



GUIDELINES TO ISLAMIC BANKS GUIDELINES NO. BU/G-2/2020/21

GUIDELINES ON MARKET RISK MANAGEMENT

1 INTRODUCTION

- 1.1 Market risk is the risk of losses to earnings or capital resulting from adverse movements in market prices, such as benchmark rates, foreign exchange rates, equity prices and commodity prices, on the economic value of an asset.
- 1.2 These Guidelines on Market Risk Management (“these Guidelines”) set forth the expectations of the Authority for Islamic banks to have adequate and effective market risk management systems commensurate to their market risk-taking activities.
- 1.3 These Guidelines further articulate sound principles and practices that should be embedded in the market risk management framework of Islamic banks and cover the following areas:
 - 1.3.1 risk management strategy, policies, and procedures; and
 - 1.3.2 risk measurement, monitoring, and control.

While Islamic banks may employ different approaches in the management of their market risk, the Authority expects that all these areas are effectively addressed.

- 1.4 An Islamic bank may take on any level of market risk in its business activities as long as those activities are within the scope of its license and its ICAAP, and the Islamic bank:
 - 1.4.1 Understands, measures, monitors and controls the risk assumed,
 - 1.4.2 Adopts risk management practices whose sophistication and effectiveness are commensurate to the risk being monitored and controlled, and
 - 1.4.3 Maintains capital commensurate with the risk exposure assumed.
- 1.5 If the Authority determines that an Islamic bank’s risk exposures are excessive relative to its capital, or that the risk assumed is not well managed, the Authority will direct the Islamic bank to reduce its exposure to an appropriate level and/or strengthen its risk management systems.



- 1.6 The principles set forth in these guidelines should be used in determining the adequacy and effectiveness of an Islamic bank's market risk management process, the level and trend of market risk exposure and adequacy of capital relative to exposure. The following facts should be considered:
- 1.6.1 The major sources of market risk exposure and the complexity and level of risk posed by the assets, liabilities, and off-balance-sheet activities of the Islamic bank;
 - 1.6.2 The Islamic bank's actual and prospective level of market risk in relation to its earnings, capital, and risk management systems;
 - 1.6.3 The adequacy and effectiveness of the Islamic bank's risk management practices and strategies as evidenced by:
 - a) The adequacy and effectiveness of Board and Senior Management oversight;
 - b) Management's knowledge and ability to identify and manage sources of market risk as measured by past and projected financial performance;
 - c) The adequacy of internal measurement, monitoring, and management information systems;
 - d) The adequacy and effectiveness of risk limits and controls that set tolerances on income and capital losses; and
 - e) The adequacy and frequency of the Islamic bank's internal review and audit of its market risk management process.
- 1.7 These Guidelines as elaborated upon further in **ANNEX 1** are issued pursuant to section 126 of the Islamic Banking Order, 2008 and applies to all Islamic banks in Brunei Darussalam.
- 1.8 The broad principles and standards under these Guidelines are aligned with the publications issued by the Basel Committee on Banking Supervision ("BCBS") such as:
- (a) "Interest Rate Risk in the Banking Book" (April 2016); and
 - (b) "Principles for Sound Stress Testing Practices and Supervision" (May 2009)
- and also publication issued by the Islamic Financial Services Board (IFSB) such as:



- (a) IFSB-1: Guiding Principles of Risk Management for Institutions (Other Than Insurance Institutions) Offering Only Islamic Financial Services (December 2005);
 - (b) Guiding Principles On Stress Testing For Institutions Offering Islamic Financial Services [Excluding Islamic Insurance (Takaful) Institutions And Islamic Collective Investment Schemes]” (March 2012); and
 - (c) CPIFR 25: Market Risk of IFSB-17 or the “Core Principles for Islamic Finance Regulation (Banking Segment) in assessing the adequacy of their market risk management systems.
- 1.9 These Guidelines are not exhaustive and subject to revision from time to time as deemed necessary by the Authority.
- 1.10 These Guidelines take immediate effect.

**MANAGING DIRECTOR
AUTORITI MONETARI BRUNEI DARUSSALAM**

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