

Circular to credit institutions on Transitional Provisions for Own Funds

Pursuant to the Circular to the financial services industry regarding the CRD IV Package ([CRDIV](#) and the [CRR](#)) dated 27 June 2013 and the Circular to credit institutions on the Draft Implementing Technical Standards (ITS) with regards to supervisory reporting, excluding reporting on Asset Encumbrance and Financial Information (FINREP) dated 28 March 2014 and amendments to the latter dated 23 April 2014, the Authority is hereby issuing a communication to all credit institutions with regards to Transitional Provisions for Own Funds in anticipation of the publication of the new regulation on Options and Discretions.

The Notes indicated in this circular are simply for ease of reference. Credit institutions are required to follow the provisions of the CRR as well as Annex II – Instructions on Own Funds of the Draft Implementing Standards on Supervisory Reporting..

Article 465 of the CRR – Own funds requirements

The own funds requirements that shall apply during the period from 1 January 2014 to 31 December 2014 shall be:

- (a) a Common Equity Tier 1 capital ratio of 4.5%;
- (b) a Tier 1 capital ratio of 6%.

Note: Consequently, Article 92(1) (a) and (b) of the CRR shall apply as from 1 January 2014.

Article 467 of the CRR – Unrealised Losses measured at fair value

The applicable percentage for the purposes of Article 467(1) of the CRR shall be:

- (a) 100% during the period from 1 January 2014 to 31 December 2014;
- (b) 100% during the period from 1 January 2015 to 31 December 2015;
- (c) 100% during the period from 1 January 2016 to 31 December 2016; and
- (d) 100% for the period from 1 January 2017 to 31 December 2017.

Note: No transitional adjustments shall be required for unrealised losses measured at fair value.

Article 468 of the CRR – Unrealised gains measured at fair value

(1) The applicable percentage for the purposes of Article 468(1) of the CRR shall be:

- (a) 100% during the period from 1 January 2014 to 31 December 2014;
- (b) 60% during the period from 1 January 2015 to 31 December 2015;
- (c) 40% during the period from 1 January 2016 to 31 December 2016; and
- (d) 20% for the period from 1 January 2017 to 31 December 2017.

(2) The applicable percentage for the purposes of Article 468(4) of the CRR shall be:

- (a) 20% for the period from 1 January 2014 to 31 December 2014;

- (b) 40% for the period from 1 January 2015 to 31 December 2015;
- (c) 60% for the period from 1 January 2016 to 31 December 2016; and
- (d) 80% for the period from 1 January 2017 to 31 December 2017.

Note: With respect to (1) above, please note that Article 468(1) of the CRR refers to the removal from CET1 items of the applicable percentage (through the transitional adjustments CA5.1 row 120 '1.3.1.1 Unrealised gains' column 010 'Adjustments to CET1' to be linked to CA1 row 520 '1.1.1.26 Other transitional adjustments to CET1 capital'). This is because figures in CA1 items are calculated according to the final provisions (i.e. as if there were no transitional provisions), with the exception of items summarizing the effect of the transitional provisions. The ultimate result will be that while no unrealised gains measured at fair value shall be included in CET1 in 2014, 40% shall be included in 2015, 60% shall be included in 2016, 80% shall be included in 2017 and 100% shall be included from 2018 onwards.

This article is to be seen in conjunction with Article 481 of the CRR 'Additional filters and deductions' which relates to the phase-out of the IFRS Prudential Filters which included unrealised gains measured at fair value in Tier 2.

Please note that during 2015, the EC will consider the Technical Advice to the Commission on possible treatments of unrealised gains measured at fair value under Article 80 of the Capital Requirements Regulation (CRR) with a view to assessing whether to require that institutions apply a different treatment for unrealised gains from the current CRR requirements.

Since IFRS permit investment properties and own use properties to be held at cost, or at fair value, credit institutions that use the latter method are to treat revaluation reserves according to this article.

Article 469 of the CRR – Deductions from Common Equity Tier 1 items

(1) The applicable percentage for the purposes of Article 469(1)(a) of the CRR as it applies to the items referred to in points (a)-(b) of Article 36(1) shall be:

- (a) 100% during the period from 1 January 2014 to 31 December 2014;
- (b) 100% during the period from 1 January 2015 to 31 December 2015;
- (c) 100% during the period from 1 January 2016 to 31 December 2016; and
- (d) 100% for the period from 1 January 2017 to 31 December 2017.

Note: Article 36(1)(a)-(b) shall apply as from 1 January 2014, that is, losses for the current financial year and intangible assets shall be deducted from CET1 items in full from 1 January 2014. No transitional adjustments shall therefore be required.

(2) The applicable percentage for the purposes of Article 469(1)(a) of the CRR as it applies to the items referred to in points (c)-(h) of Article 36(1) excluding deferred tax assets that rely on future profitability and arise from temporary differences shall be:

- (a) 20% during the period from 1 January 2014 to 31 December 2014;
- (b) 40% during the period from 1 January 2015 to 31 December 2015;
- (c) 60% during the period from 1 January 2016 to 31 December 2016; and
- (d) 80% for the period from 1 January 2017 to 31 December 2017.

Note: Only the above applicable percentages shall be deducted from CET1 items of the amounts required to be deducted pursuant to Article 36(1)(c)-(h) of the CRR, excluding deferred tax assets that rely on future profitability and arise from temporary differences. Article 36(1)(c)-(h) of the CRR relate to the following:

“(c) deferred tax assets that rely on future profitability [but do not arise from temporary differences];

- (d) for institutions calculating risk-weighted exposure amounts using the Internal Ratings Based Approach (IRB Approach) negative amounts resulting from the calculation of expected loss amounts laid down in Articles 158 and 159;
- (e) defined benefit pension fund assets on the balance sheet of the institution;
- (f) direct, indirect and synthetic holdings by an institution of own Common Equity Tier 1 instruments, including own Common Equity Tier 1 instruments that an institution is under an actual or contingent obligation to purchase by virtue of an existing contractual obligation;
- (g) direct, indirect and synthetic holdings of the Common Equity Tier 1 instruments of financial sector entities where those entities have a reciprocal cross holding with the institution that the competent authority considers to have been designed to inflate artificially the own funds of the institution;
- (h) the applicable amount of direct, indirect and synthetic holdings by the institution of Common Equity Tier 1 instruments of financial sector entities where the institution does not have a significant investment in those entities;"

Figures in CA1 items are calculated according to the final provisions (i.e. as if there were no transitional provisions), with the exception of items summarizing the effect of the transitional provisions. Transitional adjustments relating to Deductions are to be reported in CA5.1, summed up in row 140 '1.3.2 Deductions', column 010 'Adjustments to CET 1' to be linked to CA1 row 520 '1.1.1.26 Other transitional adjustments to CET 1 capital') where institutions are to add back to CET1 80% of the deductions in 2014, 60% of the deduction in 2015, 40% of the deductions in 2016 and 20% of the deductions in 2017. The amount that is added back would need to be treated in accordance with Article 472 of the CRR. For example, in 2014 the ultimate result will be that only 20% of the amount of deferred tax assets that rely on future profitability but **do not** arise from temporary differences will need to be deducted while the remaining 80% (the residual amount) will be subject to a 0% risk weight in accordance with Article 472(5) of the CRR. Deferred tax assets that rely on future profitability and arise from temporary differences shall be treated under (3) below.

(3) The applicable percentage for the purposes of Article 469(1)(c) of the CRR shall be:

- (a) 20% during the period from 1 January 2014 to 31 December 2014;
- (b) 40% during the period from 1 January 2015 to 31 December 2015;
- (c) 60% during the period from 1 January 2016 to 31 December 2016; and
- (d) 80% for the period from 1 January 2017 to 31 December 2017.

Note: Only the above applicable percentages shall be deducted from CET1 items of the amounts required to be deducted pursuant to Article 36(1)(c) and (i) of the CRR after applying Article 470 of the CRR. Article 36(1)(c) and (i) of the CRR relate to the following:

"(c) deferred tax assets that rely on future profitability;...

- (i) direct, indirect and synthetic holdings by the institution of the Common Equity Tier 1 instruments of financial sector entities where the institution has a significant investment in those entities;"

Figures in CA1 items are calculated according to the final provisions (i.e. as if there were no transitional provisions), with the exception of items summarizing the effect of the transitional provisions. Transitional adjustments relating to Deductions are to be reported in CA5.1, summed up in row 140 '1.3.2 Deductions', column 010 'Adjustments to CET 1' to be linked to CA1 row 520 '1.1.1.26 Other transitional adjustments to CET 1 capital') where institutions are to add back 80% of the deductions in 2014, 60% of the deduction in 2015, 40% of the deductions in 2016 and 20% of the deductions in 2017. The amount that is added back would need to be treated in accordance with Article 472 of the CRR. For example, with respect to **direct** holdings of CET1 instruments of financial sector entities where a credit institution has a significant investment in those entities, the residual amount **after applying Article 470 of the CRR** would need to be deducted half from Tier 1 items and half from Tier 2 items in accordance with Article 472(11) of the CRR. Therefore, in the latter case, if an institution has enough Tier 2 capital, the amount that would need to be added back to CET1 in 2014 would be 40% since a deduction of 60% (20% + 40%) would be required.

(4) By way of derogation from (3) above, for the items referred to in point (c) of Article 36(1), that existed prior to 1 January 2014, the applicable percentage for the purpose of Article 469(1)(c) of the CRR which relates to deferred tax assets that rely on future profitability and arise from temporary differences, to be deducted after applying Article 470 of the CRR, shall be:

- (a) 0% during the period from 1 January 2014 to 31 December 2014;
- (b) 10% during the period from 1 January 2015 to 31 December 2015;
- (c) 20% during the period from 1 January 2016 to 31 December 2016;
- (d) 30% during the period from 1 January 2017 to 31 December 2017;
- (e) 40% during the period from 1 January 2018 to 31 December 2018;
- (f) 50% during the period from 1 January 2019 to 31 December 2019;
- (g) 60% during the period from 1 January 2020 to 31 December 2020;
- (h) 70% during the period from 1 January 2021 to 31 December 2021;
- (i) 80% during the period from 1 January 2022 to 31 December 2022;
- (j) 90% during the period from 1 January 2023 to 31 December 2023.

Note: Deferred tax assets that rely on future profitability that existed prior to 1 January 2014 shall be treated as per (4) above. The ultimate result shall be that while no deductions shall be required in 2014, such deductions shall increase by 10% per year until full deduction shall be required from 2024 onwards.

Figures in CA1 items are calculated according to the final provisions (i.e. as if there were no transitional provisions), with the exception of items summarizing the effect of the transitional provisions. Transitional adjustments relating to Deductions are to be reported in CA5.1, summed up in row140'1.3.2 Deductions', column 010'Adjustments to CET 1' to be linked to CA1 row 520 '1.1.1.26 Other transitional adjustments to CET 1 capital') where would need to add back 100% of the deduction in 2014, 90% of the deduction in 2015, 80% of the deductions in 2016, etc. The amount that is added back would need to be treated in accordance with Article 472 of the CRR.

Article 470 of the CRR – Exemptions from deduction from Common Equity Tier 1 items

Note: The above article shall apply during the period from 1 January 2014 to 31 December 2017 instead of Article 48(1) and (4) of the CRR.

Article 471 of the CRR – Exemption from Deductions of Equity Holdings in Insurance Companies from Common Equity Tier 1 items

Note: The above article shall apply subject to a number of conditions listed in Article 471(1) of the CRR being met which include that the equity holdings of the institution in the insurance undertaking, reinsurance undertaking or insurance holding company do not exceed 15% of the CET1 instruments issued by that insurance entity as at 31 December 2012 and during the period from 1 January 2013 to 31 December 2022.

Article 472 of the CRR – Items not deducted from Common Equity Tier 1

Note: Notwithstanding Article 33(1)(c) and Article 36(1)(a) to (i) of the CRR, during the period from 1 January 2014 to 31 December 2017, institutions shall apply the above article to the residual amounts (the amount not requiring deduction) of items referred to in Article 468(4) and in points (b) and (d) of Article 469(1), as applicable. Of particular local relevance are the residual amounts relating to deferred tax assets (Article 469(1)(b) and (d) and Article 472(5) of the CRR) and holdings of CET1 instruments of financial sector entities (Article 469(1)(b) and (d) and Article 472(10) and (11) of the CRR).

Figures in CAI items are calculated according to the final provisions (i.e. as if there were no transitional provisions), with the exception of items summarizing the effect of the transitional provisions. Transitional adjustments relating to Deductions are to be reported in CA5.1, summed up in row 140 '1.3.2 Deductions', column 010 'Adjustments to CET 1' to be linked to CAI row 520 '1.1.1.26 Other transitional adjustments to CET 1 capital') where the residual amounts would need to be to CET1 and treat the latter according to this article which can require risk weighting or even deduction of half the amount from Tier 2. The latter would still need to be reported in CA5.1.

Article 473 of the CRR – Introduction of amendments to IAS 19

Note: This article relates to defined benefit pension funds.

Article 474 of the CRR – Deductions from Additional Tier 1 items

The applicable percentage for the purposes of Article 474(a) of the CRR shall be:

- (a) 20% during the period from 1 January 2014 to 31 December 2014;
- (b) 40% during the period from 1 January 2015 to 31 December 2015;
- (c) 60% during the period from 1 January 2016 to 31 December 2016; and
- (d) 80% for the period from 1 January 2017 to 31 December 2017.

Note: Only the above applicable percentages shall be deducted from Additional Tier 1 items of the amounts required to be deducted pursuant to Article 56 of the CRR. Figures in CAI items are calculated according to the final provisions (i.e. as if there were no transitional provisions), with the exception of items summarizing the effect of the transitional provisions. Transitional adjustments relating to Deductions are to be reported in CA5.1, summed up in row 140 '1.3.2 Deductions', column 020 'Adjustments to Additional Tier 1' to be linked to CAI row 730 '1.1.2.9 'Other transitional adjustments to AT1 capital') where would need to add back to AT1 80% of the deductions in 2014, 60% of the deduction in 2015, 40% of the deductions in 2016 and 20% of the deductions in 2017. The amount that is added back would need to be treated in accordance with Article 475 of the CRR.

Article 475 of the CRR – Items not deducted from Additional Tier 1 items

Note: Notwithstanding Article 56 of the CRR, during the period from 1 January 2014 to 31 December 2017, institutions shall apply the above article to the residual amounts (the amount not requiring deduction) of items referred to in Article 474(b) of the CRR.

Article 476 of the CRR - Deductions from Tier 2

The applicable percentage for the purposes of Article 476(a) of the CRR shall be:

- (a) 20% during the period from 1 January 2014 to 31 December 2014;
- (b) 40% during the period from 1 January 2015 to 31 December 2015;
- (c) 60% during the period from 1 January 2016 to 31 December 2016; and
- (d) 80% for the period from 1 January 2017 to 31 December 2017.

Note: Only the above applicable percentages shall be deducted from Tier 2 items of the amounts required to be deducted pursuant to Article 66 of the CRR. Figures in CAI items are calculated according to the final provisions (i.e. as if there were no transitional provisions), with the exception of items summarizing the effect of the transitional provisions. Transitional adjustments relating to Deductions are to be reported in CA5.1, summed up in row 140 '1.3.2 Deductions', column 030 'Adjustments to Tier 2' to be linked to CAI row 960 '1.2.10 'Other transitional adjustments to Tier 2 capital') where would need to add back to Tier 2 80% of the deductions in 2014, 60% of the

deduction in 2015, 40% of the deductions in 2016 and 20% of the deductions in 2017. The amount that is added back would need to be treated in accordance with Article 475 of the CRR.

Article 477 of the CRR - Deductions from Tier 2

Note: Notwithstanding Article 66 of the CRR, during the period from 1 January 2014 to 31 December 2017, institutions shall apply the above article to the residual amounts (the amount not requiring deduction) of items referred to in Article 476(b) of the CRR.

Article 478 of the CRR – Applicable percentages for deduction from Common Equity Tier 1, Additional Tier 1 and Tier 2 items

Note: Please refer to Articles 468(4), 469(1)(a) and (c), 474 and 476 of the CRR above.

Article 479 of the CRR - Recognition in consolidated Common Equity Tier 1 capital of instruments and items that do not qualify as minority interests

The applicable percentage for the purposes of Article 479(2) of the CRR shall be:

- (a) 80% for the period from 1 January 2014 to 31 December 2014;
- (b) 60% for the period from 1 January 2015 to 31 December 2015;
- (c) 40% for the period from 1 January 2016 to 31 December 2016; and
- (d) 20% for the period from 1 January 2017 to 31 December 2017.

Article 480 of the CRR - Recognition in consolidated own funds of minority interests and qualifying Additional Tier 1 and Tier 2 capital

By way of derogation from point (b) of Article 84(1), point (b) of Article 85(1) and point (b) of Article 87(1) of the CRR, during the period from 1 January 2014 to 31 December 2017, the percentages referred to in those Articles shall be multiplied by an applicable factor, being:

- (a) 0,2 in the period from 1 January 2014 to 31 December 2014;
- (b) 0,4 in the period from 1 January 2015 to 31 December 2015;
- (c) 0,6 in the period from 1 January 2016 to 31 December 2016; and
- (d) 0,8 in the period from 1 January 2017 to 31 December 2017.

Article 481 of the CRR - Additional filters and deductions

The applicable percentages for the purposes of Article 481(1) of the CRR shall be:

- (a) 80% for the period from 1 January 2014 to 31 December 2014;
- (b) 60% for the period from 1 January 2015 to 31 December 2015;
- (c) 40% for the period from 1 January 2016 to 31 December 2016; and
- (d) 20% for the period from 1 January 2017 to 31 December 2017.

Note: Please vide in conjunction with Article 468 of the CRR. The amount not included in CET 1, shall be treated in accordance with this article which phases-out the IFRS Prudential Filters (previously in BR/03) which included unrealised gains measured at fair value in Tier 2.

Transitional adjustments in relation to this article are to be reported in CA5.1 row 430 (1.3.3 'Additional filters and deductions') column 030 'Adjustments to Tier 2' to be linked to CA1 row 960 '1.2.10 'Other transitional adjustments to Tier 2 capital'. This is because figures in CA1 items are calculated according to the final provisions (i.e. as if there were no transitional provisions), with the

exception of items summarizing the effect of the transitional provisions. The ultimate result will be that 80% of unrealised gains measured at fair value shall be included in Tier 2 in 2014, 60% shall be included in 2015, 40% shall be included in 2016 and 20% shall be included in 2017.

Please note that during 2015, the EC will consider the Technical Advice to the Commission on possible treatments of unrealised gains measured at fair value under Article 80 of the Capital Requirements Regulation (CRR) with a view to assessing whether to require that institutions apply a different treatment for unrealised gains from the current CRR requirements.

Since IFRS permit investment properties and own use properties to be held at cost, or at fair value, credit institutions that use the latter method are to treat revaluation reserves according to this article.

Article 482 of the CRR - Scope of application for derivatives transactions with pension funds

Note: Relates to waiver from requirement to calculate own funds requirements for CVA risks.

Article 483 of the CRR - Grandfathering of State aid instruments

Note: N/A.

Article 484 of the CRR - Eligibility for grandfathering of items that qualified as own funds under national transposition measures for Directive 2006/48/EC

Note: This article shall apply only to instruments and items that were issued on or prior to 31 December 2011 and that were eligible as own funds on 31 December 2011. The inclusion of Original Own Funds items including Other Instruments eligible as Own Funds as well as Additional Own Funds items as per previous BR/03 in CET 1, AT1 and Tier 2 respectively shall be subject to limits specified in Article 486(3), 486(4) and 486(5) of the CRR respectively. Items to be treated under this Article include perpetual non-cumulative preference shares (to be treated under Article 484(3) of the CRR) and subordinated loans which do not meet the conditions laid down in Article 63 of the CRR (to be treated under Article 484(5) of the CRR). Please refer to Article 486 of the CRR below.

Article 485 of the CRR - Eligibility for inclusion in the Common Equity Tier 1 of share premium accounts related to items that qualified as own funds under national transposition measures for Directive 2006/48/EC

Note: This article only applies when instruments were issued prior to 31 December 2010 and qualified as Original Own Funds under previous BR/03. Conditions laid down in points (i) and (j) of Article 28 of the CRR need to be met in order to qualify as a CET 1 item.

Article 486 of the CRR - Limits for grandfathering of items within Common Equity Tier 1, Additional Tier 1 and Tier 2 items

The applicable percentages for the purposes of Article 486(2) to (4) shall be:

80% during the period from 1 January 2014 to 31 December 2014;
70% during the period from 1 January 2015 to 31 December 2015;
60% during the period from 1 January 2016 to 31 December 2016;
50% during the period from 1 January 2017 to 31 December 2017;
40% during the period from 1 January 2018 to 31 December 2018;
30% during the period from 1 January 2019 to 31 December 2019;
20% during the period from 1 January 2020 to 31 December 2020;
10% during the period from 1 January 2021 to 31 December 2021.

Note: Please refer to the note to Article 484 of the CRR above. The above applicable percentages which are common to the inclusion as CET1, AT1 and Tier 2 need to be considered in view of Article 486(2), (3) and (4) of the CRR where each sub-article indicates to what amount such applicable percentage needs to be applied.

Transitional adjustments in relation to this article are to be reported in CA5.2 rows 010 '1. Instruments that qualified for point a) of Article 57 of Directive 2006/48/EC', 020 '2. Instruments that qualified for point ca) of Article 57 of Directive 2006/48/EC, subject to the limit of Article 467' or 090 '3. Items that qualified for points f), g) or h) of Article 57 of Directive 2006/48/EC, subject to the limit of Article 468' which would then need to be linked to CA5.1 row 60 column 010, 020 or 030 depending on whether adjustments are required to CET1, AT1 or T2 respectively.

Draft Implementing Technical Standard on Supervisory Reporting

Annex I – Own Funds Templates

Figures in CA1 items are calculated according to the final provisions (i.e. as if there were no transitional provisions), with the exception of items summarizing the effect of the transitional provisions. For each type of capital (i.e. CET1; AT1 and T2) there are different items in which adjustments due to transitional provisions are included (vide table below). Template CA5 is exclusively used for reporting the transitional provisions.

Rows	ID	Item
010	1	OWN FUNDS
015	1.1	TIER 1 CAPITAL
020	1.1.1	COMMON EQUITY TIER1 CAPITAL
220	1.1.1.6	Transitional adjustments due to grandfathered CET1 Capital Instruments
		Articles 484 to 487 of CRR Amount of capital instruments transitionally grandfathered as CET1, such as, perpetual non-cumulative preference shares . The amount to be reported is directly obtained from CA5.
240	1.1.1.8	Transitional adjustments due to additional minority interests
		Articles 479 and 480 of CRR Adjustments to the minority interests due to transitional provisions. This item is obtained directly from CA5.
520	1.1.1.26	Other transitional adjustments to CET1 Capital
		Articles 469 to 472, 478 and 481 of CRR Adjustments to deductions due to transitional provisions. The amount to be reported is directly obtained from CA5.
530	1.1.2	ADDITIONAL TIER 1 CAPITAL
660	1.1.2.2	Transitional adjustments due to grandfathered AT1 Capital Instruments
		Articles 484 to 487, 489 and 491 of CRR Amount of capital instruments transitionally grandfathered as AT1. The amount to be reported is directly obtained from CA5.
680	1.1.2.4	Transitional adjustments due to additional recognition in AT1 Capital of instruments issued by subsidiaries
		Article 480 of CRR Adjustments to the qualifying T1 capital included in consolidated AT1 capital due to transitional provisions. This item is obtained directly from CA5.
730	1.1.2.9	Other transitional adjustments to AT1 Capital
		Articles 474, 475, 478 and 481 of CRR Adjustments due to transitional provisions. The amount to be reported is

		directly obtained from CA5.
750	1.2	TIER 2 CAPITAL
880	1.2.2	Transitional adjustments due to grandfathered T2 Capital instruments and subordinated loans
		Articles 484, 486, 488, 490 and 491 of CRR Amount of capital instruments transitionally grandfathered as T2. The amount to be reported is directly obtained from CA5.
900	1.2.4	Transitional adjustments due to additional recognition in T2 Capital of instruments issued by subsidiaries
		Article 480 of CRR Adjustments to the qualifying own funds included in consolidated T2 capital due to transitional provisions. This item is obtained directly from CA5.
960	1.2.10	Other transitional adjustments to T2 Capital
		Articles 476 to 478 and 481 of CRR Adjustments due to transitional provisions. The amount to be reported shall be directly obtained from CA5.

Future developments

Until the SSM enters into force, on 4 November 2014, it is the Malta Financial Services Authority that determines the applicability of the above transitional provisions. Once the SSM enters into force, the ECB will take charge of harmonising these options under the SSM. It is only where the CRDIV package explicitly grants options for Member States that the ECB shall apply the national legislation exercising such options.

Communications Unit
Malta Financial Services Authority
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