

*Unofficial translation*  
*Main document issued by Central Bank of Iraq*  
*Arabic Language*

# **Regulatory**

## **for Domestically Banks**

### **Classification of (D-SIBs)**



0781 500 1100 - 0771 500 1100



Al Daoudi, Mansour, Baghdad



info@etihad-law.com



www.etihad-law.com

## Table of Contents

Introduction .....	3
First: Scope of application .....	4
Second: The methodology adopted for classifying domestic systemically important banks .....	4
Table (1) Quantitative indicators adopted in determining the systemically important banks .....	4
Table (2): The Four Categories for Classifying Domestic Systemically Important Banks .....	5
Score Calculations.....	5
Third: Additional Capital Requirements for Systemically Important Local Banks - Loss Absorption	6
Table (3) Minimum Additional Capital Requirements .....	6
Fourth: Specific Measures for Systemically Important Local Banks .....	6
Appendix No. (1) Annual Data Form.....	7
The process of calling amounts from the financial center.....	8
Appendix No. (3) Summary of Proactive Measures Related to the Corporate Governance System and the Risk Management System .....	9
Appendix No. (4) Approved Method for Selecting the Sample of Banks Subject to Implementation.	9



0781 500 1100 - 0771 500 1100



Al Daoudi, Mansour, Baghdad



info@etihad-law.com



www.etihad-law.com

### Definitions table

Index	Definitions
Size	This indicator refers to the total assets within the budget and the total credit commitments to off-budget accounts.
Connection	This indicator refers to the bank's interconnected relationships with other financial institutions within Iraq, whether in terms of granting credit facilities, financing operations, or attracting and attracting funds. The greater the bank's interconnectedness with other financial institutions, the greater the level of systemic risk and the potential impact of the bank's failure on those financial institutions.
Substitution	This indicator measures the importance of the bank as a participant in the banking industry or in providing financial services, and thus the extent to which alternatives exist for the bank's financial services and its importance with regard to payment systems or banking liquidity. The greater the number of alternatives available to the bank's role as a participant in the banking industry or alternatives to its role as a provider or participant in the financial sector's infrastructure, the lower its systemic importance and the level of repercussions resulting from its failure.
Complexity	This indicator refers to the complexity of a bank's operations, whether at the level of services or the structure of operations and activities. This means the extent to which the bank is involved in financial derivatives market transactions, including foreign exchange markets, stock markets, commodity markets, credit risk swap transactions, and other transactions. The more complex the level of a bank's financial services, the greater its systemic risks and the higher the cost of rescuing it from default.

### Introduction

The recent financial crisis highlighted the interconnectedness and complementary nature of macroprudential and microprudential oversight. Furthermore, implementing a risk-based approach to oversight requires assessing the risk system on a broader scale, rather than examining each bank's annual balance sheet separately.

The weakness or failure of large banks has negative repercussions on the stability of the banking and financial system, which in turn impacts the country's overall economy. This is due to the size of these banks, their significant interconnectedness with other banks and financial institutions, the complexity of their operations, and their limited ability to cover the gap resulting from the failure or stagnation of these institutions. Accordingly, the Basel Committee on Banking Supervision has established a supervisory framework called Domestically Systemically Important Banks (D-SIBS). This framework includes a series of reforms to improve the resilience of banks and banking systems. These include, for example, increasing the quality and quantity of capital required in the banking system, improving risk coverage, and the leverage ratio to serve as a pillar of the risk-based system. These reforms also include liquidity risk measurement standards to reduce the likelihood of bank failure or insolvency by increasing the ability to absorb and absorb the risks to which these institutions may be exposed. Based on Article (4) of the Central Bank of Iraq Law No. (56) of 2004, as amended, which grants this bank supervisory and



0781 500 1100 - 0771 500 1100



Al Daoudi, Mansour, Baghdad



info@etihad-law.com



www.etihad-law.com

regulatory powers, and in line with the standards and principles issued by the Basel Committee on Banking Supervision and best international practices in this field, and to maintain the integrity of the

banking system, these controls were issued. Compliance with these controls and instructions is required, along with the following controls and instructions, as a minimum:

- Capital adequacy standard.
- Risk management.
- Corporate governance.
- Any relevant controls or instructions that are likely to have a direct or indirect (quantitative and qualitative) impact on loss absorption operations.

#### First: Scope of application

Banks operating in the Iraqi banking sector, including local banks and branches of foreign banks that are considered systemically important local banks, must adhere to these controls gradually, in accordance with the details mentioned in paragraphs (Third and Fourth) below. Branches of foreign banks may also be required to submit the results of the parent bank's internal capital adequacy assessment (ICCAP) or to strengthen the components of the Tier 1 capital base, as defined by the Basel Committee on Banking Supervision and Regulation, the Islamic Financial Services Board, and on a case-by-case basis for each bank.

#### Second: The methodology adopted for classifying domestic systemically important banks

The methodology adopted for identifying domestic systemically important banks was prepared based on the method adopted by the Basel Committee on Banking Supervision, which is divided into three basic methodologies: indicator-based, sample-based, and supervisory-based.

In light of the nature of Iraqi banking operations and environment, the indicator-based methodology was adopted according to a set of indicators explained below:

1. Size: The size of the bank's assets.
2. Interconnectedness: The interconnectedness of the bank's activities with other financial institutions within the country.
3. Substitutability: The extent to which alternatives exist for the services provided by the bank.
4. Complexity: The extent of sophistication and progress of the bank's activities and operations.

Table (1) Quantitative indicators adopted in determining the systemically important banks

Indicator	Relative importance	Measure Tool
Size	40%	Total Assets Inside and Outside Iraq Amount of Contracted Credit for Bank Branches Inside Iraq
Association	25%	Total Investments with Banking Institutions and Other Financial Companies Deposits and Funds Drawn from Banking Institutions and Other Financial Companies
Substitution	25%	Total Facilities and Financing Granted Volume of Transactions Outgoing via the RTGS Payment System
Complexity	10%	Total Assets of Bank Branches Outside Iraq Amount of Contracted Credit for Bank Branches Outside Iraq



0781 500 1100 - 0771 500 1100



Al Daoudi, Mansour, Baghdad



info@etihad-law.com



www.etihad-law.com



The methodology used in the classification process relies on the basis points method recommended by the Basel Committee on Banking Supervision, which can be explained through the following steps:

- Determining the sample of banks participating in the classification based on several indicators that the bank will adopt to determine this sample, as described in Appendix No. (4).
- Calculating the operating results of each bank individually and comparing them with the operating results of the banking sector on an aggregate basis.
- Weighting the basic indicators shown in the table above by (10,000) basis points.
- Taking into account the relative importance of the basic indicators.
- The thresholds for considering a systemically important bank were set at (400) basis points.
- The table below shows the four categories for classifying domestic systemically important banks.

*Table (2): The Four Categories for Classifying Domestic Systemically Important Banks*

Slides	Index value <sup>1</sup>	Base points
0	Systemically Non-Important Bank	Less than 400 points
1	D-Cut-Off	400 - 450 points
2	C-D	451 - 500 points
3	B-C	501 - 550 points
4	A	551 points or more

Calculation equation

$$\text{Systematic importance rating}^2 = 0.4 \left( \frac{\text{Assets}}{\sum_i^n \text{Assets}} + \frac{\text{Iraq Outside the Bank for Credit Branches}}{\sum_i^n \text{Iraq Outside the Bank for Credit Branches}} \times 10000 \right) +$$

$$0.25 \left( \frac{\text{Other Financial and Banking Companies at Investments}}{\sum_i^n \text{Other Financial and Banking Companies at Investments}} + \frac{\text{Other Financial and Banking Companies from Deposits and Funds}}{\sum_i^n \text{Other Financial and Banking Companies from Deposits and Funds}} \times 10000 \right) +$$

$$(0.25 \left( \frac{\text{Granted Loans and Financing Facilities}}{\sum_i^n \text{Granted Loans and Financing Facilities}} + \frac{\text{RTGS System in Issued Transactions}}{\sum_i^n \text{RTGS System in Issued Transactions}} \times 10000 \right) +$$

$$(0.1 \left( \frac{\text{Iraq Outside the Bank for Asset Branches}}{\sum_i^n \text{Iraq Outside the Bank for Asset Branches}} + \frac{\text{Iraq Outside the Bank for Off - Balance Sheet Branches}}{\sum_i^n \text{Iraq Outside the Bank for Off - Balance Sheet Branches}} \right) + \frac{\text{Fair Value of Assets}}{\sum_i^n \text{Fair Value of Assets}} \times 10000)$$

### Score Calculations

After calculating the scores for each bank, banks that score above the systemic importance level are automatically designated as locally systemically important. The Central Bank of Iraq may also add any bank that has not reached systemic importance to the list of locally systemically important banks, based

<sup>1</sup> If the bank obtains a score equal to the threshold, the bank will be transferred to the higher group based on the recommendation of the Basel Committee on Banking Supervision and Regulation.

<sup>2</sup> Refers to the total number of banks operating in the Iraqi banking sector.



### Third: Additional Capital Requirements for Systemically Important Local Banks - Loss Absorption

In order to enhance regulatory and supervisory measures and ensure the safety and strengthening of the capital base to increase its ability to absorb losses, it has been decided to increase the capital required to be retained within the Common Equity Tier 1 (CET1) capital. The increase will be carried out gradually according to the percentages shown in the table below. This bank has the right to impose additional restrictions on the dividend distribution process in the event that the bank fails to meet the additional requirements for the continuous basic capital. In the event of a change in the systemic importance of the bank, this case will be dealt with according to the data and assumptions contained in Appendix No. (2).

Table (3) Minimum Additional Capital Requirements

Slide	Score	1 <sup>st</sup> year 2023 based on data from 31/12/2022	2 <sup>nd</sup> year 2024, based on data from 31/12/2023	3 <sup>rd</sup> Year 2025, based on data from 31/12/2024
1	borderline - D	0.25	0.5	0.75
2	C-D	0.5	1	1.25
3	B-C	1	1.5	1.75
4	A	1.5	2.25	2.5

### Fourth: Specific Measures for Systemically Important Local Banks

This bank will implement a set of measures outlined below, based on the following considerations:

1. Specific measures that represent a minimum level of compliance by banks:
  - a. Verifying the effectiveness of the corporate governance system, particularly with regard to the board of directors, the control environment, and the disclosure and transparency process.
  - b. Enhancing the risk management process to contribute to mitigating risks.
  - c. Focusing on ensuring that the systemically important local bank has business continuity plans that are compatible with its business model.
2. Specific measures that will be implemented gradually according to the four categories shown in Table (2)
  - a. Holding meetings with members of the board of directors to verify strategic matters and the fundamental aspects upon which the bank's business model is based.
  - b. Analyzing the structure of revenues and expenses at the local and international branches level in a manner that contributes to mitigating the risks to which the bank may be exposed as a whole.
  - c. Enhancing field communication.
  - d. Continuous communication with representatives of key executive units, such as internal audit, compliance, and information and communications technology systems management.







Figure 2: Periodic updating of the list of locally important banks: Periodic review and revision. Local banks operating in the Iraqi banking sector (test and application sample) are required to submit the annual data shown in Appendix No. (1). These banks will be disclosed by this bank 3 for the purpose of informing banks of the degree and regulatory importance they have obtained. This bank will also

provide a statement that this bank will review the methodology adopted for classifying locally important banks periodically every two years in a manner consistent with the actual testing periods for the banks, or whenever necessary based on changes occurring in the banking sector environment, including, but not limited to, changes in business models, changes in the risk management, governance, and compliance framework, and mergers and acquisitions. The revision must include, at a minimum, the following:

1. Methodology
  2. Weightings and the final score obtained by the bank.
  3. Quantitative and qualitative requirements imposed on domestically important banks.
3. The primary objective of the classification is to classify domestically important banks according to the indicators specified by the Basel Committee on Banking Supervision and Regulation. This classification is intended to determine the type of supervisory and regulatory review processes upon which the bank is based. It does not, in any way, reflect an evaluation of the bank's performance.

### Appendix No. (1) Annual Data Form

Banks must submit the data listed in the table below during the first quarter of each year to initiate the classification procedures for domestically important banks, taking into account the following points:

1. Amounts are rounded to the nearest million Iraqi dinars.
2. Data must reflect the actual situation of the bank, supported by statements and documents, classified according to the assumptions listed in the table below, including, but not limited to, a statement of financing and credit facilities, a statement of deposits and attracted funds, and a trial balance for the bank's branches outside Iraq.
3. The bank may provide any additional statements or data that enhance the disclosure and transparency process.



0781 500 1100 - 0771 500 1100



Al Daoudi, Mansour, Baghdad



info@etihad-law.com



www.etihad-law.com

*The process of calling amounts from the financial center*

Indicator/Account	Disclosure Method
Total Assets Inside and Outside Iraq	The amount shown in the balance sheet is recorded in gross form.
Total Contracted Credit for Bank Branches Inside Iraq	Contractual credit accounts shown in off-balance sheet accounts for the bank's branches within Iraq only are recorded in gross form.
Total Investments with Banking Institutions and Other Financial Institutions	This account includes credit granted, financial investments, and debit balances with banks and other financial institutions, excluding investments with the public and private sectors (individuals, households, and non-profit organizations).
Deposits and Funds Drawn from Banking Institutions and Other Financial Institutions	This account includes deposits and borrowed funds (borrowings, cash advances from banking and other financial institutions, excluding deposits and borrowed funds from the public and private sectors (individuals, households, and non-profit organizations).
Total Facilities and Financing Granted	The total amount of facilities and financing granted before excluding provisions and accrued uncollected interest (i.e., productive credit + non-productive credit).
Volume of Transactions Outgoing via the RTGS Payment System	This account includes amounts transferred by the bank to all banks, institutions, and individuals via the Real Time Gross Settlement System (RTGS).
Total Assets for Bank Branches Outside Iraq	Includes the total assets of the bank's branches outside Iraq only.
Total Contracted Credit for Bank Branches Outside Iraq	Contractual credit accounts appearing in off-balance sheet accounts are recorded for the bank's branches outside Iraq only.
Financial Assets at Fair Value Through the Statement of Income and Other Comprehensive Income	Includes available-for-sale securities (listed or unlisted on financial markets) as well as securities included in the trading portfolio.



0781 500 1100 - 0771 500 1100



Al Daoudi, Mansour, Baghdad



info@etihad-law.com



www.etihad-law.com



*Appendix No. (3) Summary of Proactive Measures Related to the Corporate Governance System and the Risk Management System*

There are a set of proactive measures that must be adhered to, as follows:

First: Procedures related to the risk management system, as follows:

1. Provide us with procedures that support the process of reviewing and updating the components of the general risk management framework, including, but not limited to, policies and procedures, and stress testing scenarios.
2. Provide us with reports on the work of the Risk Management Committee, as well as a summary of the most important decisions and procedures monitored and supervised by the committee.
3. Provide us with the measures taken to enhance the effectiveness of information sharing and outputs between control departments, contributing to the process of improving risk governance.
4. Provide us with the measures taken to reduce and mitigate the risks to which the bank is exposed, particularly the material risks included in the controls.

Second: Procedures related to the corporate governance system, including the following:

1. Providing us with the policies and procedures that have been reviewed or updated and that contribute to increasing the effectiveness of the governance system, including, but not limited to, the conflict-of-interest policy, the board member suitability policy, the policy adopted for evaluating the board of directors, and the policy adopted for managing operations with relevant parties.
2. Providing us with the reports issued by the committees emanating from the board of directors and the procedures adopted for sharing the outputs of each committee among themselves.
3. What procedures have been adopted to improve disclosure and transparency?
4. Providing us with the results of monitoring the implementation of the initiatives included in the bank's strategic and operational plan.

*Appendix No. (4) Approved Method for Selecting the Sample of Banks Subject to Implementation*

The sample of banks participating in the classification is determined based on several indicators that the bank will adopt to determine this sample, as shown below, but not limited to:

1. Banks classified as systemically important banks at the local level for the year preceding the implementation period.
2. Bank Market Share (Total Assets): The bank's total assets are determined based on the bank's statement of financial position for the period subject to implementation.
3. Credit granted to the sector: The volume of credit and financing granted is determined based on the assets side for the period subject to implementation.
4. Deposit volume: The volume of deposits attracted (bank deposits and other party deposits) is determined based on the liabilities side for the period subject to implementation.



# Etihad Law Firm

Consultancy & Legal Services Ltd

5. Volume of outgoing transactions via the RTGS payment system



شركة الإتحاد للمحاماة  
و الاستشارات و الخدمات القانونية



0781 500 1100 - 0771 500 1100



Al Daoudi, Mansour, Baghdad



info@etihad-law.com



www.etihad-law.com