MFSA

MALTA FINANCIAL SERVICES AUTHORITY

BANKING UNIT

BANKING DIRECTIVES

SOLVENCY RATIO OF CREDIT INSTITUTIONS AUTHORISED UNDER THE BANKING ACT 1994

Ref: BD/04/2002

SOLVENCY RATIO OF CREDIT INSTITUTIONS AUTHORISED UNDER THE BANKING ACT 1994

INTRODUCTION

1. In terms of Section 4 (2) of the Banking Act 1994 ('the Act') the competent authority ('the authority') as appointed under Section 3 (1) of the Act may make Banking Directives as may be required for carrying into effect any of the provisions of the Act. The authority may amend or revoke such Banking Directives. The Banking Directives and any amendment or revocation thereof shall be officially communicated to banks and the authority shall make copies thereof available to the public.

2. The Solvency Ratio of Credit Institutions Directive ("the Directive") is being made pursuant to Section 17 of the Act.

SCOPE AND APPLICATION

3. The Directive applies to all credit institutions licensed under the Banking Act 1994.

4. The scope of the Directive is to standardise the rules for the compilation of the Solvency Ratio and to establish a Solvency Ratio Return for notification to the authority. To achieve the scope of the Directive within an international context, the Directive is modelled on the requisites of the Codified European Union Directive 2000/12/EC of 20 March 2000 – Title V Section 2: *Solvency Ratio.*

SOLVENCY RATIO

5. The minimum level of the solvency ratio as defined in this Directive shall be at 8%.

6. The authority may, at its discretion, set a higher minimum level for any particular credit institution.

7. The levels set under Articles 5 and 6 above shall apply both on a solo or on a consolidated basis.

8. Credit institutions shall permanently maintain at least the minimum level set under Articles 5 and 6 above as applicable.

9. All credit institutions shall calculate the solvency ratio on an individual basis. In the case of a parent undertaking, the solvency ratio shall also be calculated on a consolidated basis. Parent credit institutions and any of their subsidiaries may also be required to calculate the solvency ratio on a solo consolidated basis.

10. Section I of Appendix 1 of this Directive sets out the General Framework for the computation of the Solvency Ratio and shows the risk weightings to be applied to the assets and off-balance sheet items. Section II of the Appendix comments on the risk adjusted assets and off-balance sheet items. The commentary in Section II must also be read in conjunction with the "Banking Directive on the Publication of Audited

Financial Statement of Credit Institutions authorised under the Banking Act 1994" (BD/07).

Appendix 2 sets out the Solvency Ratio Return which credit institutions are required to complete to notify the authority under Articles 11 and 12. The Solvency Ratio Return caters for the submission of the solvency ratio on a solo and on a consolidated basis. The numbered paragraphs of Appendix 1 correspond to item numbers quoted on the Solvency Ratio Return.

NOTIFICATIONS TO THE AUTHORITY

11. Section 17 of the Act requires a credit institution to notify the solvency ratio to the authority. In this respect the authority requires credit institutions to submit the Solvency Ratio Return as prescribed in Appendix 2 of this Directive on a quarterly basis which must coincide with balance sheet date.

12. Section 17 of the Act also imposes the obligation on a credit institution to notify the authority forthwith upon the ratio falling below the required level under Article 5 or 6 of the Directive as applicable to that institution. The authority requires such notifications to be submitted under the Solvency Ratio Return accompanied by the institution's representations of the circumstances leading to this position.

BRANCHES OF OVERSEAS INSTITUTIONS

13. Consequent to Article 8 of the Own Funds of Credit Institutions Directive (BD/03) whereby a branch in Malta of an overseas institution is not required to maintain its Own Funds, the requirements for a solvency ratio do not apply.

14. The authority shall however enter into a bilateral agreement with the foreign supervisory authority which has authorised and supervises the foreign credit institution, whereby the foreign supervisory authority shall be required to inform forthwith the authority in case of non-compliance by that institution in any manner whatsoever with the solvency ratio rules of the foreign competent authority.

OFFENCES AND PENALTIES

15. Any person who commits an offence in terms of this Directive as provided for under Section 35 of the Act is liable to such penalties as may be prescribed pursuant to the said Section.

TRANSITIONAL PROVISIONS DURING 2007

16. As from 1 January 2007, credit institutions should calculate their Capital Requirements Ratio in accordance with Capital Requirements Rule BR/04, instead of Solvency Directive BD/04. However, until 1 January 2008, credit institutions may continue utilising the Solvency Ratio Directive BD/04.

17. Where the latter discretion referred to in article 16 is exercised, the following provisions would need to be adhered to until the credit institution's implementation of the Standardised Approach as defined in BR/04:

   a) 'Credit derivatives' shall be included in the list of 'Full risk' items in Annex II of Banking Directive BD/04.

   b) Otherwise, credit derivatives, whether on- or off-balance sheet shall continue to be treated as under Annex III of the current BD/04;

   c) The credit risk mitigation techniques defined under the BR/04 shall not be utilised;

   d) As long as all the bank's exposures will be risk weighted according to Banking Directive BD/04, no operational risk requirement would be imposed;

   e) Large exposure requirements will continue to be calculated in accordance with Banking Directive BD/02, instead of Banking Rule BR/02;

   f) Until date of implementation of Banking Rule BR/04, Pillar II requirements and disclosure amendments to Banking Directive BD/07 (Pillar III) will not apply.

SECTION I - GENERAL FRAMEWORK

1.0.0 Interpretation

1.1.0 'Zone A' shall comprise:

[a] Malta;

[b] all the member states of the European Union (EU);

[c] all other countries which are full members of the Organisation for Economic Co-operation and Development (OECD); and

[d] those countries which have concluded special lending arrangements with the International Monetary Fund (IMF) associated with the Fund's General Arrangements to Borrow (GAB), provided that they have not rescheduled their external sovereign debt to official or commercial bank creditors in the previous five years. Institutions are required to refer to definitions provided in EU Directive 2000/12/EC, Title 1 – Definitions and Scope, Article 1 Definitions.

1.2.0 'Zone B' shall comprise all countries not in 'Zone A'.

1.3.0 'Zone A Credit Institutions' shall mean all credit institutions authorised in Zone A countries including their branches in other countries.

1.4.0 'Zone B Credit Institutions' shall mean all credit institutions authorised outside Zone A countries including their branches even if such branches are located in a Zone A country.

1.5.0 'Non-bank sector' shall mean all borrowers other than credit institutions, central governments and central banks, regional governments and local authorities, the European Communities, the European Investment Bank and multilateral development banks as defined in sub-paragraph 1.6.0.

1.6.0 'Multilateral development banks' shall mean the International Bank for Reconstruction and Development, the International Finance Corporation, the Inter-American Development Bank, the Asian Development Bank, the African Development Bank, the Council of Europe Resettlement Fund, the Nordic Investment Bank, the Caribbean Development Bank, the European Bank for Reconstruction and Development, the European Investment Fund and the Inter-American Investment Corporation.

1.7.0 'Full-risk', 'medium-risk', 'medium/low-risk' and 'low-risk' off-balance sheet items shall mean the items described in sub-paragraph 5.2.1 and listed in Annex I.

2.0.0 The Solvency Ratio

2.1.0 The solvency ratio expresses own funds as a proportion of total assets and off-balance sheet items, risk adjusted in accordance with paragraph 4.0.0 - The denominator: risk adjusted assets and off-balance sheet items.

3.0.0 The numerator: own funds

Own funds as defined in the "Own Funds Directive" shall form the **numerator** of the solvency ratio.

4.0.0 The denominator: risk adjusted assets and off-balance sheet items

4.1.0 Assets

4.1.1 Degrees of credit risk, expressed as percentage weightings, shall be assigned to asset items in accordance with sub-paragraphs 5.1.0 to 5.1.4. The balance sheet value of each asset shall than be multiplied by the relevant weighting to produce a risk adjusted value.

4.2.0 Off-balance sheet items

4.2.1 In the case of the off-balance sheet items listed in Annex I, a two-stage calculation as prescribed in sub-paragraph 5.2.1 shall be used.

4.2.2 In the case of the interest rate and foreign exchange related off-balance sheet items listed in Annex II, the potential costs of replacing contracts in the event of counterparty default shall be calculated by means of one of the two methods set out in Annex III. Those costs shall be multiplied by the relevant counterparty weightings in sub-paragraphs 5.1.0 to 5.1.4, except that the 100% weightings as provided for in sub-paragraph 5.1.4 shall be replaced by 50% weightings to produce risk adjusted values.

4.3.0 The denominator

The total of the risk adjusted values of the assets (sub-paragraph 4.1.1) and off-balance sheet items (sub-paragraphs 4.2.1 and 4.2.2) shall be the **denominator** of the solvency ratio.

5.0.0 Risk weightings

Section II - Risk Adjusted Assets and off-Balance Sheet Items comments on risk adjusted assets and off-balance sheet items.

5.1.0 Assets

The following weightings shall be applied to the various categories of asset items:

5.1.1 Zero weighting

[a] cash in hand and equivalent items;

[b] asset items constituting claims on Zone A central governments and central banks;

[c] asset items constituting claims on the European Union;

[d] asset items constituting claims carrying the explicit guarantees of Zone A central governments and central banks;

[e] asset items constituting claims on Zone B central governments and central banks, denominated and funded in the national currencies of the borrowers;

[f] asset items constituting claims carrying the explicit guarantees of Zone B central governments and central banks, denominated and funded in the national currency common to the guarantor and the borrower;

[g] asset items secured by collateral in the form of Zone A central government or central bank securities, or securities issued by the member countries of the European Union, or by cash deposits placed with the lending institution or by certificates of deposit or similar instruments issued by and lodged with the latter;

[h] *Sub-Paragraph* ***Deleted***

[i] asset items constituting investments in collective investment schemes as long as the prospectus allows the Fund Manager to invest exclusively in assets constituting claims on Zone A central governments and central banks.

5.1.2 20% weighting

[a] asset items constituting claims on the European Investment Bank (EIB);

[b] asset items constituting claims on multilateral development banks;

[c] asset items constituting claims carrying the explicit guarantee of the EIB;

[d] asset items constituting claims carrying the explicit guarantees of multilateral development banks;

[e] asset items constituting claims on Zone A regional governments or local authorities;

[f] asset items constituting claims carrying the explicit guarantees of Zone A regional governments or local authorities;

[g] asset items constituting claims on Zone A credit institutions but not constituting such institutions' own funds as defined in the Own Funds Directive (BD/03);

[h] asset items constituting claims, with a maturity of one year or less, on Zone B credit institutions, other than securities issued by such institutions which are recognised as components of their own funds, as defined in the Own Funds Directive (BD/03);

[i] asset items carrying the explicit guarantees of Zone A credit institutions with the exception of guarantees received from a banking subsidiary or associate of the reporting institution;

[j] asset items constituting claims with a maturity of one year or less, carrying the explicit guarantees of Zone B credit institutions with the exception of guarantees received from a banking subsidiary or associate of the reporting institution;

[k] asset items secured by collateral in the form of securities issued by the EIB or by multilateral development banks;

[l] cash items in the process of collection;

[m] asset items secured by collateral in the form of securities issued by Zone A regional governments or local authorities, by deposits placed with Zone A credit institutions other than the lending institution, or by certificates of deposit or similar instruments issued by those credit institutions.

5.1.3 50% weighting

[a] loans fully and completely secured by deeds covered by a first ranking special hypothec and/or privilege on residential property which is or will be occupied or given by title of lease or emphyteusis by the borrower to third parties for residential purposes. Institutions are, however, expected to deduct such prior charges when calculating the forced sale value of the relative asset.

[b] prepayments and accrued income.

5.1.4 100% weighting

[a] asset items constituting claims on Zone B central governments and central banks except where denominated and funded in the national currency of the borrower;

[b] asset items constituting claims on Zone B regional governments or local authorities;

[c] asset items constituting claims with a maturity of more than one year on Zone B credit institutions;

[d] asset items constituting claims on the Zone A or Zone B non-bank sectors;

[e] tangible fixed assets;

[f] holdings of shares, participations and other components of the own funds of other credit institutions which are not deducted from the own funds of the reporting institution as defined in the "Own Funds Directive";

[g] all other assets except where deducted from own funds.

5.2.0 Off-balance sheet items

5.2.1 The following treatment shall apply to off-balance sheet items other than those listed in Annex II:

[a] They shall first be grouped according to the risk groupings set out in Annex I. The nominal/principal amount of the **full risk** items shall then be multiplied by a credit risk conversion factor (CCF) of 100%; **medium risk** items shall be multiplied by a CCF of 50%; **medium/low risk** items shall be multiplied by a CCF of 20%, while **low risk** items shall be multiplied by a CCF of 0%. When the nominal/principal amount is multiplied by the relevant credit conversion factor, the credit equivalent amount is achieved.

[b] The second stage shall be to multiply the credit equivalent amount by the weightings attributable to the **relevant counterparties** in accordance with the treatment of asset items prescribed in sub-paragraphs 5.1.0 to 5.1.4.

5.2.2 The methods set out in Annex III shall be applied to the interest rate and foreign exchange risks listed in Annex II.

5.2.3 Where off-balance sheet items carry explicit guarantees, they shall be weighted as if they had been incurred on behalf of the guarantor rather than the counterparty.

5.2.4 Where the potential exposure arising from off-balance sheet transactions is fully and completely secured by any of the asset items recognised as collateral in paragraphs 5.1.1 (g), 5.1.2 (k) or 5.1.2 (m), weightings of 0% or 20% shall apply, depending on the collateral in question.

6.0.0 General Principles

6.1.0 *Paragraph Deleted*

6.1.1 Paragraph deleted

6.2.0 Lower weightings

Where asset and off-balance sheet items are given a lower weighting because of the existence of explicit guarantees or eligible collateral, the lower weighting shall apply only to that part which is guaranteed or which is fully covered by the collateral.

6.3.0 Netting of on-balance sheet items

Debit balances on accounts with the reporting credit institution may only be offset against credit balances on other accounts with that credit institution where all of the following criteria are met:

(a) there is formal agreement with the customer(s) to do so, or where a legal right of set-off exists. Such arrangements should, to the best of the reporting institution's knowledge, be enforceable in a liquidation of the customer(s);

(b) both the debit and credit balances are denominated in the same currency;

(c) the debit and credit balances relate to the same customer, or to customers in the same company group, eg. a parent company and its subsidiary. For a group facility, the facility should be advised in the form of a net amount and controlled by the reporting institution on that basis. Such an arrangement should be supported by a full cross guarantee structure;

(d) the customer(s) involved in the transaction(s) giving rise to the credit and debit balances has local resident status. Local residents are those customers of the reporting institution which are resident in the same country as the office of the reporting institution in whose books the credit and debit balances appears. No set-off is allowed in respect of balances relating to non-local customers, even if one of the parties is a local resident. Where more than one office of the reporting institution is involved in the transactions, the offices should also be in the same country.

The reporting institution's application of these principles must remain consistent.

6.4.0 Netting of off-balance sheet items

Any requirement by a credit institution to net off-balance sheet items should be referred to the competent authority for the necessary approval.

SECTION II - COMMENTARY ON RISK ADJUSTED ASSETS AND OFF BALANCE SHEET ITEMS

7.1.00 Commentary on risk adjusted assets

7.1.01 Cash

Cash shall comprise all local and foreign notes and coins including gold and other bullion. A zero percent weighting shall be applied.

7.1.02 Balances with Central Bank of Malta

Report balances deposited with the Central Bank which may be withdrawn without notice. A zero percent weighting shall be applied.

7.1.03 Reserve deposit with the Central Bank of Malta

Report the reserve deposit held with the Central Bank in terms of the Central Bank of Malta Act Cap. 204. A zero percent weighting shall be applied.

7.1.04 Cheques in course of collection

Report cheques and other items in course of collection. A 20% weighting shall be applied.

7.1.05 Malta Government treasury bills

Report Malta Government treasury bills. A zero percent weighting shall be applied.

7.1.06 Loans and advances to credit institutions

Report all loans and advances to domestic and foreign credit institutions including deposits and other money market placements. For the allocation of weightings refer to Section I sub-paragraphs 5.1.0 to 5.1.4.

7.1.07 Loans and advances to customers

Report all loans and advances to domestic and foreign customers other than credit institutions. For the allocation of weightings refer to Section I sub-paragraphs 5.1.0 to 5.1.4.

For the purpose of loans falling in the 50% weight band, "fully and completely secured" means that the value of the residential property must be greater than or equal to the value of the loan (i.e. a maximum loan to value ratio of 100%). Where residential properties have been revalued and it is found that the loan to value ratio exceeds 100%, such loans should be weighted at 100%. However, if the shortfall in the security value is fully covered by a specific provision, the net amount of the exposure can continue to be weighted at 50%. Conversely, where a revaluation indicates that the loan to value ratio has fallen to 100% or less, the loan may be weighted at 50%. In addition if any part of the property is used for non-residential purposes the loan shall be classified in the 100% weight band.

7.1.08 Debt securities

Report transferable debt securities and any other fixed income securities. For the allocation of weightings refer to Section I sub-paragraphs 5.1.0 to 5.1.4.

7.1.09 Equity shares

Report under this item:

[a] shareholdings in companies which may not be classified as associated and subsidiary companies and not deducted from own funds in accordance with the Own Funds Directive (BD/03);

[b] variable yield securities such as unit trust units; and

[c] preference shares which carry the right to participate in profits.

A 100% weighting shall apply.

7.1.10 Investments in associated companies

Report under this item shareholdings in associated companies not deducted from own funds in accordance with the Own Funds Directive (BD/03). A 100% weighting shall apply.

7.1.11 Shares in subsidiary companies

Report under this item shares in subsidiary companies not deducted from own funds in accordance with the Own Funds Directive (BD/03). A 100% weighting shall apply.

7.1.12 Tangible fixed assets

Report all tangible fixed assets. A 100% weighting shall apply. Assets leased out under operating leases should be reported under this item. Assets leased out under finance leases should be reported under sub-paragraphs 7.1.06 or 7.1.07 as applicable. Where the reporting institution is the lessee under a finance lease or a hirer under a hire purchase contract the asset should be recorded in the 100% weight band. If the reporting institution is acting as a broker or agent for a sub-lease or back-to-back lease, the asset should not be reported on the balance sheet provided that there is no recourse to the reporting institution in the event of a default.

7.1.13 Prepayments and accrued income

Report prepayments and accrued income. A 50% weighting shall apply.

7.1.14 Other assets

Report assets not reported elsewhere. For the allocation of weightings refer to Section I sub-paragraphs 5.1.0 to 5.1.4.

7.2.00 Commentary on off-balance sheet items

The weighted amount column for off-balance sheet items is derived by multiplying the nominal/principal amount by the relevant credit conversion factor and the resultant credit equivalent amount should then by multiplied by the appropriate risk weight.

7.2.01 Direct credit substitutes (100% CCF)

Direct credit substitutes relate to the financial requirements of a counterparty, where the risk of loss to the reporting institution on the transaction is equivalent to a direct claim on the counterparty, i.e. the risk of loss depends on the creditworthiness of the counterparty. Report instruments such as:

[a] acceptances granted and risk participations in bankers' acceptances. Where a reporting institution's own acceptances have been discounted by that institution the nominal value of the bills held should be deducted from the nominal amount of the bills issued under the facility;

[b] guarantees given on behalf of customers to stand behind the current obligations of the customer and to carry out these obligations should the customer fail to do so, e.g. a loan guarantee;

[c] guarantees of leasing operations; and

[d] irrevocable standby letters of credit or other irrevocable obligations serving as financial guarantees where the credit institution has an irrevocable obligation to pay a third party beneficiary if the customer fails to repay an outstanding commitment. Irrevocable standby letters of credit which are related to non-financial transactions should be reported under paragraph 7.2.02 below.

7.2.02 Documentary credits (100% or 20% CCF)

[a] Report documentary credits issued or confirmed by the reporting institution. Documentary credits should be weighted according to the counterparty on whose behalf the credit is issued. Confirmed documentary credits shall be weighted according to the counterparty issuing the documentary credit. Such documentary credits shall carry a credit conversion factor of 100%.

[b] Documentary credits issued by the reporting institution which are, or are to be, collateralised by the underlying shipment, that is where the credit provides for the reporting institution to retain title to the underlying shipment shall carry a credit conversion factor of 20%.

[c] Documentary credits issued and confirmed on behalf of a counterparty back-to-back with letters of credit of which the counterparty is a beneficiary ("back-to-back" documentary credits) should be reported in full.

[d] Documentary credits advised by the reporting institution or for which the reporting institution is acting as reimbursement agent should not be reported.

7.2.03 Transactions with recourse (100% CCF)

Asset sales with recourse where the credit risk remains with the credit institution (e.g. if the credit institution sells part, or all, of a loan to another credit institution, under conditions that in the event of the borrower's default, the purchaser of the loan has recourse to the selling credit institution) fall into the weighting category determined by the asset and **not** according to the counterparty with whom the transaction has been entered into.

7.2.04 Forward asset purchases (100% CCF)

The weight should be determined by the asset to be purchased and **not** the counterparty with whom the contract has been entered into. Include commitments for loans and advances and other on-balance sheet items with certain drawdown. Exclude foreign currency spot deposits with value dates one or two working days after trade date.

7.2.05 Forward forward deposits placed (100% CCF)

Agreements between two parties whereby one will pay and the other receive an agreed rate of interest on a deposit to be placed by one with the other at some predetermined date in the future. Exclude foreign currency spot deposits with value dates one or two working days after trade date. The weight should be determined according to the counterparty with whom the deposit will be placed.

7.2.06 Uncalled partly-paid shares and securities (100% CCF)

Report uncalled partly paid shares and securities irrespective of whether a specific date has been established for the call on the unpaid part of the shares and securities held.

7.2.07 Endorsement of bills (100% or 0% CCF)

[a] Endorsement of bills (including 'pour aval' endorsements) should be reported at the full nominal amount, less any amount for bills which the reporting institution now holds but had previously endorsed.

[b] Where the reporting institution is the first endorser of a bill which bears the name of another credit institution, such re-endorsements should be reported under the sub-item 'by credit institutions'. Such items carry a CCF of 0%. If the reporting institution is not the first endorser of a bill bearing the name of another credit institution, such endorsements need not be reported.

7.2.08 Transaction-related contingents (50% CCF)

Transaction related contingents relate to the on-going trading activities of a counterparty where the risk of loss to the reporting institution depends on the likelihood of a future event which is independent of the creditworthiness of the counterparty. They are essentially guarantees which support particular non-financial obligations rather than supporting customers' general financial obligations. Report such items as:

[a] performance bonds, warranties and indemnities;

[b] bid or tender bonds;

[c] advance payment guarantees;

[d] customs and excise bonds. The amount recorded for such bonds should be the reporting institution's maximum liability; and

[e] irrevocable standby letters of credit relating to a particular contract or to non-financial transactions.

Where the reporting institution has endorsed its own acceptances no further amounts should be reported than the acceptances reported in item 7.2.01-Direct credit substitution.

Endorsements of bills which do not bear the name of another credit institution should be reported under the sub-item 'other' according to the risk weight category of the issuer.

7.2.09 Sale and repurchase agreements (50% CCF)

Report sale and repurchase agreements when the reporting institution is the seller (transferor) of the asset and the asset sold is not reported on the balance sheet i.e. where the commitment to repurchase the asset is reported as an off-balance sheet item because there is no irrevocable commitment to repurchase the asset. If the asset sold is kept on-balance sheet, i.e. where there is an irrevocable commitment to repurchase the asset, it should not be reported here but in the relevant line under the appropriate on-balance sheet item of this return.

The weight category should be determined by the issuer of the security (or borrower in the case of a loan) and **not** according to the counterparty with whom the transaction has been entered into.

7.2.10 NIFs and RUFs (50% CCF)

Note issuance facilities (NIFs) and revolving underwriting facilities (RUFs) should include the total amounts of the reporting institution's underwriting obligations. Where the facility has been drawn down by the borrower and the notes are held by anyone other than the reporting institution, the underwriting obligation should continue to be reported at the full nominal amount.

The reporting institution's own holding of the notes should be reported in the relevant balance sheet item of this return and therefore the nominal amount of the notes held should be deducted from the nominal amount of the facility.

7.2.11 Undrawn credit facilities and other commitments (50% or 0% CCF)

Report under this item "undrawn credit facilities" and "other commitments" as hereinafter referred as "commitments" not included in any of the preceding paragraphs. Examples of off-balance sheet instruments which qualify under this heading include agreements to lend, to purchase or underwrite securities and to provide guarantees or acceptance facilities.

[a] Commitments should be classified as to whether:

[i] they have an original maturity of one year or less or are unconditionally cancellable at any time (0% CCF); or

[ii] they have an original maturity of over one year (50% CCF).

[b] The reporting institution is regarded as having a commitment from the date the customer is advised of the facility (e.g. the date of the letter advising the customer) regardless of whether the commitment is revocable or irrevocable, conditional or unconditional.

[c] Commitments for loans and other on-balance sheet items with certain drawdown should not be reported here but in sub-paragraph 7.2.04 - Forward asset purchases.

[d] Rolling or undated/open-ended commitments, forward asset purchases e.g. overdrafts, should be included under [a][i] provided that they are unconditionally cancellable at any time without notice and are subject to a credit review at least annually. Other rolling or undated commitments should be reported under [a][ii].

[e] Unused credit card lines should be reported under [a][i].

[f] The maturity of a commitment should be determined in accordance with the following:

[i] Original and remaining maturity:

The maturity of a commitment should be measured as from the date when the commitment was entered into until the final date by which it must be drawn down in full.

[ii] Renegotiations of the term of a commitment:

In the case where the terms of a commitment have been renegotiated the maturity should be measured as from the date of the renegotiation until the end of the period of the renegotiated commitment providing the renegotiation involves:

- a full credit assessment of the customer; and
- the lender's right, without notice, to withdraw the commitment.

Where these conditions are not met the original starting date of the commitment must be used to determine its maturity rather than the date of renegotiation.

[iii] A commitment to provide a loan which has a maturity of over one year but which must be drawn down within a period of one year or less:

Such commitments should be treated as having a maturity of one year or less so long as any undrawn portion of the facility is automatically cancelled at the end of the drawdown period.

[iv] A commitment to provide a loan (or purchase an asset) to be drawn down in a number of branches, some one year or less and some over one year:

The whole commitment should be considered as having a maturity of over one year.

[v] Commitments for fluctuating amounts:

Where a commitment provides for a customer to have a facility limit which varies during the period of the commitment, e.g. for seasonal reasons, the amount of the commitment should at all times be taken as the maximum amount that can be drawn under the commitment for the remaining period of the commitment.

[vi] Forward commitments:

A forward commitment is where the reporting institution is committed to granting a facility at a future date. The original maturity of the commitment is to be measured from the date the commitment is entered into until the final date by which the facility must be drawn in full.

[vii] Commitments for off-balance sheet transactions:

A distinction is drawn between a commitment to provide an off-balance sheet instrument which **may or may not** be drawn by the customer and a commitment to provide an off-balance sheet instrument with **certain** drawdown.

Before reporting a commitment to provide an off-balance sheet instrument which **may or may not** be drawn down by the customer, the principal/nominal amount shall first be multiplied by the relevant credit conversion factor of the relevant off-balance sheet instrument before applying the normal off-balance sheet procedure. For example, a commitment of over one year to provide a transaction related contingent shall be multiplied by a CCF of 50% (CCF of a transaction related contingent) before being further multiplied by a CCF of 50% (CCF for a long term commitment) and the relevant weighting of the counterparty to arrive at the weighted amount. In the return report the nominal/principal amount multiplied by the relevant CCF;

A commitment (short-term or long-term) to provide an off-balance sheet item where it is **certain** that the drawdown will occur at some point in the future, including a range of dates, shall be reported as if the off-balance sheet transaction has been actually entered into.

7.2.12 Interest rate related contracts

Report single currency interest rate swaps, basis swaps, forward rate agreements, interest rates futures, interest rate options purchased, forward forward deposits accepted and similar instruments. Interest rate futures and options should not be reported under this item where the contracts concerned are traded on exchanges subject to daily margining requirements. In such instances, the cash margin payment should be reported under sub-paragraphs 7.1.06 or 7.1.07 in the 100% weight band.

7.2.13 Foreign exchange related contracts

[a] Only exchange rate contracts of over 14 days original maturity (excluding a settlement period of up to 2 days) are to be reported.

[b] Foreign currencies are to include gold, silver, platinum and palladium.

[c] Report cross currency swaps, cross currency interest rate swaps (the exchange of principal on such swaps should be excluded from the on-balance sheet section of this return), outright forward foreign exchange contracts, currency futures, currency options purchased and similar instruments. Currency futures and options traded on exchanges subject to daily margining requirements should not be reported under this item. In such instances, the cash margin payment should be reported in sub-paragraphs 7.1.06 or 7.1.07 in the 100% weight band.

CLASSIFICATION OF OFF-BALANCE SHEET ITEMS

Full risk (100% credit conversion factor)

- Direct credit substitutes including:
  - General guarantees of indebtedness,
  - Acceptances,
  - Endorsements on bills not bearing the name of another credit institution,
  - Transactions with recourse,
  - Irrevocable standby letters of credit having the character of credit substitutes,
- Documentary credits issued and confirmed (see also medium/low risk),
- Forward asset purchases,
- Forward forward deposits placed,
- The unpaid portion of partly paid shares and securities,
- Commitments with certain drawdown,
- Other items also carrying full risk.

Medium risk (50% credit conversion factor)

- Transaction related contingents not having the character of direct credit substitutes including:
  - Warranties and indemnities (including tender, performance, customs and tax bonds),
  - Guarantees (not having the character of credit substitutes),
  - Irrevocable standby letters of credit (not having the character of credit substitutes),
- Asset sale and repurchase agreements when the reporting bank is the transferor of an asset and is not entitled to show the asset in its balance sheet,
- Undrawn credit facilities (agreements to lend, purchase or underwriting of securities, provide guarantees or acceptance facilities) with an original maturity of over one year,
- Note issuance facilities (NIFs) and revolving underwriting facilities (RUFs),

- Other items also carrying medium risk.

Medium/low risk (20% credit conversion factor)

- Documentary credits in which underlying shipment acts as collateral and other self-liquidating transactions,
- Other items also carrying medium/low risk.

Low risk (0% credit conversion factor)

- Undrawn credit facilities (agreements to lend, purchase securities, provide guarantees or acceptance facilities) with an original maturity of up to and including one year or which may be cancelled unconditionally at any time without notice,
- Endorsements of bills which have previously been accepted by a bank,
- Other items also carrying low risk.

TYPES OF OFF-BALANCE SHEET ITEMS CONCERNING INTEREST RATES AND FOREIGN EXCHANGE RELATED CONTRACTS

Interest-rate contracts

- Single currency interest rate swaps,
- Basis swaps,
- Forward rate agreements,
- Forward forward deposits accepted,
- Interest rate futures,
- Interest rate options purchased,
- Other contracts of a similar nature.

Foreign exchange contracts

- Cross currency swaps,
- Cross currency interest rate swaps,
- Outright forward foreign exchange contracts,
- Currency futures,
- Currency options purchased,
- Other contracts of a similar nature.

THE TREATMENT OF INTEREST AND FOREIGN EXCHANGE RELATED CONTRACTS

Reporting institutions should complete either Method 1 ("marking to market" approach) or Method 2 ("original exposure" approach) to derive the credit equivalent amount of these instruments. In general, where a reporting institution actively trades these instruments or where such instruments form a significant part of its treasury operation, Method 1 should be completed. Method 2 should be completed only by those institutions that do not actively trade interest rate and foreign exchange related instruments after agreement with the competent authority. In case of Method 1 reporting institutions should submit all workings showing the methodology for calculating market values.

Where there is a separate bilateral contract for novation, recognised by the competent authority between a credit institution and its counterparty under which any obligation to each other to deliver payments in their common currency on a given date are automatically amalgamated with other similar obligations due on the same date, the single net amount fixed by such novation is weighted, rather than the gross amounts involved.

Method 1: the 'marking to market' approach

Step (a): by attaching current market values to contracts (marking to market) the current replacement cost of all contracts with positive values is obtained.

Step (b): to obtain a figure for potential future credit exposure (*), the notional principal amounts or underlying values are multiplied by the following percentages:

Residual Maturity	Interest rate contracts	Foreign exchange contracts
One year or less Over one year	0 % 0.5%	1% 5%

Step (c): the sum of current replacement cost and potential future credit exposure is multiplied by the risk weightings allocated to the relevant counterparties.

(*) Except in the case of single currency 'floating/floating interest rate swaps' in which the current replacement cost will be calculated.

Method 2: the 'original exposure' approach

Step (a): the notional principal amount of each instrument is multiplied by the percentages given below:

Original Maturity (**)	Interest rate contracts	Foreign exchange contracts
One year or less	0.5%	2%
Over one year but not exceeding two years	1.0%	5%
Additional allowance for each additional year	1.0%	3%

Step (b): the original exposure thus obtained is multiplied by the risk weightings allocated to the relevant counterparties.

(**) In the case of interest rate contract, credit institutions may, subject to the consent of the competent authority, choose either original or residual maturity.