	daily remargining
Secured lending	20 business days	daily revaluation

<sup>59</sup> Amended on 1 April 2022

<sup>60</sup> Includes PSEs which are treated as sovereigns by the national supervisor.

<sup>61</sup> MDBs receiving a 0% risk weight shall be treated as sovereigns.

<sup>62</sup> The haircut of 25% also applies to transactions in which a bank lends non-eligible instruments e.g. non-investment grade corporate debt securities; and for transactions in which banks' exposures are unrated.

<sup>63</sup> Under the simple approach, banks shall use a standard supervisory haircut of 8% for the currency mismatch (assuming daily marking-to-market).