

ELUCIDATION
TO
FINANCIAL SERVICES AUTHORITY REGULATION
NUMBER 8/POJK.03/2014
CONCERNING
RISK-BASED BANK RATING FOR ISLAMIC COMMERCIAL BANKS
AND ISLAMIC BUSINESS UNITS

I. GENERAL REVIEW

In accordance with Act Number 21 of 2008 concerning Islamic Banking, Bank is obliged to maintain its rating. Bank soundness should be maintained and/or stepped up so that public trust in Bank can be maintained. In addition, Bank Rating is used as one of the means for evaluating the condition of and problems facing Bank and for determining follow up actions to overcome Bank's weaknesses or problems, in the forms of corrective action by Bank as well as supervisory action by the Financial Services Authority.

Bank soundness is a reflection of Bank's condition and performance, which constitutes a means for supervisory authority in determining supervision strategy and focus for the Bank. In addition, Bank soundness is also important to all related parties, namely owners, management, and the public who uses the Bank's services.

Development of the banking industry, particularly the products and services, is becoming more complex and diverse that it can raise Bank's risk exposure and risk profile. Along the same line, the approach to assessment internationally is also heading towards the risk-based supervision approach including additional risk related to the implementation of Islamic principles. Rises in risk exposure and risk profile as well as the implementation of risk-based supervision approach in turn influence assessment of Bank Rating.

In line with Bank's business development that is constantly dynamic and influences the risk level facing Bank, methodology for the assessment of Bank Rating requires enhancement in order to better reflect Bank's condition currently and in the future. This adjustment is required in order for the assessment of Bank Rating be more effectively used as a tool for evaluating Bank's performance, including in relation to the implementation of risk management with a focus on significant risks, and compliance to prevailing

regulations as well as implementation of the prudential and Islamic principles. This adjustment is made by enhancing the assessment of Bank Rating with the use of the risk-based approach and an adjustment to the assessment factors of Bank Rating.

The assessment of Bank Rating using the risk-based approach constitutes a comprehensive and structured assessment on results of the integration of risk profile and performance, which covers the implementation of good corporate governance, earnings, and capital.

This approach enables the Financial Services Authority as the supervisory agency to undertake supervisory actions that are appropriate and on time because the assessment is performed comprehensively on all assessment factors and is focused on significant risks as well as can immediately be communicated to the Bank in the framework of determining supervisory follow-up actions.

In addition, in line with implementation of the risk-based supervision, supervision cannot be sufficiently conducted only on the Bank as individual but supervision should also be conducted on the Bank in consolidated manner including in the assessment of rating. Therefore, assessment of Bank Rating should also cover assessment of Bank Rating in consolidated manner. As such, assessment of Bank Rating should be rearranged in order to be in line with developments that have occurred.

II. ARTICLE BY ARTICLE

Article 1

Self-explanatory.

Article 2

Paragraph (1)

Self-explanatory.

Paragraph (2)

Self-explanatory.

Paragraph (3)

Assessment of Bank Rating in consolidated manner is applied on Islamic Commercial Bank that exercises Control over Subsidiary Companies.

Paragraph (4)

Assessment of Bank Rating on Islamic Business Unit is an integral part of assessment of rating of its parent company, the Islamic Commercial Bank.

Article 3

Paragraph (1)

Self- explanatory.

Paragraph (2)

Self- explanatory.

Paragraph (3)

Updating of self-assessment of Bank Rating is performed at any time, among others in the event of:

- a. worsening of Bank financial condition;
- b. Bank is facing problems among others liquidity and capital risks; or
- c. other conditions which according to the Financial Services Authority require updating of the rating assessment.

Paragraph (4)

Self-explanatory

Paragraph (5)

In the event the deadline for submission of the result of Bank Rating self-assessment falls on a holiday, result of the Bank Rating self-assessment shall then be submitted on the next working day.

Article 4

Paragraph (1)

Self- explanatory.

Paragraph (2)

Updating of Bank Rating is performed at any time, among others in the event of:

- a. worsening of Bank financial condition;
- b. Bank is facing problems among others liquidity and capital risks; or
- c. other conditions which according to the Financial Services Authority require updating of the rating assessment.

Paragraph (3)

Other information can be in the forms of:

- a. information on the results of evaluations by other authorized authorities;
- b. publicly known information such as the result of evaluation by a rating institution and information from mass media; and/or
- c. data or information related to a foreign Bank branch office concerning the financial condition and rating of its head office abroad, performed by an authorized authority or international rating institution.

Article 5

Paragraph (1)

A prudential meeting is a meeting undertaken by a supervisory agency with Bank in the framework of obtaining information related to the implementation process of the rating self-assessment.

Paragraph (2)

Self-explanatory.

Article 6

Paragraph (1)

Assessment of the Bank Rating of Islamic Commercial Bank is performed based on a comprehensive and structured analysis of the performance, risk profile, problems being faced by, and development prospect of the Bank.

Paragraph (2)

Assessment of the Bank Rating of Islamic Business Unit is performed based on a comprehensive and structured analysis of the performance, risk profile, problems being faced by, and development prospect of the Islamic Business Unit.

Article 7

Paragraph (1)

Assessment of inherent risks constitutes an assessment on risks that are inherent in Bank's business activities, both those that can be quantified as well as those that cannot, which have the potential of influencing Bank financial position.

Assessment of the quality of risk management implementation constitutes an assessment of the aspects of: (i) good corporate governance risk, (ii) management framework risk, (iii) management process risk, adequacy of human resources, and adequacy of management information system; as well as (iv) adequacy of risk control system by giving attention to Bank's business characteristics and complexity.

The definition and scope of each risk refer to the prevailing regulation concerning implementation of risk management for Banks.

Paragraph (2)

Assessment of Good Corporate Governance implementation is performed within a governance system comprising of 3 (three) aspects of governance, namely governance structure, governance process, and governance outcome.

Assessment focus of the implementation of Good Corporate Governance principles refers to prevailing regulation concerning Implementation of Good Corporate Governance for Islamic Commercial Banks by giving attention to the business characteristics and complexity of Islamic Commercial Bank business.

Paragraph (3)

Assessment of the Islamic Commercial Bank's earnings performance, earnings sources, and earnings stability is performed by taking into consideration the aspects of earnings level, trend, structure, and stability, by giving attention to the performance of peer group as well as Islamic Commercial Bank's earnings management, both through an analysis of quantitative as well as qualitative aspects.

Analysis of the quantitative aspects is performed by using core indicators as the basis for evaluation. In addition, when necessary, the use of other supporting indicators can be added in order to sharpen the analysis, which is aligned to the business scale, characteristics, and/or complexity of Islamic Commercial Bank's business.

Analysis of the qualitative aspects is performed among others by taking into consideration earnings management, earnings contribution to capital expansion, and earnings prospect.

Paragraph (4)

Assessment of capital adequacy level and capital management is performed by Islamic Commercial Bank by taking into consideration the risk profile and the level, trend, structure, and stability of capital, by giving attention to the performance of peer group as well as capital management of the Islamic Commercial Bank, both through analyses of quantitative as well as qualitative aspects.

Analysis of the quantitative aspects is performed using core indicators. In addition, when necessary, the use of other supporting indicators can be added in order to sharpen the analysis, by taking into consideration the business scale, characteristics, and/or complexity of the Islamic Commercial Bank's business.

Analysis of the qualitative aspects is performed among others by taking into consideration management of capital and the capacity to ability to access capital.

Article 8

Paragraph (1)

Self-explanatory.

Paragraph (2)

Smaller factor rating sequence reflects sounder Bank condition.

Paragraph (3)

Letter a

Risk level is determined based on the level of inherent risk and quality of risk management implementation of each risk.

Letter b

Determination of the inherent risk level and quality of risk management implementation on composite basis is performed based on a comprehensive and structured analysis on the level of inherent risk and quality of risk management implementation of each risk by giving

attention to the significance of each risk on the overall risk profile.

Letter c

Self-explanatory.

Paragraph (4)

Self-explanatory.

Paragraph (5)

Self-explanatory.

Paragraph (6)

Determination of the rating of Islamic Commercial Bank's capital factor, which is performed among others by taking into consideration the additional capital charge related to the risk profile of the Islamic Commercial Bank, refers to prevailing regulation concerning Obligation to Fulfill Minimum Capital for Islamic Commercial Banks and Islamic Business Units.

Article 9

Paragraph (1)

The comprehensive analysis is also performed by taking into consideration Bank's ability to face significant changes in external condition.

Paragraph (2)

Smaller Composite Rating sequence reflects sounder Bank condition.

Paragraph (3)

Bank condition that is generally extremely sound so as to be assessed of being extremely capable in facing significant negative influence coming from changes in business condition and other external factors is reflected in the ratings of assessment factors, among others, in the case of an Islamic Commercial Bank, risk profile, implementation of Good Corporate Governance, earnings, and capital, which in general are extremely good. Meanwhile in the case of an Islamic Business Units, it is reflected in risk profile that is in general extremely good. If there are weaknesses, in general these weaknesses are not significant.

Paragraph (4)

Bank condition that is generally sound so as to be assessed of being capable in facing significant negative influence coming from changes in business condition and other external factors is reflected in the ratings of assessment factors, which in the case of an Islamic Commercial Bank are risk profile, implementation of Good Corporate Governance, earnings, and capital, which are in general good. Meanwhile in the case of an Islamic Business Unit, it is reflected in risk profile that is in general good. If there are weaknesses, in general these weaknesses are less significant.

Paragraph (5)

Bank condition that is generally adequately sound so as to be assessed of being adequately capable in facing significant negative influence coming from changes in business condition and other external factors is reflected in the ratings of assessment factors, in the case of an Islamic Commercial Bank among others risk profile, implementation of Good Corporate Governance, earnings, and capital, which are in general adequately good. Meanwhile in the case of an Islamic Business Unit, it is reflected in risk profile that is in general adequately good. If there are weaknesses, in general these weaknesses are sufficiently significant and if these weaknesses cannot be well resolved by management, they can disrupt the sustainability of Bank's business.

Paragraph (6)

Bank condition that is generally less sound so as to be assessed of being less capable in facing significant negative influence coming from changes in business condition and other external factors is reflected in the ratings of assessment factors, in the case of an Islamic Commercial Bank among others risk profile, implementation of Good Corporate Governance, earnings, and capital, which are in general less than good. Meanwhile in the case of an Islamic Business Unit, it is reflected in risk profile that is in general less than good. There are weaknesses that are in general significant. These weaknesses cannot be well resolved by management and are disrupting the sustainability of Bank's business.

Paragraph (7)

Bank condition that is generally not sound so as to be assessed of being incapable in facing significant negative influence coming from changes in business condition and other external factors is reflected in the ratings of assessment factors, in the case of an Islamic Commercial Bank among others risk profile, implementation of Good Corporate Governance, earnings, and capital, which are in general not good. Meanwhile in the case of an Islamic Business Unit, it is reflected in risk profile that is in general not good. There are weaknesses that are in general extremely significant and as such the resolutions require funding support from shareholders or fund sources from other parties to strengthen the Bank's financial condition.

Article 10

Analysis of the significance of the influence of a problem is performed by taking into consideration among others the following matters:

- a. negative impact of the problem and/or violation of stipulations on the sustainability of Bank's business/performance;
- b. there is an indication of deliberate violation of stipulations;
- c. there is an indication of deliberate non-fulfillment of commitment; and/or
- d. number and/or frequency of violations.

Examples of problems or violations that have significant influence are among others engineered situations including window dressing and internal management disputes that influence the operation and/or business sustainability of Bank.

Article 11

Paragraph (1)

Assessment of the Bank Rating is performed based on a comprehensive analysis of Bank's performance, risk profile, problems being faced, and development prospect.

Assessment of each factor is performed in a consolidated manner between the Bank and Subsidiary Companies.

Paragraph (2)

Subsidiary Company's risk, which is assessed by measuring the risk profile in consolidated manner, is determined by giving

attention to the business characteristics of the Subsidiary Company and its influence on Bank's risk profile in consolidated manner.

The measuring of risk level in consolidated manner is performed by using risk measuring parameters that are suitable to the business characteristics of the Subsidiary Company.

Paragraph (3)

Good Corporate Governance assessment factors of Subsidiary Company, which are used in assessing the implementation of the Good Corporate Governance principles in consolidated manner, are determined by giving attention to the business characteristics of the Subsidiary Company and its influence on Bank's Good Corporate Governance in consolidated manner.

Paragraph (4)

Self-explanatory.

Paragraph (5)

Self-explanatory.

Article 12

Self-explanatory.

Article 13

Paragraph (1)

The action plan, which constitutes Bank's commitment, contains plans for corrective measures, which the Bank will execute in the framework of resolving significant problems being faced as well as the target date of completion accepted by the Financial Services Authority.

Paragraph (2)

Self-explanatory.

Paragraph (3)

Letter a

The specific time limit for submission of the action plan is determined by the Financial Services Authority by taking into consideration the level of complexity and significance of Bank's problems.

Letter b

In the event the deadline for submission of the action plan on results of self-assessment falls on a holiday, the action plan on results of self-assessment of Bank Rating shall be submitted on the next working day.

Article 14

Letter a

Target completion time for the action plan covers the target completion time for each stage of the action plan as well as the overall completion.

The report on the action plan implementation to be submitted by the Bank shall contain among others explanations concerning realization of the action plan implementation, supplemented by proofs of implementation and/or related supporting documents.

Letter b

The report on action plan implementation to be submitted by Bank shall contain among others explanations on the progress and problems being faced in the implementation of the action plan, supplemented by proofs and/or related supporting documents.

Article 15

Self-explanatory.

Article 16

The stating of Bank management and/or shareholders in the list of parties who have received the predicate of having failed the fit and proper test is made after having gone through the assessment process in accordance with the prevailing regulation for the fit and proper test.

Article 17

Paragraph (1)

Self-explanatory.

Paragraph (2)

Self-explanatory.

Paragraph (3)

Self-explanatory.

Article 18

Self-explanatory.

Article 19

Paragraph (1)

Self-explanatory.

Paragraph (2)

Self-explanatory.

Article 20

Self-explanatory.

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