ORDINANCE N 35 of 17.10.2006 ON THE CAPITAL ADEQUACY AND LIQUIDITY OF INVESTMENT INTERMEDIARIES

Adopted by Resolution No. 67-H from 17 October, 2006 of the Financial Supervision Commission, prom. SG iss. 97 from 1 Dec., 2006 in effect as of 1 Jan., 2007, am. iss. 4 in 2007; am. and suppl. iss. 68 in 2008; iss. 28 in 2009

Chapter One
GENERAL PROVISIONS

Art. 1. (1) (Am. – SG, iss. 68 in 2008) This Ordinance lays down the structure and the elements of the own funds of investment intermediaries according Art. 6 para 1 of the Markets in Financial Instruments Act (MFIA) and the requirements to their capital adequacy and the ensuring of their liquidity and solvency, as well as the manners and methods for the capital requirements calculation.

(2) The Ordinance also governs the supervision on a consolidated basis, related to the activities of the investment intermediaries, groups, financial holding companies and mixed-activity financial holding companies, as well as the volume of information and cooperation in relation to the exercised supervision.

(3) The provisions of this Ordinance shall not apply to:

1. credit institutions;

2. legal entities which deal on own account on the markets in financial futures, options or other derivative financial instruments and on the money market for the sole purpose of hedging positions on the markets of derivative financial instruments or which deal for the accounts of other members of those markets and which are guaranteed by clearing members of the same markets, where responsibility for ensuring the performance of contracts entered by such entities is assumed by clearing members of the same markets;

3. (Am. – SG, iss. 68 in 2008) the investment intermediaries which perform investment services under Art. 5 para 2 item 1 and/or 5 of the MFIA and do not hold client cash and securities and for whom, by this reason, no liabilities to clients may arise.

Chapter Two
MINIMUM REQUIRED INITIAL CAPITAL IN THE ISSUE OF A LICENSE TO PURSUE BUSINESS AS INVESTMENT INTERMEDIARY

Art. 2. The initial capital of an investment intermediary shall consist of:

1. (Am. – SG, iss. 68 in 2008) the equity capital subscribed and paid up by the shareholders or other proprietors;
2. the premium reserves, excluding cumulative preferential shares;
3. (Am. – SG, iss. 68 in 2008) the obligatory reserves within the meaning of Article 10, para 1 of the MFIA;

4. reserves, formed according the investment intermediary's Articles of Association;

5. other reserves;

6. undistributed profit from past years, less all expected taxes or dividends;

7. the loss from past years, whose value shall be deducted from the initial capital;

8. the profit of the investment intermediary's current period according an interim financial statement, if the statement is certified by a registered auditor, reduced by all foreseeable charges or dividends;

Art. 3. (1) The initial capital under Art. 2 shall include the cash contributions and the value of the non-cash contributions (contributed property), with the subject of:

1. shares and bonds, admitted to trading on a regulated market, which are with a market price;

2. (Am. – SG, iss. 68 in 2008) real rights over movable and immovable property, directly related to the activities and services under Art. 5 para 2 and 3 of the MFIA.

(2) The value of the rights according para 1 item 2 may not exceed 20 per cent of the minimal amount of capital under para 4.

Art. 4. (1) (Am. – SG, iss. 68 in 2008) An investment intermediary which performs one or more of the investment services and activities under Art. 5 para 2 item 1, 2 and 4 of MFIA and holds client cash and/or securities shall have initial capital of at least BGN 250 000, provided that it does not perform the investment services and activities under Art. 5 para 2 item 3 and 6.

(2) (Am. – SG, iss. 68 in 2008) An investment intermediary which provides investment services under Art. 5 para 2 item 2 of the MFIA, may hold the financial instruments – subject of the order, for own account, where:

1. the positions have arisen as a result of the impossibility for the investment intermediary to execute the orders accurately;

2. the total market value of these positions may not exceed 15% of its initial capital value;

3. the investment intermediary satisfies the requirements according Art. 19, 21, 23 and Chapter Nine;

4. the positions are of unforeseen and temporary nature and are held only for the time which is required for the transaction's completion.

(3) (Am. – SG, iss. 68 in 2008) The holding of positions in the non-trading book in financial instruments with the purpose of the own funds' investment shall not be considered to be trade with regard to the services under para 1.

(4) (Am. – SG, iss. 68 in 2008) An investment intermediary which performs investment services and activities under Art. 5 para 2 item 3 and 6 of the MFIA, shall have an initial capital of at least BGN 1 500 000;

(5) (Am. – SG, iss. 68 in 2008) An investment intermediary which does not execute investment services and activities under Art. 5 para 2 item 3 and 6 of the MFIA, and does not hold client cash and securities, shall have an initial capital of at least BGN 100 000.

Art. 5. (Cancelled – SG, iss. 68 in 2008).

Chapter Three
INVESTMENT INTERMEDIARY'S OWN FUNDS

Art. 6. (1) (Am. – SG, iss. 68 in 2008) The own funds (capital base) of an investment intermediary on unconsolidated basis shall be determined as the sum of the amount of the original own funds and the amount of the supplementary capital.

(2) (Am. – SG, iss. 68 in 2008) The original own funds are formed with sum of the elements under item 1 - 9, less the sum of the elements under para 3 as follows:

1. (Am. – SG, iss. 68 in 2008) the equity capital subscribed and paid up by the shareholders or other proprietors;
2. share premium accounts, excluding cumulative preferential shares;
3. (Am. – SG, iss. 68 in 2008) the obligatory reserves within the meaning of Article 10 para 1 of the MFIA;
4. reserves, formed according the investment intermediary's Articles of Association;
5. other reserves;
6. undistributed profit (brought forward) from past years, less all expected taxes or dividends;
7. the loss (brought forward) from past years, whose value shall be deducted from the original capital;
8. profit of the investment intermediary's current period according an interim financial statement, certified by a registered auditor, net of any foreseeable charge or dividend;
9. general risk reserves.

(3) The original capital is reduced by:

1. fixed intangible assets at book value;
2. material losses of the current financial year;
3. the redeemed own shares of the investment intermediary at book value;

(4) An investment intermediary, which is an originator of securitization, shall not include in the elements under para 2 item 3 – 7, the gains arising from the capitalization of the future incomes from the securitized positions, providing enhancement of the credit quality of the positions in securitization.

(5) (Am. – SG, iss. 68 in 2008) If the investment intermediary includes the profit from the current period under para 2 item 8 in the original capital and in a next reporting period closes at a higher profit than that for the preceding reporting period, it can include the amount of the audited profit from the preceding period in the original capital for that period. If the next reporting period closes with smaller profit than the audited under sentence one, it can include this profit in the original capital only if the financial statement for the nest reporting period is certified by a registered auditor.

Art. 7. (1) (Am. – SG, iss. 68 in 2008) The supplementary capital is formed with the sum of the elements under para 1-4, less the sum of the elements under para 5, as follows:

1. reserves from revaluation of non-current material assets;

2. other elements of the own funds, provided that, whatever their legal or accounting designations might be, they meet the following conditions:

a) they are freely available to the investment intermediary to cover normal operational risks, before the financial year closing and revenue and capital losses identification;

b) they are reflected in the accounting records of the investment intermediary;

c) their amount is determined by the management body of the investment intermediary and confirmed by a registered auditor;

d) the Financial Supervision Commission, hereinafter referred to as the "Commission", has been informed and exercises supervision over them;

3. securities of indeterminate duration and other instruments that fulfill the following conditions:

a) the received funds may not be reimbursed on the bearer's initiative and the reimbursement may not be effected without the written consent of the Commission's deputy chairman in charge of Investment Activity Supervision Division, hereinafter referred to as "deputy chairman";

b) the conditions of the debt agreement shall provide for the investment intermediary to have the option of deferring the payment of interest on the debt;

c) the lender's claim under the debt agreements on the investment intermediary shall be wholly subordinated to those of all non-subordinated creditors;

d) the conditions of the issue of securities, settled in the agreement shall be such that the amount of principal and due interest to allow the investment intermediary to cover its losses and to continue its usual operations;

e) only fully paid-up amounts shall be taken into account.

4. cumulative preferential shares and subordinated loan capital, if the written agreement envisages that in the event of the bankruptcy or liquidation, the claims on them shall be satisfied after all other creditors' debts outstanding at the time have been settled.

(2) In regard to an investment intermediary, calculating the risk-weighted exposures amounts according Chapter Twelve, Section II, the positive values, obtained as a result of the calculations, according Annex 5, Section 1, item 4 are recognized as other elements according para 1 item 2 up to the rate of 0,6% of the risk-weighted exposures, calculated under Chapter Twelve Section II. In the calculation of the value of the risk-weighted exposures shall not be included the values, calculated about securitizing positions, to which risk weight equal to 1 250% has been assigned.

(3) Subordinated loan capital under para 1 item 4 shall fulfill the following additional criteria:

1. only fully paid-up amounts shall be taken into account.

2. the originally agreed maturity is at least five years. In case that the maturity of the subordinated debt is not fixed, the subordinated debt may become executable with a five years' notice, unless its repayment is done with the approval of the deputy chairman. The deputy chairman may allow early repayment, provided that a request has been made by the creditor and this will not affect the investment intermediary's solvency;

3. the loan agreement shall not include clauses, providing that the debt shall become repayable before the agreed repayment date, save for the cases of winding-up of the investment intermediary;

4. during the last five years before the repayment date, the amount of the subordinated debt shall be included in the supplementary capital with a reduction of 20 per cent annually, and after the repayment date it shall be excluded in full when calculating the own funds.

(4) The positions under para 1, item 2 - 4 may be included in the own funds after the investment intermediary obtains a permission by the deputy chairman in accordance with Art. 154.

(5) The supplementary capital of the investment intermediary shall be reduced by the book value of:

1. an investment intermediary's holding in other investment intermediaries and financial institutions, where the amount of the holding is more than 10% of its capital;

2. the amounts provided as subordinated debt under para 3 and other instruments under para 1 item 2 and 3 to investment intermediaries and financial institutions, in which the investment intermediary has holdings exceeding 10% of its capital in each case;

3. the total amount of holdings of the investment intermediary in other investment intermediaries and financial institutions, where the amount of the holding represents up to 10 percent of its capital and the amounts provided as subordinated debts under para 3 and other instruments under para 1 item 2 and 3 to other investment intermediaries and financial institutions, other than those under item 1 and 2 of this provision, exceed 10% of the investment intermediary's own funds, the amounts provided as subordinated debt and other instruments being calculated before the deduction of the funds under this paragraph;

4. an investment intermediary's participation in insurance undertakings, reinsurance undertakings and insurance holding companies, having obtained a license to pursue business under the *acquis communitaire,* as well as the provided by it amounts included in their own capital;

5. the negative amount obtained as a result of the calculation according item 4, Section 1 of Annex No. 5 and the expected loss amounts, calculated according item 3.4 and 3.5, Section I, Annex 5 when the investment intermediary calculates its risk-weighted exposures amounts under Chapter Twelve, Section II;

6. the amount of the exposure, arisen on the basis of securitizing items, which according item 6 of Annex 7 received a risk weight of 1 250%, calculated by method indicated in the same.

(6) The supplementary capital under para 1 item 1-4 shall be subject to the following limits:

1. the total of the supplementary capital under para 1 item 1-4 may not exceed the amount of the original own funds;

2. the supplementary capital under para 1 item 4 may not exceed 50% of the amount of the original own funds;

(7) (Am. – SG, iss. 68 in 2008) After the application of the limits under para 6, half of the total under para 5 shall be deducted from the original own funds, and the other half is deducted from the supplementary capital under para 1 item 1-4. If a half of the amount under para 5 exceeds the amount under para 1 item 1-4, the excess shall be deducted from the original own funds. The amount under para 5 item 6 shall not be deducted, unless it has been included in the calculation of risk-weighted exposure amounts for the purposes of article 19 according item 6 of Annex 7.

(8) In the calculation of the own funds under Art. 6 and para 1 – 7 for the purposes of Chapter Nine, the items referred to in para 5 item 5 and 6 and para 2 shall not be taken into account.

(9) The investment intermediary may exceed the limits laid down in para 6 only temporarily in exceptional circumstances and after obtaining a permission of the deputy chairman.

(10) Where the investment intermediary' holding in another investment intermediary, financial institution, insurance or reinsurance undertaking or insurance holding company are held temporarily for the purposes of rendering a temporary financial assistance in relation to transformation or reorganization of the entity, subject to authorization by the deputy chairman, the own funds may not be deducted with the positions referred to in para 5 item 1-4.
(11) Guarantees extended by central governments and local authorities shall not be included in the own funds of investment intermediaries public companies.

Art. 8. (1) (Am. – SG, iss. 68 in 2008) Subject to authorization by the deputy chairman, the investment intermediary which is obligated to comply with the capital adequacy requirements calculated according Art. 24, Chapters Six, Eight, Nine, Ten, Eleven and Annex No. 9, may apply an alternative method for determining the own funds.

(2) (Suppl. – SG, iss. 68 in 2008) The own funds under para 1 may not be used to cover capital requirements other than those for cover of the indicated in para 1 risks.

(3) (Am. – SG, iss. 68 in 2008) The own capital determined according the alternative method shall be formed with the sum of the amounts of the elements under item 1 - 3, reduced by the amount of item 4, as follows:

1. (Am. – SG, iss. 68 in 2008) the own funds, determined according Art. 6 and Art. 7, excluding the elements under Art. 7 para 5 item 1-4, in the cases where the investment intermediary must reduce the sum of the elements under item 1 – 3 with the amount under item 4;

2. the net trading-book profit, net of any foreseeable charges or dividends, less net losses on its other business, provided that none of these positions has already been included in item 1 as an element under Art. 6 para 2 item 3-8 or Art. 6 para 3 item 2;

3. the subordinated loan capital or the amount of the position under para 7 on the conditions, stated in para 4-6 and para 8;

4. illiquid assets, specified in Art. 9.

(4) The subordinated loan under para 3 item 3 shall meet the following requirements:

1. it shall have initially agreed maturity of at least two years;
2. it shall be fully paid up;
3. according the provisions in the agreement, it shall not be allowed, except than in winding up, the debt to become repayable before the initially agreed repayment date, unless the deputy chairman's approval for that has been received;
4. neither the principal nor the interest may be repaid if such repayment would result in reduction of the investment intermediary's own funds to less than the required minimum capital.

(5) The investment intermediary shall notify forthwith the deputy chairman of all repayments on such subordinated loan capital, in case that the amount of its own funds under para 3 falls below 120% of the overall capital requirements.

(6) (Am. – SG, iss. 68 in 2008) The subordinated loan capital referred to in para 3 item 3 may not exceed 150% of the amount of the original own funds, designated to meet the requirements according Art. 24 and Chapter Six, Seven, Eight, Nine, Ten and Eleven, where the maximum amount may be reached only in particular circumstances determined by the deputy chairman.

(7) The deputy chairman may permit the investment intermediary to replace the subordinated loan capital referred to in para 3 item 3 with the elements of Art. 7 para 1 item 1-4.

(8) (Suppl. – SG, iss. 68 in 2008) The deputy chairman may permit the investment intermediary to exceed the maximum allowed amount for the subordinated loan capital under para 6, if he/she judges it admissible without violation of the prudential principles and provided that the total of such subordinated loan capital and the elements referred to in para 7 does not exceed 200 % of the original own funds left to meet the capital requirements under

Art. 24 and Chapter Six, Eight, Nine, Ten, Eleven and Annex No. 9, or 250% of the same amount when the investment intermediary deducts the amount of para 3 item 4 from the own funds amount in calculating the own funds.

(9) The subordinated loan capital under para 3 item 3 may be included in the own funds after the investment intermediary receives a permission of the deputy chairman under Art. 154.

Art. 9. (1) The illiquid assets according Art. 8 para 3 item 4 shall consist of:

1. tangible (non-current) fixed assets, reduced by that part of the value of the land and buildings that served as security of loans received against these assets;

2. shares and holdings in credit and financial institutions, including the amounts provided in the form of subordinated loan to such institutions, which are included in their own funds, unless they have been deducted from the own funds under Art. 7 para 5 item 1-4 or under Art. 10 para 1 item 4;

3. shares, holdings and other investments in undertakings, other than credit or financial institutions, in the cases when such investments are not readily marketable;

4. negative value of subsidiaries' own funds;

5. (Am. – SG, iss. 68 in 2008) deposits, other than those to be repaid within 90 days, and other than the payments in connection with the obligation to maintain deposits in order to secure transactions in futures and options;

6. loans and other amounts due, other than those due to be repaid within 90 days; and

7. physical stocks, unless they are already subject to capital requirements at least as stringent as those set out in Articles 19 and Article 23.

(2) In case where the shares and holdings in a credit or other financial institution are held by the investment intermediary for short period for the purpose of temporary financial assistance operation designated for transformation or reorganization of those institutions, the deputy chairman may permit it to waive the application of the limitations under this article.

(3) The deputy chairman may permit the investment intermediary to also waive the application of the limitations under Art. 9 in respect to those shares and holdings, which are included in its trading book.

Art. 10. (1) Investment intermediaries, belonging to a group, which with the deputy chairman's permission calculate the own funds according the provisions of Art. 8 Art. 9, as an exception of the requirements for consolidated supervision under Art. 136, shall apply the following limitations in the calculation of their own funds:

1. they shall deduct the illiquid assets under Art. 8 para 3 item 4 from the amount of own funds;
2. exception indicated in Art. 8 para 1 item 1 shall not include the elements under Art. 7 para 5 item 1-5 in undertakings which participate in the consolidation;

3. the limits referred to in Art. 7 para 6 shall be calculated with reference to the original own funds less the elements of Art. 7 para 5 item 1-5 as referred to in item 2 and which are a part of the original own funds of those undertakings included in the scope of consolidation;

4. the amount of the positions of own funds under Art. 7 para 5 item 1-5, referred to in item 3 shall be deducted from the original own funds, rather than from the total of all elements under Art. 7 para 7 and more particularly for the purposes of Art. 8 para 6-8.

(2) Where an investment intermediary calculates risk-weighted exposure amounts, taking account of the settlement risk and the counterparty credit risk according Chapter Twelve, Section II and the calculations are made according Section 1 of Annex 5, the following conditions shall apply:

1. value adjustments made to take account of the credit quality of the counterparty may be included by the investment intermediary in the sum of the value adjustments and provisions made for the exposures indicated in Chapter Seven;

2. if the credit risk of the counterparty is taken into account in the revaluation of a position included in the trading book and provided that the investment intermediary has been given due permission by the deputy chairman, the expected loss amount for the counter-party risk exposure shall be zero.

(3) For an investment intermediary, which applies adjustments according para 2 item 1, such value adjustments may not be done in a manner other than that indicated in para 2.

Chapter Four
NON-TRADING AND TRADING BOOK

Section I
General Provisions

Art. 11. (1) For the purpose of calculating the capital requirements for credit and market risk, the investment intermediary allocates all its positions between a non-trading and trading book.

(2) The non-trading book consists of balance sheet and off-balance sheet positions, which have not been included as positions in the investment intermediary’s trading book.

(3) The trading book shall consist of all positions in financial instruments and commodities, which the investment intermediary holds either with trading intent or in order to hedge other elements of the trading book. The trading book shall not include instruments and commodities, which are not able to be hedged or for whose tradability there are restrictive covenants.

(4) Positions held with trading intent are positions in financial instruments and commodities, held by the investment intermediary intentionally for short-term resale and/or with the intention of benefiting from actual or expected short-term price differences between buying and selling prices or from other price or interest rate variations. These positions shall include proprietary positions of the investment intermediary and its positions arising from market making and client servicing.

(5) The positions or sub-books held with trading intent, shall comply with the following requirements:

1. there must be a clearly documented and approved by the management body of the investment intermediary trading strategy for the positions or sub-portfolios, which shall include expected holding horizon;

2. there must be clearly defined rules and procedures for the active management of the positions, which shall include the following:

a) (Am. – SG, iss. 68 in 2008) positions entered by the front office unit in the investment intermediary;

b) position limits are set and monitored for appropriateness;

c) (Am. – SG, iss. 68 in 2008) the front office has the autonomy to enter into/manage the positions within agreed limits and according the approved trading strategy of the investment intermediary;

d) positions are reported to the investment intermediary's management body as an integral part of the investment intermediary's risk management process;

e) positions are actively monitored with reference to market information sources and an assessment made of the marketability or hedge-ability of the positions or their inherent risks, including the assessment of the quality and availability of market inputs to the valuation process, level of market turnover and sizes of positions traded in the market;

3. there must be clearly defined rules and procedures to monitor the positions for compliance with the investment intermediary's trading strategy including the monitoring of turnover and stale positions in the trading book.

(6) The deputy chairman shall exercise supervision over the structure of the investment intermediary's trading book.

Section II
Systems and Method for the Trading Book Assessment

Art. 12. (1) An investment intermediary shall establish and maintain systems and controls sufficient to provide prudent and reliable valuation estimates related to the trading book.

(2) The systems and controls shall include at least of the following:

1. (Am. – SG, iss. 28 in 2009) documented rules and procedures for the process of valuation, including clearly defined responsibilities of the various areas involved in the determination of the valuation, sources of market information and review of their appropriateness, frequency of independent valuation, timing of closing prices, procedures for adjusting valuations, and the month end and ad hoc verification procedures;

2. (Am. – SG, iss. 68 in 2008) reporting procedure for the department accountable for the valuation process, that is clear and independent of the front office, to the relevant person who manages and represents the investment intermediary.

Section III
Inclusion of Positions and Management of the Investment Intermediary's Trading Book

Art. 13. (1) The investment intermediary shall have clearly defined policies and procedures for inclusion of positions in the trading book and overall management of the trading book for the purposes of calculating the capital requirements, consistent with the provisions of Art. 11 and according its risk profile, which at a minimum shall address:

1. the positions and activities included in its trading book for the purposes of calculating the capital requirements;

2. (Am. – SG, iss. 28 in 2009) the extent to which a position can be marked-to-market daily by reference to data from an active, liquid and two-way market;

3. for positions that are marked-to-model, the extent to which the investment intermediary can:

a) identify all material risks of the positions;

b) hedge all material risks of the positions with instruments for which an active, liquid, two-way market exists;

c) derive reliable estimates for the key assumptions and parameters used in the model.

4. the extent to which the investment intermediary can, and is required to generate valuations for the positions that can be validated externally in a consistent way;

5. the extent to which legal restrictions or other operational requirements would affect the investment intermediary's ability to effect a liquidation or hedge of a position in the short term;

6. the extent to which an investment intermediary can and is required to actively manage the positions within its trading activity;

7. the extent to which an investment intermediary may transfer risk or positions between the non-trading and trading book and the criteria for such transfer.

(2) The compliance of the investment intermediary's operation with the policy and procedure under para 1 shall be documented and subject to periodical internal check.
(3) Term trading-related repo-style transactions, that an investment intermediary accounts for in its non-trading book may be included in its trading book for capital requirements purposes so long as all such repo-style transactions are included therein. To be included in the trading book, the repo-style transactions under sentence one must meet the requirements of Art. 11 para 4 and 5, and both legs of the transaction to be in the form of either cash or securities

includable in the trading book. Regardless of where they are booked, for all repo-style transactions the investment intermediary shall calculate counterparty credit risk charge.

(4) The investment intermediary may include in its trading book a position arising from internal hedge position, provided that it is held with trading intent and that the general criteria under Art. 11 and 12 are met, and that it corresponds to the following requirements:

1. it shall not be primarily intended to avoid or reduce capital requirements;

2. internal hedges shall be properly documented and subject to internal approval and audit procedures;

3. the internal transaction shall be dealt with at market conditions;

4. the market risk that is generated by the internal hedge shall be actively managed within the authorized for the trading book limits;

5. internal transactions shall be monitored precisely according envisaged procedures.

(5) An internal hedge position is a position that materially or completely offsets the component risk element of a non-trading book position or a set of positions.

(6) The hedged risks from the non-trading book shall be treated as risks in the trading book and are included in the calculation of the capital requirements to the trading book.

(7) Where an investment intermediary hedges a non-trading book credit risk exposures using credit derivatives from its trading book (an internal hedge), the non-trading book exposure shall not be deemed to be hedged in the calculation of the capital requirements, unless a credit derivative has been bought from an eligible third party - credit protection provider, and the credit derivative meets the requirements set out in point 24.2 of Annex 6. Where such third party protection is purchased and is recognized as a hedge of a non-trading book exposure for the purposes of calculating capital requirements, neither the internal nor external credit derivative hedge shall be included by the investment intermediary in the trading book for the purposes of calculating capital requirements.

Section IV
Trading Book Positions Assessment

Art. 14. (1) The positions in the trading book shall be assessed in compliance with the methods of prudent valuation under this Section. According these methods the investment intermediary must ensure conformity of the applied value for every position in the trading book to its current market value. The value shall take into account the dynamic nature of the positions in the trading book, requirements to reasonable justification, the investment intermediary's activity and the purpose of the capital requirements in relation to the trading book positions.

(2) The positions in the trading book shall be valued at least once daily.

Art. 15. (1) Marking to market method is at least daily valuation of positions at readily available close out prices that are sourced independently, including exchange prices, screen process or quoted from several independent reputable brokers.

(2) With the method under para 1, the investment intermediary uses the more prudent side of bid/offer unless it is a significant market maker in the particular type of financial instrument or commodity in question and it can close out at mid market.

Art. 16. (1) Where it is not possible to apply the method under Art. 15 para 1, investment intermediaries must mark to model their positions and sub-portfolios before applying trading book capital treatment. Marking to model is any valuation which has to be benchmarked, extrapolated or otherwise calculated from a market input.

(2) The following requirements must be complied with by the investment intermediary when applying marking to model:

1. investment intermediary's management body shall be aware of the elements of the trading book which are subject to mark to model and of the uncertainty which the model creates in the reporting of risk and performance of the business;

2. market inputs shall be sources, where possible, in line with market prices, and the appropriateness of the market inputs of the particular position being valued and the parameters of the model shall be assessed on a frequent basis;

3. where available, valuation methodologies which are accepted market practice for particular financial instruments or commodities shall be used;

4. where the model is developed by an investment intermediary itself, it shall be based on appropriate assumptions, which have been assessed and challenged by suitably qualified parties independent of the development process. The model shall be developed or approved by a unit in the investment intermediary, which is independent of the front office and shall be independently tested, including validation of the mathematics, assumptions and software implementation;

5. there shall be formal change control procedures in place and a secure copy of the model shall be held and periodically used to check valuations;

6. (Suppl. – SG, iss. 68 in 2008) the risk management and control unit shall be aware of the weaknesses of the models used and how to reflect those in the valuation output;

7. the model shall be subject to periodic review to determine the appropriateness of its performance, including assessment of the appropriateness of assumptions, analysis of profit and loss versus risk factors and comparison of actual close out values to model outputs.

Art. 17. (1) The investment intermediary at least once monthly shall perform an independent review of the accuracy and independence of the market prices and model inputs used in the application of the methods according Art. 15 and 16. The verification shall be performed by a unit independent of the front office.

(2) In the cases under para 15 and para 16, where independent pricing sources are not available, or they are subjective, the investment intermediary shall apply valuations adjustments.

Art. 18. (1) The investment intermediary shall adopt procedures for making adjustments of the valuations or the reserves.

(2) The valuation or reserve adjustments shall take into account the following factors:

1. unearned credit spreads;
2. close-out costs;
3. operational risks;
4. early termination;
5. investing and funding costs;
6. future administrative costs;
7. model risk.

(3) An investment intermediary shall form reserves, considering the following factors:

1. period of time it would take to fully hedge out the positions or risks associated with these positions;
2. the volatility and average of bid/offer spreads;
3. the availability of market quotes, number and identity of market makers;
4. volatility and average of trading volumes;
5. market concentration;
6. the aging of positions;
7. the extent to which the valuation relies on the model under Art. 16 para 1 and the impact of the risks inherent to it over the valuation;

(4) An investment intermediary which uses third party valuations or marking to model according Art. 16 para 1, shall consider whether to apply a valuation adjustment.

(5) The investment intermediary shall consider the need for establishing reserves for less liquid positions which may arise as a result of market events or as a result of its activity, such as concentration of positions and/or overdue positions and on an ongoing basis reviews their continued suitability

(6) When valuation adjustments or formation of reserve give rise to material losses for the current year, these shall be deducted from the original capital

(7) Other profit/losses originating from valuation adjustments or formation of reserve shall be included in the calculation of the net trading book profits according Art. 8 para 3 item 2 and

be added to/deducted from the investment intermediary's supplementary capital to cover market risks.

(8) The adjustments in the valuations or the reserves exceeding the values obtained according the investment intermediary's accounting policy shall be treated according para 6 if they result in substantial losses, or according Art. 7 in the other cases.

Chapter Five
CAPITAL REQUIREMENTS FOR COVER OF THE RISKS IN RELATION TO THE INVESTMENT INTERMEDIARIES OPERATION

Art. 19. (1) An investment intermediary's own funds shall always be more than or equal to the sum of :

1. the capital requirements to the positions kept by the investment intermediary in its trading-book, calculated in accordance with the methods and options laid down in the provisions of Chapter Six, Seven, Nine, Annex No. 9 and as appropriate Chapter Eleven;

2. (Am. – SG, iss. 68 in 2008) the capital requirements for all of the investment intermediary's business activities, calculated in accordance with the methods and options laid down in Chapter Eight, Ten and as appropriate, Chapter Eleven.

3. (New – SG, iss. 68 in 2008) the capital requirements for all of the investment intermediary's business activities for the operational risk, calculated in accordance with Chapter Thirteen, Section I.

(2) Regardless of the requirement of para 1, the amount of an investment intermediary's own funds may not be less than 25 per cent of the minimum required amount of the initial capital under Art. 4.

(3) The amount of own funds at book value may not be less than the minimum size of the initial capita under para 4 in consistence of the scope of the issued license for pursuance of business.

(4) (Am. – SG, iss. 68 in 2008) The deputy chairman may allow an investment intermediary to calculate the capital requirements for its trading book positions according Art. 21, Art. 67 para 2 and 3 and Art. 68, if in the preceding reporting period:

1. the value of the positions in the trading book does not normally exceed 5% of the investment intermediary's total business;

2. the total trading-book positions do not normally exceed the BGN equivalence of EUR 15 000 000;

3. (Am. – SG, iss. 68 in 2008) the value of the positions in the trading-book never exceeds 6% of the investment intermediary's total business and the total trading-book positions never exceed the BGN equivalence of EUR 20 000 000.

(5) (New – SG, iss. 68 in 2008) For the purposes of para 3 item 1 and 2 it shall be considered that the trading-book positions do not normally exceed the above stated values, if these values are not exceeded within 5 consecutive working days.

(6) (Prev. para 5 – SG, iss. 68 in 2008) The proportion that the trading-book business bears to the total business of the investment intermediary shall be determined on the basis of the value of the balance sheet and off-balance sheet positions.

(7) (Prev. para 6, am. – SG, iss. 68 in 2008) For the purposes of the calculation of the balance sheet and off-balance sheet positions under para 6, the debt instruments shall be valued at their market prices or at nominal values, equities at their market prices and derivatives according to market price or nominal value of the instruments underlying them. Long positions and short positions shall be summed regardless of their signs.

(8) (Prev. para 7, suppl. – SG, iss. 68 in 2008) If the amount of the trading-book positions exceeds the limits under para 4 item 1 and/or item 2, or either or both of the limits imposed in para 4 item 3 more than three folds per one calendar month, the investment intermediary shall forthwith notify the deputy chairman of the exceeding and shall start to calculate the capital requirements in respect to its trading-book business in compliance with para 1 item 1 from the beginning of the next reporting period.

Art. 20. (1) (Am. – SG, iss. 68 in 2008; iss. 28 in 2009) An investment intermediary shall keep at any time cash and/ or government securities at amount not less than 50 per cent of its current liabilities. The cash according to sentence one shall be kept by the investment intermediary in compliance with the limitation under Art. 34, para 1, sentence one and para 2 of the MFIA.

1. (Cancelled – SG, iss. 28 in 2009);

3. (Cancelled – SG, iss. 28 in 2009).

(2) (New – SG, iss. 68 in 2008; am. iss. 28 in 2009) Cash according to para 1 may be cash kept in safe or cash, kept on current or deposit accounts at a bank, which is not in bankruptcy proceedings. The cash kept on current or deposit accounts at a bank must be at the rate of not less than 70% of all moneys of the investment intermediary.

(3) (Prev. para 2 – SG, iss. 68 in 2008; am. iss. 28 in 2009) Government securities under para 1 are these issued by the Republic of Bulgaria, or another Member State, as well as debt securities, issued or guaranteed by the Republic of Bulgaria or another Member State, by the Bulgarian National Bank or by the central banks of other Member States, which have a market price or are with a residual maturity not longer than 90 days;

Art. 21. (Am. – SG, iss. 68 in 2008) An investment intermediary under Art. 19 para 4 may calculate capital requirements in respect to its trading-book for credit risk and dilution risk - 8% of the total of the risk-weighted exposure amounts calculated in accordance with Chapter Twelve;

Art. 22. (1) For the purposes of Art. 37 para 2 of debt securities issued in local currency, the investment intermediary may assign a zero-risk weighting to the issuers, indicated in Chapter Six, Table No. 1, except for those included in categories three and four.

(2) If a competent authority from a Member State, according the provisions of Chapter Six, approves a third country's collective investment undertaking (CIU) as eligible, subject to the permission of the deputy chairman, this approval may be accepted by the investment intermediary without conducting additional procedure of assessment.

Art. 23. (1) (Am. – SG, iss. 68 in 2008) An investment intermediary, in compliance with the provisions of para 2 – 4 and Art. 142 shall maintain at any time own funds for cover of the capital requirements according Art. 19.

(2) (Am. – SG, iss. 68 in 2008) With the approval of the deputy chairman, an investment intermediary, that has not obtained a license to pursue business under Art. 5 para 2 item 3 and 6 of the MFIA, may maintain own funds which are more than or equal to the higher of the following amounts:

1. (Am. – SG, iss. 68 in 2008) the sum of the capital requirements under Art. 21 and Art. 19, para 1, item 1 and 2;
2. the amount laid down in Art. 24.

(3) (Am. – SG, iss. 68 in 2008) The deputy chairman may allow the own funds of an investment intermediary under Art. 4 para 4 to be always more than or equal to the sum of the capital requirements calculated in accordance with the requirements contained in Art. 21 and Art. 19 para 1 item 1 and 2 and the amount laid down in Art. 24, where it is:

1. an investment intermediary that deals on own account for the purpose of executing a client order, or for the purpose of gaining entrance to a clearing and settlement system or recognized exchange when acting in agency capacity or executing a client order;

2. investment intermediaries, that:

a) do not hold client money or securities;

b) undertake only dealing on own account;

c) have no external customers

d) the execution and settlement of whose transactions are carried out by a clearing institution and are guaranteed by that institution.

(4) The investment intermediaries under para 2 and 3 shall apply all other provisions regarding operational risk, set out in Art. 142 para 1 item 9.

Art. 24. (1) (Am. – SG, iss. 68 in 2008) Investment intermediaries shall be required at all times to hold own funds equivalent to one quarter of their preceding fiscal year's fixed overheads.

(2) In case of a material change in the investment intermediary's activity in the current year compared with the preceding, the deputy chairman may obligate it to adjust the required amount under para 1.

(3) Where an investment intermediary has not a full preceding financial year, starting from the day of license obtaining, the amount of the own funds shall be determined on the basis of the fixed overheads projected in its business plan, unless an adjustment to the overheads in the plan is required by the deputy chairman.

(4) An investment intermediary shall determine their own funds under para 1 on the basis of the annual financial statement, certified by a registered auditor.

(5) Paragraphs 1 – 4 shall be applied only by investment intermediaries under Art. 23 para 2 or 3 or under § 5 of the Transitional and Final Provisions and only in a manner set forth in these provisions.

Art. 25. (1) (Am. – SG, iss. 68 in 2008) An investment intermediary must comply with the requirements laid down in Art. 19, Art. 142 para 1 and 2 and Chapter Nine on an individual basis.

(2) An investment intermediary which is neither a subsidiary, nor a parent undertaking in the Republic of Bulgaria, as well as an investment intermediary which is not included in consolidation pursuant to Art. 135, shall comply on an individual basis with the requirements laid down in Art. 131 para 1 – 3 and Art. 142 para 3 and 4.

(3) An investment intermediary which is neither a parent undertaking nor a subsidiary, as well as an investment intermediary which is not included in the consolidation pursuant to Art. 135 shall comply on an individual basis with the requirements of Chapter Fifteen, Section III.

Chapter Six
CALCULATING CAPITAL REQUIREMENTS FOR POSITION RISK

Section I
General Provisions

Art. 26. (1) The investment intermediary's net position shall be any excess of the long over the short positions, or the short over the long positions in the same equity, debt and convertible issues, as well as in identical financial futures, options, warrants and covered warrants.

(2) In calculating the net position, the investment intermediary may treat the positions in derivative instruments as positions in the underlying security.

(3) No netting shall be allowed between convertible and offsetting position in the instrument underlying it, except in the cases envisaging capital requirements to cover any loss which conversion may entail.

(4) All net positions, irrespective of their signs must be converted by the investment intermediary on a daily basis into Bulgarian leva (BGN) at the prevailing spot exchange rate of the Bulgarian National Bank

Art. 27. (1) Investment intermediaries shall treat interest-rate futures, forward-rate agreements (FRA) and forward commitments to buy or sell debt instruments as combinations of long and short positions, as follows:

1. long interest-rate futures position shall be treated as a combination of a borrowing maturing on the delivery date of the futures contract and a holding of an asset with maturity date equal to that of the instrument or the underlying position of the concerned futures contract;
2. a sold forward-rate agreement (FRA) shall be treated as a long position with a maturity date equal to the settlement date, plus the contract period, and as a short position with maturity equal to the settlement date;
3. a forward commitment to buy a debt instrument shall be treated as a combination of a borrowing maturing on the delivery date and a long (spot) position in the debt instrument.

(2) For the purposes of this Article, long position means a position, in which the investment intermediary has fixed the interest rate it will receive at some time in the future, and short position means a position in which the investment intermediary has fixed the interest rate it will pay at some time in the future.

(3) In order to calculate the capital required against specific risk for interest-rate futures and forward rate agreements (FRAs), both the borrowing and the asset holding shall be included in the first category set out in Table 1 in Annex 1, and for the a forward commitment to buy a debt instrument, the borrowing is included in the first category set out in Table 1, Annex 1, and the debt instrument under whichever category is appropriate for it in the same table.

(4) The deputy chairman may allow the capital requirements to the exchange-traded futures to be equal to the margin required by the relevant exchange, if the margin provides and accurate measure of the risk associated with the future and that it is at least equal to the capital requirement for a future, calculated by the methods in this chapter or applying the internal models method described in Chapter Eleven.

(5) The deputy chairman may allow the capital requirements for an OTC derivatives contracts of the types referred to in para 1, cleared by a recognized clearing house, to be equal to the margin required by the clearing house, if the margin provides an accurate measure of the risk associated with the derivatives contract and that it is at least equal to the capital requirements for the derivative instruments in question, calculated by the methods in this Chapter or by the internal models method, described in Chapter Eleven.

Art. 28 (1) For the purposes of this Chapter, the investment intermediary shall treat the options on interest rates, debt instruments, equities, equity indices, financial futures, swaps and foreign currencies as if they were positions equal in value to the amount of the underlying instrument to which the option refers, multiplied by its delta.

(2) Where an investment intermediary has a position in option under para 1, multiplied by delta, it may net it off against any offsetting positions in the identical underlying securities or derivatives.

(3) The investment intermediary uses delta which is set by the relevant exchange or by the Commission. Whenever delta is not set in the manners described in sentence one, as well as

for OTC-options, it shall be calculated by the investment intermediary by a method, approved by the deputy chairman.

(4) The deputy chairman may obligate the investment intermediary to calculate delta by determined by him methodology.

(5) The investment intermediary shall set aside own funds also for the other risks associated with options, apart from the delta risk.

(6) The deputy chairman may allow the requirements against a written exchange-traded option to be equal to the margin required by the relevant exchange, if the margin provides an accurate measure of the risk associated with the option and that it is at least equal to the capital requirements against options, calculated by the methods of this Chapter or applying the internal models method of Chapter Eleven.

(7) The deputy chairman may allow the investment intermediary the capital requirements for the OTC options cleared by a recognized clearing house, to be equal to the margin required by the clearing house, if the margin provides an accurate measure of the risk associated with the option and that it is at least equal to the capital requirements for OTC derivative instruments, calculated by the methods set out in this Chapter or by the internal models method of Chapter Eleven.

(8) The deputy chairman may allow the investment intermediary the capital requirements on a bought by it exchange-traded or OTC option to be the same as that for the instrument underlying it, where the requirement may not exceed the market value of the option.

(9) The investment intermediary shall calculate the capital requirements against a written OTC option in relation to the instrument underlying it.

Art. 29. The investment intermediary shall treat the warrants relating to debt instruments and equities in the way, described in Art. 28.

Art. 30. (1) Swaps for interest-rate risk purposes shall be treated by the investment intermediary on the same basis as on-balance-sheet instruments.

(2) In the case under para 1, the investment intermediary shall treat an interest-rate swap under which it receives floating-rate interest and pays fixed-rate interest as equivalent to a long position in a floating-rate instrument of maturity equivalent to the period until the next date of interest fixing and a short position in fixed-rate instrument with the same maturity as the swap itself.

Art. 31. (1) When the investment intermediary is the party who assumes the credit risk (the "protection seller"), in the calculation of the capital requirements for market risk, unless specified differently, the notional amount of the credit derivative contract must be used.

(2) for the purpose of calculating the specific risk requirements, the investment intermediary – protection seller applies the maturity of the of the credit derivative contract instead of the maturity of the obligation, except for the case of para 3 item 1.

(3) The investment intermediary – protection seller determines its positions under para 1 and 2 in the following way:

1. for a total return swap it creates a long position in the general market risk of the reference obligation and a short position in the general market risk of a government security with a maturity equivalent to the period until the next interest fixing and which is assigned a 0% risk weight under Annex No. 4, creating also for a total return swap a long position in the specific risk of the reference obligation.

2. for a credit default swap it does not create a position for general market risk, for the purposes of the calculations of specific risk, the investment intermediary must record a synthetic long position in an obligation of the reference entity, unless the derivative is rated and meets the conditions for a qualifying debt item, in which case a long position in the derivative is recorded. If premium or interest payments are due, the investment intermediary shall represent these cash flows as base positions in government securities.

3. for a single name credit linked note it shall create a long position in the general market risk of the credit-linked note itself, as an interest rate product and for the purpose of specific risk calculation, the investment intermediary creates a synthetic long position in an obligation of the reference entity and an additional long position in the issuer of the securities.

4. for a multiple name credit linked note and providing proportional protection, it creates a long position in the specific risk of the issuer of the note, as well as a position in each reference entity, with the total notional amount of the contract assigned across the positions according to the proportion of the total notional amount that each exposure to a reference entity represents. Where the investment intermediary can select more than one obligation of a reference entity, then for the specific risk calculation it shall apply the obligation with the highest risk weighting.

5. for a first-asset-to-default credit derivative it shall create a position for the notional amount in an obligation of each reference entity. If the size of the maximum credit event payment is lower than the capital requirement under para 1, the investment intermediary shall take the maximum payment amount as the capital requirement for specific risk.

6. for a second-asset-to-default credit derivative it creates a position for the notional amount in an obligation of each reference entity less the one that is with lowest specific risk capital requirement, and in case that the size of the maximum credit event payment is lower than the capital requirement under para 1, the investment intermediary shall take the maximum payment as the capital requirement for specific risk.

(4) In regard to the credit linked notes under para 3 item 3 and 4, that have an external rating and meet the conditions for a qualifying debt item, the investment intermediary – protection seller shall record a single long position with the specific risk of the notes, and in the cases under para 3 item 5 and 6, where a first or second-asset to default derivative is externally

rated and meets the conditions of a qualifying debt item, then it need only calculate one specific risk charge reflecting the derivative rating.

Art. 32. (1) Where the investment intermediary is the party who transfers credit risk (the "protection buyer"), it determines its positions as opposite to those of the "protection seller" under Art. 31, save for the cases under Art. 31, para 3 item 3 and 4.

(2) If at a given moment there is a call option in combination with a step-up, the investment intermediary – protection buyer treats such moment as the maturity of the protection.

(3) In the case of n^{th} to default credit derivatives, the investment intermediary – protection buyer shall be allowed to off-set specific risk for n-1 of the underlyings (i.e. the n-1 assets with the lowest specific risk charge).

Art. 33. (1) Where the investment intermediary marks to market and manages the interest-rate risk on the derivative instruments according Art. 27 – 30 on a discounted-cash-flow basis, it may use sensitivity models to calculate those positions.

(2) The investment intermediary may use the models under para 1 also for any bonds which are amortized over its residual life rather than via one final repayment of principal.

(3) The sensitivity models under para 1 and 2 and their use shall be approved by the deputy chairman.

(4) The models should generate positions which have the same sensitivity to interest-rate changes as the underlying cash flows. The positions shall be included in the calculation of capital requirements according to the provisions laid down in Art. 37 – 47.

(5) The investment intermediary shall assess the models sensitivity with reference to independent movement in sample rates across the yield curve with at least one sensitivity point for each of the maturity periods set out in Table 2 of Annex No. 1.

Art. 34. The deputy chairman may give approval to the investment intermediary, which does not use the models under Art. 33 to treat as fully offsetting any positions in derivative instruments under Art. 27-30 which meet the following conditions:

1. the positions are of the same value and denominated in the same currency;
2. the reference rate for floating-rate positions or coupons for fixed-rate position is closely matched;
3. the next interest-fixing date for floating-rate positions and residual maturity for fixed coupon positions corresponds with the following limits:

a) if the next interest-fixing date and residual maturity are with a period less than one month, they must be the same day;

b) if the next interest-fixing date and residual maturity are with a period between one month and one year, a difference within up to 7 days may exist between then;

c) if the next interest-fixing date and residual maturity are with a period over one year, a difference up to 30 days may exist between them.

Art. 35. In case that the investment intermediary is the transferor of securities or guaranteed rights relating to title to securities in a repurchase agreement and the lender of securities, it shall include these securities in the calculation of its capital requirement under this Chapter provided that such securities are included in the trading book.

Art. 36. (1) The investment intermediary shall divide into two components the position risk on the traded debt instruments or equities or debt or equity derivatives in order to calculate the capital required against it.

(2) The first component of the position risk shall be its specific-risk, that is the risk of a price change in the instrument concerned due to factors related to its issuer or, in the case of a derivative, related to issuer of the underlying instrument.

(3) The second component of the position risk shall cover its general risk, that is the risk of a price change in the instrument due to a change in the level of interest rates, in the case of traded debt instruments or debt derivative, or to a change in the price of the concerned instrument due to broad equity-market movement unrelated to any specific attributes of individual securities in the case of an equity or equity derivative.

Section II
Traded Debt Instruments

Art. 37. (1) The investment intermediary shall classify the net positions in traded debt instruments according to the currency in which they are denominated and shall calculate the capital requirement for general and specific risk in each individual currency separately.

(2) The investment intermediary shall assign its net positions in the trading book, as calculated in accordance with Art. 26 to the appropriate categories in Table 1, Annex 1 on the basis of their issuer or obligator, external or internal credit assessment and residual maturity, and then multiply them by the weightings shown in that table.

(3) In order to calculate the capital requirement against specific risk, the investment intermediary shall sum its weighted under para 2 positions, regardless of whether they are long or short. The positions of the investment intermediary in issued by it debt instruments shall not participate in the calculation of specific risk.

(4) An investment intermediary calculating the value of the risk weighting of exposures under Chapter Twelve, Section II, shall have to qualify for a credit quality step the obligator of the exposure which shall have an internal rating with a probability of default (PD), equivalent to or lower than that associated with the appropriate credit quality step of exposures to corporates under the rules in Chapter Twelve, Section I.

(5) Instruments issued by a non-qualifying issuer shall receive a specific risk capital charge of 8% or 12% according to Table 1 of Annex 1. The deputy chairman may require the investment intermediary to apply a higher specific risk charge to such instruments and/or to

disallow offsetting for the purposes of defining the extent of general market risk between such instruments and any other debt instruments.

(6) For securitization exposures that would be subject to a deduction treatment as set out in Art. 7 para 5 item 6, or risk-weighted at 1 250 %, according Annex 7, the investment intermediary shall calculate a capital charge that is no less than that envisaged in those provisions.

(7) In respect to unrated liquidity facilities, the investment intermediary shall apply a capital charge that is no less than that set out in Annex 7.

Art. 38. (1) For the purposes of classification of the items under Art. 37, qualifying items shall include:

1. long and short positions in assets qualifying for a credit quality step corresponding at least to the investment grade in the mapping process described in Chapter Twelve, Section I;

2. long and short positions in assets which because of the solvency of the issuer, have a probability of default (PD) which is not higher than that of the assets referred to under item 1, according the provisions of Chapter Twelve, Section II;

3. long and short positions in assets for which a credit assessment by a nominated external credit assessment institution is not available and which meet the following conditions:

   a) they are considered by the investment intermediary to be sufficiently liquid;

   b) their investment quality, according to the investment intermediary's own discretion, is at least equivalent to that of the assets referred to under item 1;

   c) they are listed on at least one regulated market in the Republic of Bulgaria or another Member State or on a regulated market in a third country, which is recognized by the Commission;

4. long and short positions in assets issued by an issuer, subject to capital adequacy requirements equivalent to the requirements under this Ordinance, which in the investment intermediary's judgment are sufficiently liquid and whose investment quality is at least equivalent to that of the assets referred to under item 1;

5. securities issued by an issuer of equivalent or higher credit quality than that of issuers associated with credit quality step 2 according the provisions of Chapter Twelve, Section I and that are subject to capital adequacy requirements comparable to the requirements under this Ordinance.

(2) The manner in which the investment intermediary assesses the debt instruments shall be analyzed and the deputy chairman may obligate the investment intermediary to correct the assessments, if he/she decides that the debt instruments concerned are subject to too high a degree of specific risk to be qualifying items.

(3) The investment intermediary shall apply the maximum weighting shown in Table 1, Annex 1 to instruments that show a particular risk because of the insufficient solvency of the issuer.

Section III
Calculation of the General Risk on the Traded Debt Instruments According the Maturity Method

Art. 39. (1) The procedure for calculating the investment intermediary's capital requirements against general risk involves the following two steps.

1. the investment intermediary shall weight all positions according to their maturity in order to calculate the capital required against them;

2. the investment intermediary may reduce the requirement to weighted positions, that are held alongside an opposite weighted position within the same maturity band.

(2) The investment intermediary may reduce the requirements under para 1, item 2 when the opposite weighted positions fall into different maturity band, with the size of this reduction depending on whether the two positions fall into the same zone or not and on the particular zones they fall into.

(3) The investment intermediary shall assign its net positions to one of the maturity bands indicated in Table 2 of Annex 1, on the basis of residual maturity in the case of fixed-rate instruments and on the basis of the period until the interest rate is next set in the case of instruments on which the interest rate is variable.

(4) The investment intermediary shall allocate the debt instruments with a coupon of 3% or more and those with a coupon less than 3%, respectively to column 2 or column 3 of Table 2 of Annex 1 and according the maturity band to which the debt instruments have been allocated, the investment intermediary shall then multiply each of them by the relevant weighting.

Art. 40. (1) The investment intermediary shall then work out the sum of the weighted long positions and the sum of the weighted short positions in each maturity band.

(2) The amount of the weighted long positions which the investment intermediary matches by the weighted short positions in a given maturity band shall be the matched weighted position in that band.

(3) The investment intermediary shall calculate the total of the matched weighted positions in all maturity bands, the residual long or short positions shall be the unmatched weighted position for the relevant maturity band.

Art. 41. The investment intermediary shall compute the total of the unmatched weighted long, respectively short positions for the relevant maturity bands from the three zones. That part of the unmatched weighted long position for a given zone that is matched by the unmatched weighted short positions in the same zone shall be the matched weighted position for that zone, while the residual unmatched weighted long or unmatched weighted short position shall be the unmatched weighted position for that zone.

Art. 42. (1) The investment intermediary shall match the unmatched weighted long (short) position in zone one with the unmatched weighted short(long) position in zone two, thus obtaining the matched weighted position between zones one and two.

(2) After the matching under para 1, the investment intermediary shall match the unmatched weighted long (short) positions in zone 2 which are left over and the unmatched weighted short (long) positions in zone 3, in order to obtain the matched weighted position between zones 2 and 3.

(3) The investment intermediary may, if it decides so, reverse the order of calculation according para 1 and 2, so as to calculate the matched weighted position between zones two and three before calculating that position between zones one and two.

(4) After carrying out the matching under the preceding paragraphs, the investment intermediary shall match the residual unmatched weighted positions between zone 1 and zone 3.

(5) The investment intermediary shall sum the residual unmatched weighted positions, following the matching under para 1-4.

Art. 43. An investment intermediary shall calculate the capital requirement as the sum of:

1. 10% of the sum of the matched weighted positions in all maturity bands;
2. 40% of the matched weighted position in zone 1;
3. 30% of the matched weighted position in zone 2;
4. 30% of the matched weighted position in zone 3;
5. 40% of the matched weighted position between zone 1 and zone and between zone 2 and zone 3;
6. 150% of the matched weighted position between zones 1 and 3;
7. 100% of the residual unmatched weighted positions.

Section IV
Calculation of the General Risk on Traded Debt Instruments According the Duration-based Method

Art. 44. The deputy chairman may allow in the calculation of the capital requirement for the general risk on traded debt instruments, the investment intermediary to use the method based on their duration, instead of the maturity-based method under Section III.

Art. 45. (1) When applying the duration-based method, the investment intermediary calculates the yield to maturity on the basis of the market value of the debt instruments.

(2) In the case of floating-rate instruments, the investment intermediary shall assume that the principal is due on the date when the interest rate can next be changed.

Art. 46. (1) After determining the yield to maturity, the investment intermediary shall calculate the modified duration of each debt instrument on the basis for formula 1 of Annex 1, allocating then each debt instrument on the basis of its modified duration to the appropriate zone in Table 3 of Annex 1.

(2) After the calculation under para 1, the investment intermediary shall calculate the duration-weighted position for each instrument by multiplying its market price by its modified duration and by the assumed interest-rate change.

Art. 47. (1) The investment intermediary shall calculate its duration-weighted long and short positions within each zone, after which it shall match them, thus forming the matched duration-weighted position for that zone.

(2) The investment intermediary shall calculate the unmatched duration-weighted positions for each zone according the procedures laid down for unmatched weighted positions in Art. 42.

(3) The capital requirement shall be calculated as the sum of:

1. 2% of the matched duration-weighted position for each zone;
2. 40% of the matched duration-weighted positions between zones 1 and 2 and between zones 2 and 3;
3. 150% of the matched duration-weighted position between zones 1 and 3;
4. 100% of the residual unmatched duration-weighted positions.

Section V
Calculation of the General and Specific Risk on Equities

Art. 48. The investment intermediary shall sum all its net long positions and its net short positions in accordance with Art. 26. The sum of the two figures shall be its overall gross position, and the difference between them shall be its overall net position.

Art. 49. (1) The investment intermediary shall multiply the overall gross position by 4% in order to calculate its capital requirement against specific risk.

(2) The deputy chairman may reduce the capital requirements under para 1 to be 2% for those portfolios of equities of an investment intermediary which meet the following conditions:

1. the equities shall not be those of issuers which have issued only traded debt instruments that are in the band for capital requirement of 8% or 12% according Table 1 of Annex 1 or for which lower requirements apply because they are guaranteed or secured;
2. the equities must be highly liquid;

3. no individual position shall comprise more than 5% of the value of the investment intermediary’s overall equity portfolio.

(3) The deputy chairman may authorize the individual positions under para 2 item 3 to be of size up to 10% of the portfolio value, provided that the total of such positions does not exceed 50% of its value.

Art. 50. The investment intermediary’s capital requirement against general risk shall be its overall net position multiplied by 8%.

Art. 51. (1) Where the investment intermediary has positions in stock-index futures, its delta –weighted equivalents of options in stock-index futures and stock indices, hereinafter referred to as ‘stock-index futures’, it shall treat them as positions in each of their constituent underlying equities.

(2) With the approval of the deputy chairman, the investment intermediary may offset opposite positions in the underlying equities themselves.

(3) The deputy chairman shall carry out checks of any investment intermediary which has netted off its positions in one or more of the equities constituting a stock-index future against opposite positions in the stock-index future itself, has adequate capital to cover the risk of loss caused by the future’s values not moving in line with that of its constituent equities.

(4) The deputy chairman shall also conduct the check under para 3 in cases where the investment intermediary holds opposite positions in stock-index futures which are not identical in respect of their maturity and/or their composition.

Art. 52. (1) With regard to stock-index futures which are traded on a regulated market and the indices in the deputy chairman’s judgment are broadly diversified, the investment intermediary shall not calculate capital requirement against specific risk. The investment intermediary shall calculate for them a capital requirement against general risk of 8%.

(2) The stock-index futures under para 1 shall be included in the calculation of the overall net position according Art. 48, but disregarded in the calculation of the overall gross position.

(3) If a stock-index future is not broken down into its constituent underlying positions, it shall be treated by the investment intermediary as if it were an individual instrument.

(4) The specific risk of the individual equity under para 3 can be ignored if the stock-index future in question is traded on a regulated market, and the deputy chairman has defined it as a broadly diversified index.

Section VI
Underwriting

Art. 53. (1) The deputy chairman may allow an investment intermediary in the case of underwriting of debt or equity instruments, to use the following procedure in calculating its capital requirement:

1. to calculate the net positions by deducting underwriting positions which are subscribed or sub-underwritten by third parties on the basis of a written agreement;

2. to reduce its net positions by the reduction factors in Table 4 of Annex 1;

3. to calculate its capital requirements using the reduced underwriting positions.

(2) The deputy chairman shall give an approval only if the investment intermediary attests that it holds sufficient capital against risk of loss which exists between the time of the initial commitment and working day 1.

Section VII
Specific Risk Capital Charges for Trading Book Positions Hedged by Credit Derivatives

Art. 54. (1) Full allowance of protection, ensured by credit derivative contracts, shall be given when the value of two legs of the transactions always moves in the opposite directions and in the same extent and shall be admitted where:

1. the two legs of the transaction consist of completely identical instruments;

2. a long cash position is hedged by a total rate return swap (or vice versa) and there is exact match between the reference obligation and the underlying exposure, and the maturity of the swap itself may be different from that of the underlying exposure.

(2) in the cases under para 1, a specific risk capital charge should not be applied to either side of the position.

Art. 55. (1) An 80% offset can be applied when the two legs of the transaction always move in the opposite direction and where there is an exact match in terms of the reference match, in the maturity of the reference obligation and the credit derivative, and in the currency of the underlying exposure.

(2) In the case under para 1, the key features of the credit derivative contract should not cause the price movement of the credit derivative to materially deviate from the price movements of the cash position.

(3) In case that the transaction transfers risk, the specific risk offset under para 1 will be applied to the side of the transaction with the higher capital charge, while the specific risk requirements on the other side shall be zero.

Art. 56. (1) Partial offset may be realized when the two legs of the transaction usually move in the opposite direction and shall be allowed where:

1. the position meets the conditions of Art. 54 para 1 item 2 but there is an asset mismatch between the reference obligation and the underlying exposure, the positions meeting the following requirements:
   a) the reference obligation ranks pari passu or is junior to the underlying obligation;

   b) the underlying obligation and the reference obligation share the same obligor and have legally enforceable cross-default or cross-acceleration clauses.

2. the position meets the conditions of Art. 54 para 1 item 1 or Art. 55, but there is a currency or maturity mismatch between the credit protection and the underlying asset, and the currency mismatches should be included in the normal reporting of foreign exchange risk according Annex 3;

3. the position falls under Art. 55 but there is an asset mismatch between the cash position and the credit derivative, but the underlying asset is included in the obligations in the credit derivative documentation.

(2) In the cases under para 1, rather than adding the specific risk capital requirements for each side of the transaction, only the higher of the two capital requirements shall apply.

Art. 57. For all situations not falling under Art. 54-56, a specific risk capital charge will be assessed against both sides of the positions.

Section VIII

Capital Requirements for positions of collective investment undertakings (CIUs) in the trading book

Art. 58. The investment intermediary shall calculate the capital requirements for positions in collective investment undertakings (CIUs) which meet the conditions for inclusion in the trading book in accordance with the methods set out in Art. 59-64.

Art. 59. (1) In respect to its positions in CIUs the investment intermediary shall calculate a capital requirement for position risk (specific and general) of 32%, unless otherwise envisaged.

(2) Without prejudice to the provisions of Art. 72 para 9 or Art. 101 para 2 item 4, the investment intermediary shall calculate for positions in CIUs capital requirements for position risk (specific and general) and foreign-exchange risk of no more than 40%.

(3) No offsetting is permitted between the underlying investments of CIUs and other positions held by the investment intermediary, unless otherwise stated in this Ordinance.

Art. 60. (1) The investment intermediary shall calculate the capital requirements in accordance with the methods indicated in Art. 61-64 for positions in a collective investment undertaking which is supervised or whose home Member State is the Republic of Bulgaria or another Member State, and meeting the following conditions:

1. the CIU's prospectus or equivalent document shall include:

a) the categories of assets the CIU is authorized to invest in;

b) the investment limits, if any, and the methodologies to calculate them;

c) if leverage is allowed, the maximum level of leverage;

d) if investment in OTC financial derivatives or repo-style transactions are allowed to the CIU, a policy to limit counterparty risk arising from these transactions.

2. the business of the CIU shall be reported in half-yearly and annual reports to enable an assessment to be made of the assets and liabilities, income and operations over the reporting period;

3. the units/shares of the CIU are redeemable on a daily basis at the request of the units holders;

4. investments in the CIU shall be segregated from the assets of the CIU management company;

5. there shall be adequate risk assessment of the CIU by the person realizing the investment.

(2) The deputy chairman may allow an investment intermediary to use the methods according Art. 61 – 64 also for the positions in third country CIUs if they meet the requirements under para 1.

Art. 61. (1) Where the investment intermediary is aware of the underlying instruments of the CIU on a daily basis, it shall calculate the capital requirements for position risk (general and specific) in compliance with them and according the methods set out in this Chapter or in accordance with the methods stated in Chapter Eleven, if permission for the latter has been granted by the deputy chairman.

(2) The investment intermediary shall treat its positions in collective investment undertakings as positions in the underlying investments.

(3) The investment intermediary may do netting between positions in the underlying investments of the CIU and other positions held by it, as long as it holds a sufficient quantity of units to allow for exchange for the underlying investments.

Art. 62. (Am. – SG, iss. 68 in 2008) The investment intermediary may calculate the capital requirements for position risk (general and specific) for its positions in CIUs in accordance with Art. 61 para 1 and for positions created with the purpose to replicate the composition and performance of an externally generated index or a basket of equities or debt securities, subject to the following conditions:

1. (Am. – SG, iss. 68 in 2008) the purpose of the CIU is to replicate the composition and performance of an externally generated index or a basket of equities or debt securities;
2. (Suppl. – SG, iss. 68 in 2008) a minimum correlation coefficient of 0,9 between daily price movements of the CIU's shares or units and the index or basket of equities or debt securities it tracks can be established over a period of six months.

Art. 63. Where the investment intermediary is not aware of the underlying investments of the CIU on a daily basis, it calculates the capital requirements for position risk (general and specific) in accordance with the methods set out in this Chapter, subject to satisfying the following conditions:

1. it is assumed that the collective investment undertaking invests to the maximum extent allowed according its investments limitations in the asset classes attracting the highest capital requirement for position risk, and then continues making investments in descending order until the maximum total investment limit is reached. The investment intermediary will treat its position in the CPU as a direct holding in the assumed position;

2. It shall be taken account of the maximum indirect exposure that it could achieve by taking leveraged positions through the CIU and will proportionately increase its position in the CIU up to the maximum allowed by the investment limits exposure to the underlying investment items;

3. if the capital requirement for position risk (general and specific) according to this article exceeds that set out in Art. 59, the capital requirements shall be capped at that level.

Art. 64. The investment intermediary may assign to a third party to calculate and report capital requirements for position risk (general and specific) for positions in CIUs, provided that the correctness of the calculations and their reporting in consistence with the methods, set forth in this Chapter, is adequately ensured.

Chapter Seven
CALCULATION OF CAPITAL REQUIREMENTS FOR SETTLEMENT AND COUNTERPARTY CREDIT RISK

Section I
Settlement Risk

Art. 65. (1) In the case of concluded transactions in which debt securities, equities, foreign currencies or commodities are unsettled after their due delivery date, an investment intermediary must calculate the difference between the agreed settlement price for the subject of the transaction and its current market value, where the difference could involve a loss for the intermediary.

(2) Paragraph 1 shall not apply for repurchase and reverse repurchase agreements and securities or commodities lending or borrowing.

(3) To calculate the capital requirement for cover of the risk of change in the market value due to delay in the settlement, the investment intermediary shall multiply the difference under para 1 by the appropriate factor according the time of delay in the following table:

Number of working days after due settlement date	Coefficient (%)
5 – 15	8
16-30	50
31-45	75
46 *or more*	100

Art. 66. (1) To cover the risk in free deliveries, an investment intermediary shall be required to hold own funds, as set out in para 2, if:

1. it has paid for securities, foreign currencies or commodities before receiving them or it has delivered securities, foreign currencies or commodities before receiving payment for them;

2. in the case of cross-border transactions, one working day or more has elapsed since it made payment or delivery.

(2) The treatment of exposures to settlement risk in free deliveries shall be done as follows:

1. up to first contractual payment or delivery leg – no capital requirement is calculated;

2. from first contractual payment or delivery leg up to four days after second contractual payment or delivery leg – the exposure shall be treated as settlement risk exposure under Art. 65;

3. (Am. – SG, iss. 68 in 2008) from five business days post second contractual payment or delivery leg until extinction of the transaction – the transferred value plus current positive exposure is deducted from own funds.

(3) In applying a risk weight to free delivery exposures according para 2 item 2, the investment intermediary using the approach set out in Chapter Twelve, Section II may assign an estimate of probability of default (PDs) to counterparties, for which they have no other non-trading book exposure on the basis of the counterparty's external rating, and in the cases where the investment intermediary uses own estimates of loss given defaults ('LGDs'), it may apply the LCD set out in Annex No. 5, provided that they apply it to all such exposures.

(4) In cases other than those under para 2 and 3, the investment intermediary using the approach set out in Chapter Twelve, Section II may apply the risk weights, as set out in Chapter Twelve, Section I, provided that it applies them to all such exposures, or may apply a 100% risk weight to all such exposures.

(5) If the amount of positive exposures resulting from free delivery transactions is not material, an investment intermediary may apply a risk weight of 100% to these exposures.

(6) In the cases of a system wide failure of a settlement or clearing system, the deputy chairman may allow the investment intermediary not to calculate the capital requirements as set out in Art. 65 para 1 until the systems begin to function normally. In this case, the failure of a counterparty to settle a trade shall not be deemed a default for the purposes of credit risk.

Section II
Counterparty Credit Risk

Art. 67. (1) An investment intermediary shall be required to hold own funds against the counterparty credit risk (CCR) arising from exposures due to the following:

1. OTC derivative instruments and credit derivatives;
2. repurchase agreement, reverse repurchase agreements, securities or commodities lending or borrowing transactions based on securities or commodities including in the trading book;
3. margin lending transactions based on securities or commodities;
4. long settlement transactions.

(2) Exposure values and risk-weighted exposure amounts for such exposures shall be calculated in accordance with the provisions of Chapter Twelve

(3) In the case of para 2, in calculating risk-weighted exposure amounts, an investment intermediary may not use the Financial Collateral Simple Method, set forth in Annex No. 6, for the recognition of the effects of financial collateral.

Art. 68. (1) In the case of repurchase transactions and securities or commodities lending or borrowing transactions booked in the investment intermediary's trading book, all financial instruments and commodities that are obtained as a result of these transactions and are eligible to be included in the trading book, may be recognized as eligible collateral in the calculation under Art. 67 para 2. Exposures due to OTC derivative instruments booked in the trading book and commodities that are eligible to be included in the trading book may also be recognized as eligible collateral.

(2) For the purposes of calculating volatility adjustments, where financial instruments or commodities under para 1 are not recognized as collateral according Annex 6 and are lent, sold or provided, or borrowed, purchased or received by way of collateral or otherwise in pursuance of such transactions, and the investment intermediary is using the Supervisory

Volatility Adjustments approach under Annex N 6, such instruments and commodities shall be treated by it in the same way as non-main index equities listed on a recognized exchange.

(3) Where an investment intermediary is using Own Estimates of Volatility adjustments approach, set forth in Annex N 6, in respect of financial instruments or commodities which are not recognized as collateral, volatility adjustments must be calculated for each individual item.

(4) Where an investment intermediary is using Internal Models Approach, stated in Annex No. 6, it may also apply this method in the trading book.

Art. 69. (1) In relation to the recognition of master netting agreements covering repurchase transactions, securities or commodities lending or borrowing transactions, or other capital market-driven transactions, netting across positions in the trading book and the non-trading book will only be recognized for the purposes of the calculation under Art. 66 para 2, when netted transactions fulfill the following conditions:

1. all transactions are marked to market daily;
2. all positions obtained as a result of the netting transactions may be recognized as eligible financial collateral under Chapter Twelve, Section III.

(2) In the case under para 1 item 2 the provisions of Art, 68 shall not apply.

Art. 70. Where a credit derivative included in the trading book forms part of an internal hedge and the credit protection is recognized according the provisions of Chapter Twelve, Section III, the investment intermediary shall deem that there is no counterparty risk arising from the position in the credit derivative.

Art. 71. (1) The capital requirements for counterparty credit risk shall be 8% of the total risk-weighted exposure amounts.

(2) In the calculation of the minimum capital requirements related to counterparty credit risk and the minimum capital requirements related to the credit risk, the exposures to recognized investment intermediaries from third countries or recognized clearing houses and exchanges from third countries shall be treated as exposures to institutions.

Chapter Eight

CALCULATION OF CAPITAL REQUIREMENTS FOR COVER OF FOREIGN-EXCHANGE RISK

Art. 72 (1) If the sum of an investment intermediary's overall net foreign-exchange position and its net gold position, calculated in accordance with the procedure set out in para 2, exceeds 2% of its total own funds, the investment intermediary shall multiply the sum of these net positions by 8% in order to calculate its own-funds requirement against foreign-exchange risk.

(2) A two-stage calculation shall be used for capital requirements for foreign-exchange risk, where in the first stage the investment intermediary calculates the net open position in each currency (including the reporting currency) and in gold. The net open position shall consist of the following elements (positive or negative):

1. the net spot position - i.e. all asset items less all liability items, including accrued interest, in any currency, or for gold - the net spot position in gold;

2. the net forward position - i.e. all amounts to be received less all amounts to be paid under forward exchange and gold transactions, including currency and gold futures and the principal on currency swaps not included in the spot position under item 1;

3. irrevocable guarantees and similar instruments that are certain to be called and likely to be irrecoverable;

4. net future income and/or expenses not yet accrued but already fully hedged;

5. (Am. – SG, iss. 68 in 2008) the net delta equivalent amount, or such based on delta of the total book of foreign-currency, gold options, etc.;

6. the market value of options other that foreign-currency and gold options.

(3) Subject to approval by the deputy chairman, the investment intermediary may include net future incomes and/or expenses, not yet accrued but already fully hedged by a forward foreign-exchange contract, in the net value of the open position under para 2. In such case the investment intermediary shall be obligated to apply the chosen approach consistently.

(4) Any positions arisen from hedging against the adverse effect of the exchange rate volatility on its capital ratio may be excluded from the calculation of the net open currency position under para 2 if such positions are of a non-trading or structural nature and their exclusion, or any variation of the terms of their exclusion, shall require the consent of the deputy chairman.

(5) Paragraph 4 shall also apply to foreign exchange positions of the investment intermediary related to items that are already deducted in the calculation of own funds.

(6) In the calculation of net foreign exchange positions of collective investment undertakings (CIUs) under para 2, an investment intermediary shall take into account their real foreign exchange positions, where for their reporting information may be used from reports prepared by third parties if such reports' correctness is adequately ensured.

(7) (Am. – SG, iss. 68 in 2008) In the case of para 6, where an investment intermediary does not have sufficient information of the foreign exchange positions in a CIU, it shall assume that the CIU has invested in foreign exchange other than the Bulgarian lev, up to the maximum extent allowed according the relevant investment limitations. The investment intermediary shall, for trading book positions, take account of the maximum indirect exposure that it could achieve by its positions in the CIU when calculating their capital requirement for foreign exchange risk, this being done by proportionally increasing its position in the CIU up to the maximum exposure to the underlying investment items according the investment limitations.

(8) The investment intermediary shall treat the position under para 7 of the CIU in foreign exchange as a separate currency, similar to the treatment of investments in gold, subject to the modification that, if the direction of the CIU's investment is available, the total long position may be added to the total long open foreign exchange position and the total short position may be added to the total short open foreign exchange position, no netting being allowed between such positions prior to the calculation.

(9) The deputy chairman shall have the discretion to allow investment intermediaries to use the net present value when calculating the net open position in each currency and in gold.

(10) In the second stage, net short and long positions in each currency other than the reporting currency and the net long or short positions in gold shall be converted at spot rates into BGN at the official exchange-rate of the Bulgarian National Bank. They shall then be summed separately to form the total of the net short positions and the total of the net long positions respectively. The higher of these two totals shall be the overall net foreign-exchange position.

Art. 73. (1) With the deputy chairman's permission by derogation from Art. 72, the investment intermediary may apply the procedures of this article to calculate the capital charge for the purposes of covering foreign-exchange risk. The deputy chairman may allow the investment intermediary to provide lower capital requirements than those regulated under Art. 72 against positions in closely correlated currencies.

(2) A pair of currencies closely correlated are such with which the likelihood of a loss (calculated on the basis of daily exchange-rate data for the preceding three or five years) occurring on equal and opposite positions in such currencies over the following 10 working days, is 4% or less of the value of the matched position in question, valued in terms of BGN, and is:

1. at least 99%, when an observation period of three years is used;
2. at least 95%, when an observation period of five years is used.

(3) The capital requirement on the matched position in two closely correlated currencies shall be 4% multiplied by the value of the matched position, and on unmatched positions in closely correlated currencies, and all positions in other currencies, it shall be 8%, multiplied by the higher of the sum of the net short or the net long positions in those currencies after the removal of matched positions.

(4) The deputy chairman may allow investment intermediaries to remove positions in any currency which is subject to a legally binding intergovernmental agreement to limit its variation relative to other currencies covered by the same agreement regardless of whichever of the methods is applied by the investment intermediary. Investment intermediaries shall calculate their matched positions in such currencies and subject them to a capital requirement no lower than half of the maximum permissible variation laid down in the intergovernmental

agreement in respect of the currency concerned and the unmatched positions in those currencies shall be treated in the same way as other currencies;

(5) The deputy chairman may allow the capital requirement on the matched positions in currencies of Member States participating in the second stage of the economic and monetary union to be 1,6%, multiplied by the value of such matched positions.

(6) Net positions in composite currencies may be broken down into the component currencies according to the quotas in force.

Chapter Nine

CAPITAL REQUIREMENTS TO COVER THE RISK ASSOCIATED WITH LARGE EXPOSURES

Art. 74. (1) For the purposes of this Chapter, "Exposures" mean any asset or off-balance-sheet items referred to in Chapter Twelve, Section I, without application of the risk weights or degrees of risk which they bear.

(2) Exposures arising from the items referred to in Annex N 10 shall be calculated in accordance with one of the methods indicated in Annex 3.

(3) (Am. – SG, iss. 68 in 2008) With the agreement of the deputy chairman, all elements entirely covered by own funds, may be excluded by the investment intermediary from the exposures, provided that such own funds are not included in those required for the cover of the capital requirements under Article 19 or in the calculation of other monitoring ratios provided for in law or this Ordinance.

(4) Exposures shall not include the following items:

1. in the case of foreign exchange transactions, exposures incurred in the ordinary course of settlement during the 48 hours following payment;
2. in the case of transactions for the purchase or sale of securities, exposures incurred in the ordinary course of settlement during 5 working days following payment or delivery of the securities, whichever is the earlier.

Art. 75. (Am. – SG, iss. 28 in 2009) An investment intermediary's exposure to a person or a group of connected persons shall be considered a large exposure where its value is equal to or exceeds 10% of its own funds.

Art. 76. The investment intermediary must have sound administrative and accounting procedures and adequate internal control mechanisms for the purposes of identifying and recording all large exposures and subsequent changes to them in accordance with the provisions of this Ordinance, and for that of monitoring those exposures as a part of the overall process of exposures monitoring.

Art. 77. (1) (Am. – SG, iss. 68 in 2008; iss. 28 in 2009) The investment intermediary must monitor daily its exposures to an individual person or to a group of connected persons, as well as to account for its large exposures sum in the report under Art. 144 para 1 with the purpose of limiting the risk of their excessive concentration.

(2) The investment intermediary shall notify latest by the next business day the Commission of any newly arisen large exposure, as well as of any increases in existing large exposures of at least 20% with respect to the previous communication, including the date and reason for such increase.

(3) (Suppl. – SG, iss. 68 in 2008) The investment intermediary shall submit to the Commission a report on the capital adequacy and liquidity, turnover statement and a balance sheet for the date of the large exposure arising, as well as copies and documents, evidencing the date of the large exposure occurrence and its nature, within the period under para 2.

(4) An investment intermediary shall analyse on a daily basis also its exposures to collateral issuers for excessive concentration and shall report to the Commission of the availability of such within 3 days after its occurrence.

Art. 78. (1) (Am. – SG, iss. 28 in 2009) The investment intermediary's exposure to a person or group of connected persons may not exceed 25% of its own funds.

(2) (Am. – SG, iss. 28 in 2009) Where the person or the group of connected persons are a parent undertaking or subsidiary of the investment intermediary and/or are one or more subsidiaries of the parent undertaking, the exposition under para 1 may not exceed 20% of its own funds.

(3) The amount of the large exposures of the investment intermediary may not exceed 800% of its own funds.

(4) (Am. – SG, iss. 28 in 2009) If the exposures exceed some of the limits under para 1 – 3, the investment intermediary shall notify the Commission without delay, but not later than the end of the day following that when the exceeding occurred. The notification shall indicate the reasons that led to the exceeding and concrete measures and term for bringing the exposures in compliance with the established limits. If needed, the deputy chairman may set other term, or obligate the investment intermediary to change the envisaged measures for bringing the exposures in compliance with the limits under para 1 – 3. Article 157, para 2, item 4 – 6 shall apply accordingly.

Art. 79. (1) (Am. – SG, iss. 28 in 2009) For the purposes of calculating the value of exposures under Art. 78 para 1 - 3, investment intermediaries using the Financial Collateral Comprehensive Method under Chapter Twelve, Section III, may use a value lower than the value of the exposure, but not lower than the total of the fully-adjusted exposure values of their exposures to an individual person or a group of connected persons.

(2) Fully adjusted exposure value means that calculated under Chapter Twelve, Section III taking into account the credit risk mitigation, volatility adjustments, and any maturity mismatch.

(3) The deputy chairman may permit an investment intermediary which applies own estimates of LGDs and conversion factors for each class of exposures according Chapter Twelve, Section II, for which the deputy chairman decides that the same can estimate the effects of financial collateral on the relevant exposures separately from other LGD-relevant aspects, to reflect those effects in the calculation of the exposures value for the purposes of calculation large exposures under Art. 78 para 1 - 3.

(4) In the cases under para 3 the recognition of funded credit protection shall be subject to compliance with the requirements under Chapter Twelve, Section II.

(5) The deputy chairman shall issue a permission under para 3, if it establishes that the applied methods of estimate, prepared by the investment intermediary to reduce the exposures for the purposes of Art. 78, are appropriate. When an investment intermediary has obtained permission for the applying of own estimate of the effects of the financial collateral, the same shall be applied in consistence with the adopted method for the capital requirements calculation.

(6) (Am. – SG, iss. 68 in 2008) An investment intermediary permitted to use own estimates of LGDs and conversion factors for each class of exposures under Chapter Twelve, Section II, but which does not calculate the value of its exposures according to para 3, may be permitted to use the approach set out in para 1. An investment intermediary may not use both methods simultaneously.

Art. 80 (1) An investment intermediary that calculates the large exposures according the methods described in Art. 79, shall conduct periodic stress tests of their credit-risk concentrations, including in relation to the realizable value of any collateral taken. The stress tests shall address risks arising from potential changes in market conditions that could adversely impact the investment intermediary' adequacy of own funds and risks arising from the realization of collateral in stressed situations.

(2) In the event that such stress test indicates a lower realizable value of collateral taken than would be permitted to be taken into account under Art. 79, the value of collateral permitted to be recognized in calculating the value of exposures for the purposes of Article 78, para 1 - 3 shall be reduced accordingly.

(3) The investment intermediary under para 1 shall include the following in their strategies to address concentration risk:

1. rules and procedures to address risks arising from maturity mismatches between exposures and any credit protection on those exposures;

2. rules and procedures in the event that a stress tests indicates a lower realizable value of collateral than taken into account under Art. 79;

3. rules and procedures relating to concentration risk arising from the application of credit risk mitigation techniques, and in particular large indirect credit exposures, for example to a single issuer of securities taken as collateral.

(4) (Am. – SG, iss. 28 in 2009) In cases where the effect of the collateral is recognized according Art. 80, any covered part of the exposure is treated as having been incurred to the collateral issuer rather than to the individual person.

Art. 81. (1) For the purposes of Art. 78 para 1 - 3, an investment intermediary may assign a weighting of 20% to asset items constituting claims on and other exposures to regional governments and local authorities in the Republic of Bulgaria or another Member State, or collaterized by them claims where they would be assigned a 20% risk weight under Chapter Twelve, Section I as well as assign a weighting of 0% in respect of the claims, exposures and the collaterized claims from the same persons in the cases when they would be assigned a 0% risk weight.

(2) For the purposes of Art. 78 para 1 - 3, an investment intermediary may assign a weighting of 20% to asset items constituting claims on and other exposures to investment intermediaries and credit institutions with a maturity between 1 and 3 years and a weighting of 50% to asset items constituting claims to investment intermediaries and credit institutions with a maturity of more than three years, provided that the latter are represented by debt instruments that are traded on a regulated market and are subject to daily quotation on that market or their issuance was approved by the competent authority of the issuer's home Member-State.

(3) The positions under para 2 may not be included in the own funds.

Art. 82. (1) (Am. – SG, iss. 28 in 2009) Where an exposure to a person of an investment intermediary is guaranteed by a third party, or by collateral in the form of securities issued by a third party, it shall be treated as:

1. (Am. – SG, iss. 28 in 2009) exposure as having been incurred to the third party – guarantor and not to the person;

2. (Am. – SG, iss. 28 in 2009) exposure as having been incurred to the third party that issued the securities and not the person.

(2) In the cases under para 1 item 1 where:

1. the guarantee is denominated in a currency different from that in which the exposure is denominated, the amount of the guarantee will be calculated in accordance with the provisions on the treatment of currency mismatch for unfunded credit protection in Annex 6;

2. a mismatch between the maturity of the exposure and the maturity of the protection will be treated in accordance with the provisions of Annex 6 concerning maturities mismatch;

3. partial coverage of the exposure shall be treated in accordance with Annex No. 6.

(3) The securities under para 1 item 2 shall not include debt securities issued by national governments or central banks, international organizations, international development banks, regional governments, state and local authorities and undertakings from the public sector in the Republic of Bulgaria or other Member States and to which a 0% risk weight is assigned according Chapter Twelve, Section I.

(4) For the purposes of this Article, the term "guarantee" shall include credit derivatives within the meaning of Chapter Twelve, Section III other than credit linked securities.

Art. 83 (1) Investment intermediaries which calculate the capital requirements to positions included in the trading book in accordance with Chapter Six, Seven and, as appropriate, Chapter 11, shall monitor and control their large exposures in accordance with Art. 74 – 82, unless otherwise envisaged in para 2 – 6 and Art. 84.

(2) (Am. – SG, iss. 28 in 2009) The exposures to individual persons which arise on the trading book shall be calculated by summing the following items:

1. (Am. – SG, iss. 28 in 2009) the excess – where positive – of long positions over the short positions in all the financial instruments issued by a person; the net positions in each of the different instruments being calculated according to the methods laid down in Chapter 6;

2. the net exposures, in the case of the underwriting of a debt or an equity instrument;

3. (Am. – SG, iss. 28 in 2009) the exposures with a given person due to the transactions, agreements and contracts referred to in Chapter Seven, such exposures being calculated in the manner laid down in that Chapter.

(3) The net exposures under para 2 item 2 are calculated by deducting those underwriting positions which are subscribed or sub-underwritten by third parties on the basis of a formal agreement reduced by the factors set out in Table No. 4 of Annex 1.

(4) For the purposes of para 2 item 2, the investment intermediary shall establish and maintain systems to monitor and control large exposures related to underwriting issues, between the

time of the initial commitment and working day one in the light of the nature of the risks incurred in the markets in question.

(5) (Am. – SG, iss. 28 in 2009) In calculating the exposures to an individual person under para 2 item 3, the references in Art. 67 para 2 to Chapter Twelve, Section II shall be excluded.

(6) (Am. – SG, iss. 28 in 2009) The exposures to groups of connected persons on the trading book shall be calculated by summing the exposures to individual persons in a group, as calculated in paragraph 3.

Art. 84 (1) (Am. – SG, iss. 28 in 2009) The overall exposures to individual persons or groups of connected persons shall be calculated by the investment intermediary by summing the exposures which arise on the trading book and the exposures which arise on the non-trading book, taking into account Art. 79 - 82.

(2) In order to calculate the exposure which arises on the non-trading book, investment intermediaries shall take the exposure arising from assets which are deducted from their own funds by virtue of Art. 8 para 3 item 4 to be zero.

(3) (Am. – SG, iss. 28 in 2009) In the calculation of large exposures to individual persons or groups of connected persons for the purposes of Art. 77 para 1, an investment intermediary shall not include the recognition of credit risk mitigation. When calculating the large exposures, such in relation to repurchase transactions, securities or commodities lending or borrowing transactions shall not be taken into account.

(4) (Am. – SG, iss. 28 in 2009) The sum of the investment intermediary's exposures to individual persons or group of connected persons determined according para 1 shall be limited in accordance with Articles 79-82.

(5) With the approval of the deputy chairman, an investment intermediary may exceed the limits laid down in Articles 78 - 82 if the following conditions are met:

1. (Am. – SG, iss. 28 in 2009) the exposures on the non-trading book to an individual person or group of connected persons do not exceed the limits laid down in Articles 78-82, those limits being calculated with reference to own funds as specified in this Ordinance, so that the excess arises entirely on the trading book;

2. the investment intermediary meets an additional capital requirement on the excess in respect of the limits for large exposures laid down in Art. 78 para 1 and 2, that additional capital requirement being calculated in accordance with Annex N 9 hereto;

3. (Am. – SG, iss. 28 in 2009) where a period of 10 days or less has elapsed since the excess of the limits occurred, the trading-book exposure to the person or group of connected persons in question shall not exceed 500% of the own funds;

4. any excesses that have persisted for more than 10 days must not, in aggregate, exceed 600% of the own funds;

5. (Am. – SG, iss. 28 in 2009) The investment intermediary shall notify the Commission within 10 days after the end of each month of all excesses of the limits under Art. 78 para 1 and 3 for the preceding month, where the notification shall indicate the amount of each excess and the person's name.

(6) An investment intermediary may not execute transactions of temporarily transferring exposures to another company, which is in the same group in which the intermediary is or to another company, or undertaking artificial transactions to close out an exposure before the expiry of the 10-day period and create a new exposure with the purpose of avoiding the limits under Art. 78, para 1 and 2.

(7) An investment intermediary shall maintain an information system and notify the Commission of the transferring under para 6 without delay, but not later than the end of the day following the day of the transaction's conclusion.

Chapter Ten

CAPITAL REQUIREMENTS FOR COMMODITIES RISK

Section I

General Provisions

Art. 85. (1) Investment intermediaries shall calculate the capital requirements to cover risk of positions in exchange traded commodities or commodities derivatives on the non-trading and trading book.

(2) Each position in commodities or commodity derivatives shall be expressed in terms of the standard unit of measurement for the relevant commodity. The spot price of each commodity when it is in currency other the Bulgarian lev, shall be recalculated in BGN at the exchange rate of the Bulgarian National Bank on the reporting date.

(3) The net position in each commodity shall be the excess of an institution's long (short) positions over its short (long) positions in the same commodity and identical commodity futures, options and warrants. Investment intermediaries may treat positions in commodity derivative instruments as positions in the underlying commodity.

(4) Positions in the same commodity shall be considered the following positions:

1. positions in different sub-categories of commodities in cases where the sub-categories are deliverable against each other;

2. positions in similar commodities if they are close substitutes and if a minimum correlation of 0,9 between price movements can be clearly established over a minimum period of one year.

(5) Positions in gold or gold derivatives, as well as positions which are stock financing, shall not be included in the calculation of the capital requirement for commodities risk.

(6) The interest-rate and foreign-exchange risks for positions in commodities and commodity derivative instruments shall be included in the calculation of general risk for traded debt instruments and in the calculation of foreign-exchange risk.

Section II

Treatment of Particular Instruments

Art. 86. (1) An investment intermediary shall measure commodity futures and forward commitments to buy or sell individual commodities as a notional amount in terms of the standard for the underlying commodity unit of measurement and shall assign them a maturity with reference to expiry date.

(2) The deputy chairman may allow the investment intermediary the capital requirement for an exchange-traded futures to be equal to the margin required by the exchange, in case that the margin provides an accurate measure of the risk associated with the futures and that it is at least equal to the capital requirement for futures that would result from a calculation made according this Chapter or applying the internal models method described in Chapter Eleven.

(3) The deputy chairman may allow the investment intermediary the capital requirement for an OTC commodity derivatives contract under para 1 and 2, cleared by a recognized clearing house, to be equal to the margin required by the clearing house if the margin provides an accurate measure of the risk associated with the derivatives and that it is at least equal to the capital requirement that would result from a calculation made using the methods set out in this Chapter or applying the internal models method described in Chapter Eleven.

Art. 87. (1) In case of commodity swaps, where one side of the transaction is a fixed price and the other the current market price, the swap shall be incorporated by the investment intermediary into the maturity ladder approach, as set out in Art. 93 para 2, as a series of positions equal to the notional amount of the contract, with one position corresponding with each payment on the swap and slotted into the maturity ladder;

(2) The position under para 1 would be long position if the investment intermediary is paying a fixed price and receiving a floating price and a short positions if receiving a fixed price and paying a floating price;

(3) Commodity swaps where the sides of the transaction are in different commodities are to be reported by the investment intermediary in the relevant reporting ladder for the maturity ladder approach to commodity risk.

Art. 88. (1) Options on commodities or on commodity derivatives shall be treated as if they were positions equal in value to the amount of the underlying to which the option refers, multiplied by its delta. The positions under sentence 1 may first be netted off against any offsetting positions in the identical underlying commodity or commodity derivative.

(2) The investment intermediary shall use delta which is set by the relevant exchange or the Commission. Where delta has not been set according sentence one, as well as in case of OTC options, it shall be calculated by the investment intermediary by a methodology approved by the deputy chairman.

(3) The deputy chairman may obligate an investment intermediary to calculate delta by determined by him/her methodology.

(4) An investment intermediary shall provide cover of the commodities options for all other risks, apart from the delta risk, associated with them.

(5) The deputy chairman may allow the investment intermediary the capital requirement for a written exchange-traded commodity option to be equal to the margin required by the exchange if the margin provides an accurate measure of the risk associated with the options and that is at least equal to the capital requirement that would result from a calculation made using the method set out in this Chapter or applying the internal models method described in Chapter Eleven.

(6) The deputy chairman may allow the investment intermediary the capital requirement for an OTC commodity option cleared by a recognized clearing house, to be equal to the margin required by the clearing house if the margin provides an accurate measure of the risk associated with the option and that it is at least equal to the capital requirement that would result from a calculation made using the methods set out in this Chapter or applying the internal models method described in Chapter Eleven.

Art. 89. Warrants relating to commodities shall be treated in the same way as referred to in Art. 88.

Art. 90. The investment intermediary - transferor of commodities or guaranteed rights relating to title to commodities in a repurchase agreement or which is a lender of commodities in a commodities lending agreement shall include such commodities in the calculation of its capital requirement under this Chapter.

Section III

Calculation of the Capital Requirement for Commodities Risk

Art. 91. In calculating the capital requirement for commodities risk, investment intermediaries may use the following methods:

1. Simplified approach;

2. Maturity ladder approach;

Art. 92. (1) The capital requirement for each commodity by the simplified approach shall be calculated as the sum of:

1. fifteen percent (15%) of the net position (long or short), multiplied by the spot price for the commodity;

2. three percent (3%) of the gross position (long plus short) multiplied by the spot price for the commodity.

(2) The capital requirement for commodity risk shall be the total amount of the capital requirement for each commodity calculated according the preceding paragraph.

Art. 93. (1) To calculate the capital requirement for commodities risk by the maturity ladder approach, an investment intermediary shall use a separate maturity ladder for each commodity according the following table.

Maturity band (1)	Spread rate (in %) (2)
0 ≤ 1 month	1,50
> 1 ≤ 3 months	1,50
> 3 ≤ 6 months	1,50
> 6 ≤ 12 months	1,50
> 1 ≤ 2 years	1,50
> 2 ≤ 3 years	1,50
> 3 years	1,50

(2) All positions in the same commodity and the positions pursuant to Art. 85 para 4 shall be assigned to the appropriate maturity band of the ladder under para 1, where physical stocks shall be assigned to the band from 0 to 1 month.

(3) Positions in the same commodity, as well as those determined as such pursuant to Art. 85 para 4, shall be mutually offset and assigned to the appropriate maturity bands on a net basis, provided that:

1. the contracts mature on the same date;

2. the contracts mature within 10 days of each other if the contracts are traded on markets which have daily delivery dates.

(4) The investment intermediary shall calculate the sum of the long positions and the sum of the short positions in each maturity band. The amount of the long (short) position which is matched by the short (long) position in a given maturity band shall be the matched position in that band, while the residual long or short position shall be the unmatched position for the same band.

(5) That part of the unmatched long (short) position for a given maturity band that is matched by the unmatched short (long) position for a next maturity band shall be the matched position between two maturity bands. That part of the unmatched long or unmatched short position that cannot be thus matched shall be the unmatched position.

(6) The capital requirement for each commodity shall be calculated on the basis of the relevant maturity ladder as the sum of the following:

1. the sum of the matched long and short positions, multiplied by a spread rate of 1.5% and by the spot price for the commodity;

2. the matched position between two maturity bands for each maturity band into which an unmatched position is carried forward, multiplied by a carry rate of 0,6% and by the spot (current) price for the commodity;

3. the residual unmatched positions, multiplied by an outright ratio of 15% and by the spot (current) price for the commodity.

(7) The capital requirement for commodities risk shall be the sum of the capital requirements for each commodity, calculated according para 6.

Art. 94. (1) With the deputy chairman's approval, an investment intermediary may use extended maturity ladder approach in the calculation of capital requirement for commodities risk, if the same:

1. undertakes significant commodities business;

2. has a diversified commodities portfolio;

3. does not meet the necessary requirements to apply internal models in accordance with Chapter Eleven in the calculation of the capital requirement on commodities risk.

(2) With the method under para 1, instead of the indicated in Art. 93 para 1 – 3, 6 and 7 rates, the investment intermediary shall apply the minimum rates according the following Table:

Type of rate	Precious metals (except gold)	Base metals	Agricultural products (softs)	Other, including energy products
Spread rate (%)	1,0	1,2	1,5	1,5
Carry rate (%)	0,3	0,5	0,6	0,6
Outright rate (%)	8	10	12	15

Chapter Eleven
INTERNAL MODELS

Art. 95. (1) With the deputy chairman's approval, an investment intermediary may calculate its capital requirements for position risk, foreign-exchange risk and/or commodities risk using its own internal risk-management models instead of or in combination with the methods described under Chapter Six, Eight and Ten.

(2) The deputy chairman shall give approval to the investment intermediary only if the investment intermediary's risk-management system is trustworthy and meets the following requirements:

1. the internal risk-measurement model is closely integrated into the daily risk-management process in the investment intermediary and serves as the basis for reporting risk exposures to its management body;

2. (Am. – SG, iss. 68 in 2008) the investment intermediary has a risk management and control unit that functions independently from business trading units and reports directly to the investment intermediary's management body and which:

a) designs and implements the investment intermediary's risk-management system;

b) produces and analyses daily reports on the output of the risk-measurement internal model and on the appropriate measures to be taken for compliance with the established limitations;

c) conducts the initial and on-going validation of the internal model;

3. (Am. – SG, iss. 68 in 2008) the investment intermediary's management body is actively involved in the risk-control process and the daily reports produced by the risk-management and control unit are reviewed by the body having the authority to enforce both reductions of positions taken by individual traders as well as in the investment intermediary's overall risk exposure;

4. the investment intermediary has sufficient numbers of staff skilled in the use of sophisticated models in the trading, risk-control, audit and back-office areas;

5. the investment intermediary has established procedures for monitoring and ensuring compliance with the adopted documented set of internal policies and controls concerning the overall operation of the risk-measurement system;

6. there is a proven track record of the model's accuracy in measuring risks;

7. the investment intermediary once monthly conducts stress testing of the internal risk measurement model according a preliminarily prepared program and the results of these tests are reviewed by its management body and reflected in the risk policies and limits it sets**.** The stress tests are directed mainly to the risks which may not be captured appropriately in the internal models, such as for instance illiquidity of markets in stressed market conditions, concentration risk, one way markets, event and jump-to-default risks, non-linearity of products, deep out-of-the-money positions, positions subject to the gapping of prices; the used in the conducting of the stress tests assumptions reflect the nature of the portfolios and the time it could take to hedge out or manage the risks under severe market conditions;

8. (Am. – SG, iss. 68 in 2008) the investment intermediary's internal audit unit shall conduct once yearly a verification of the risk-measurement process which shall include at least:

a) (Am. – SG, iss. 68 in 2008) the adequacy of the documentation of the risk-management system and process and the organization of the risk-management and control unit;

b) the integration of market risk measures into daily risk management and the integrity of the management information system;

c) the process for approving risk-pricing models and valuation systems that are used by front and back-office personnel;

d) the scope of market risks captured by the internal model and the validation of any significant changes in the risk-measurement process;

e) the accuracy and completeness of position data, the accuracy and appropriateness of volatility and correlation assumptions, and the accuracy of valuation and risk sensitivity calculations;

f) the verification process the institution employs to evaluate the consistency, timeliness and reliability of data sources used to run internal models, including the independence of such data sources;

g) the verification process the institution uses to evaluate back-testing that is conducted to assess the models' accuracy.

Art. 96. (1) Investment intermediaries shall have processes in place to ensure that their internal models have been adequately validated by suitably qualified parties independent of the development process to ensure that they are conceptually sound and adequately capture all material risks.

(2) The validation shall be conducted when the internal model is initially developed and when any significant changes are made to the internal model. The validation shall also be conducted on a periodic basis but especially where there have been any significant structural changes in the market or changes to the composition of the portfolio which might lead to the internal model no longer being adequate in the new conditions.

(3) Beside the tests for the results of the internal model, the validation shall also include the following:

1. tests to demonstrate that any assumptions made within the internal model are appropriate and do not underestimate or overestimate the risk;

2. an investment intermediary shall carry out its own internal model validation tests in conformity to the risks and structures of its portfolio;

3. the use of hypothetical portfolios to ensure that the internal model is able to account for particular structural features that may arise, such as for example material basis risks and concentration risk.

Art. 97. (1) The investment intermediary shall monitor the accuracy and performance of its internal model by conducting a back-testing programme.

(2) The back-testing has to provide for each business day a comparison of the one-day value-at-risk measure generated by the investment intermediary's internal model for the portfolio's end-of-day positions to the one-day change of the portfolio's value by the end of the subsequent business day.

(3) The deputy chairman may examine the investment intermediary's capability to perform back-testing under para 1 on both actual and hypothetical changes in the portfolio's value.

(4) Back-testing on hypothetical changes in the portfolio's value is based on a comparison between the portfolio's end-of-day value and, assuming unchanged positions, its value at the end of the subsequent day.

(5) The deputy chairman may obligate investment intermediaries to take appropriate measures to improve their back-testing programme if he deems the results of the internal risk measurement model deficient. The deputy chairman may obligate the investment intermediary to perform back-testing on either hypothetical, or actual trading.

(6) In the event of para 5, with back-testing on hypothetical trading the changes are used in the portfolio value that would occur were end-of-day positions to remain unchanged, and for actual trading - fees, commissions, and net interest income are not included.

Art. 98. (1) With the deputy chairman's permission, an investment intermediary may use an internal model in the calculation of the capital requirements for specific risk associated with traded debt and equity positions, if in addition to compliance with the conditions in this Chapter, the internal model meets the following conditions:

1. it explains the historical price variation in the portfolio;
2. it captures concentration in terms of magnitude and changes of composition of the portfolio;
3. it is robust to an adverse environment;
4. it is validated through back-testing aimed at assessing whether specific risk is being accurately captured;
5. it includes demonstration that the internal model is sensitive to material idiosyncratic differences between similar but not identical positions;
6. it captures event risk.

(2) The tests under para 1 item 4 may be conducted on the basis of the relevant sub-portfolios and in a consistent manner.

(3) Where the investment intermediary is subject to event risk that is not reflected in its value-at-risk measure, because it is beyond the 10-day holding period and 99 percent confidence interval, it shall ensure that the impact of such events is factored in to its internal capital assessment;

(4) The investment intermediary's internal model shall conservatively assess the risk arising from less liquid positions and positions with limited price transparency under realistic market scenarios. The model must meet the minimum data standards, the proxies shall be conservative and may be used only where available data is insufficient or is not reflective of the true volatility of a position or portfolio.

Art. 99. (1) In the calculation of the capital requirements for specific risk associated with traded equities and bonds, the investment intermediary shall adopt a method including the default risk of its trading book positions that is incremental to the default risk captured by the value-at-risk measure as specified in Art. 98.

(2) To avoid double accounting, when calculating its incremental default risk charge under para 1, the investment intermediary shall take into account the extent to which default risk has already been incorporated into the value-at-risk measure, especially to risk positions that could and would be closed within 10 days in the event of adverse market conditions or other indications of deterioration in the credit environment.

(3) Where an investment intermediary captures its incremental default risk through a surcharge, it shall have in place methodologies for validating the measure.

(4) The investment intermediary shall demonstrate that the method used under this article meets soundness standards set out in Chapter Twelve, Section II, under the assumption of a constant level of risk, and adjusted where appropriate to reflect the impact of liquidity, concentrations, hedging and the option features.

(5) An investment intermediary that does not capture the incremental default risk through an internally developed method shall calculate the surcharge through an approach consistent with either the approach set out in Chapter Twelve, Section I, or the approach set out in Chapter Twelve, Section II.

Art. 100. (1) With respect to cash or synthetic securitisation exposures that would be subject to a deduction treatment under the treatment set out in Article 7 para 7, or risk-weighted at 1,250% as set out in item 6 of Annex N 7, the investment intermediary under Art. 98 shall calculate capital charge that is no less than set forth under these provisions.

(2) An investment intermediary that is a dealer in exposures under para 1 may apply a different than the indicated under para 1 approaches if it demonstrates in addition to trading intent, that a liquid two-way market exists for the securitisation exposures, and in the cases of synthetic securitisation that it uses solely credit derivatives for the securitisation exposures themselves or all their constituent risk components.

(3) For the purposes of para 2 a two-way market is deemed to exist where there are independent good faith offers to buy and sell so that a price reasonably related to the last sales price or current competitive bid and/or offer quotations can be determined within one day and settled at such a price within a relatively short time conforming to trade custom.

(4) An investment intermediary under para 2 shall have sufficient market data to ensure that it fully captures the concentrated default risk of these exposures in its internal approaches for measuring the incremental default risk.

Art. 101. An investment intermediary for which the deputy chairman establishes according Art. 97 para 5 that the results of the tests for the used by it internal model are not reliable shall apply a separate capital charge for specific risk as calculated according to Chapter Six.

Art. 102. (1) The capital chare for an investment intermediary which uses an internal model shall be the higher value of:

1. its previous day's value-at-risk measure according to the parameters specified in this Chapter plus, where appropriate, the incremental default risk charge required under Art. 98-100;

2. an average of the daily value-at-risk measures on each of the preceding 60 business days, multiplied by multiplication factor equal to 3, adjusted by the plus factor referred to in para 2 plus, where appropriate, the incremental default risk charge required under Art. 98-100.

(2) The multiplication factor shall be increased by a plus-factor of between 0 and 1 depending on the number of overshootings for the most recent 250 business days as evidenced by back-testing according the following Table:

Number of overshootings	Plus-factor
Fewer than 5	0,00
5	0,40
6	0,50
7	0,65
8	0,75
9	0,85
10 or more	1,00

(3) An overshooting is an one-day change in the portfolio's value that exceeds the related one-day value-at-risk measure generated for the same day on the basis of the internal model.

(4) The investment intermediary shall calculate overshootings consistently on the basis of back-testing either on actual or on hypothetical changes in the portfolio's value.

(5) In order to calculate the plus-factor under para 2, the number of overshootings shall be defined at least once quarterly.

(6) The deputy chairman, in individual cases and owing to an exceptional situation, may allow the use of a multiplication factor 0.00, if the investment intermediary has demonstrated that the use of the multiplication factor is unjustified and that the model is basically sound.

(7) If the deputy chairman establishes more than 11 overshootings for the most recent 250 working days, he/she shall order discontinuance of the model's use or impose appropriate measures to ensure that the model is improved promptly.

(8) The investment intermediary shall notify the deputy chairman within five working days of overshootings that result form their back-testing programme and that would imply an increase of a plus-factor**.**

(9) In the calculation of the value-at-risk measure the investment intermediary shall observe the following minimum standards:

1. at least daily calculation of the value-at-risk measure;
2. a 99th percentile, one-tailed confidence interval is used in the calculation;
3. a 10-day equivalent holding period is used in the calculation;
4. a historical observation period of at least one year shall be used in the calculation except where a shorter observation period is justified by a significant upsurge in price volatility;
5. three-monthly data set updates.

Art. 103. The internal risk-measurement model must cover all the material price risks of options or option-like positions and shall guarantee that any other risks not captured by the model are covered adequately by own funds.

Art. 104 (1) The internal risk-measurement model shall capture a sufficient number of risk factors, depending on the level of activity of the investment intermediary in the respective markets, including at least the risk associated with change in interest rate, currency risk, the risk associated with shares and the commodity risk.

(2) For determination of the risk factors, the internal risk-measurement system shall incorporate:

1. a set of risk factors corresponding to the interest rates in each currency in which the investment intermediary has interest rate sensitive on- or off-balance sheet positions; the

investment intermediary shall modulate the yield curve using some of the commonly recognized methods. With regard to significant positions exposed to risk associated with interest rate, the yield curve of the main currency and markets shall be divided at least in six maturity intervals, in order to cover the change in the volatility of the interest rate according the yield curve; the system must also cover the risk of incomplete correlation among the different yield curves;

2. the risk factors corresponding to gold and to the individual foreign currencies in which the institution's positions are denominated; with regard to positions in collective investment indertakings shall be accounted their actual currency positions; the investment intermediary may use the reports on currency positions of the collective investment undertakings prepared by third parties where their accuracy has been sufficiently ensured; in case that the investment intermediary has no information on the currency expositions of the collective investment undertakings, the positions shall be accounted for according Art. 72 para 7 and 8.

3. separate risk factors for each of the equity markets on which shares are traded and in which the institution holds significant positions.

4. separate risk factors for each commodity in which the investment intermediary holds significant positions, taking account of the market characteristics, notably delivery dates and the scope provided to traders to close out positions; the system must also cover the risk of the imperfect correlation between similar but not identical commodities and the changes in the forward prices arising from mismatch of the maturities.

(3) an investment intermediary may use in the internal model empirical correlations within risk categories and across risk categories if the system for measuring correlations is sound and implemented with integrity.

Chapter Twelve

MINIMUM CAPITAL REQUIREMENTS IN RELATION TO THE CREDIT RISK

Section I

Standardized Method

Art. 105. (1) (Am. – SG, iss. 68 in 2008) Investment intermediaries shall apply either the Standardised Approach provided for in this Section or, if permitted by the deputy chairman, the Internal Ratings Based Approach provided for in Chapter Twelve, Section II to calculate their risk-weighted exposure amounts for the purposes of Article 21 item 1.

Art. 106. (1) The exposure value of an asset item shall be its balance-sheet value and the exposure value of an off-balance sheet item listed in Annex II shall be a percentage of its value as follows:

1. 100% of the full-risk item;

2. 50% of the medium-risk item;

3. 20% of the medium/low-risk item;

4. 0% of the low-risk item.

(2) In the case of an investment intermediary using the Financial Collateral Comprehensive Method under item 34 – 44 of Annex 6, where an exposure takes the form of securities or commodities sold under a repurchase transaction or under a securities or commodities lending or borrowing transaction, and margin lending transactions the exposure value shall be increased by the volatility adjustment appropriate to such securities or commodities as prescribed in item 28 – 44 of Annex 6.

(3) The exposure value of a derivative instrument listed in Annex 10 shall be determined in accordance with one of the methods, presented in Annex 3, with the effects of contracts of novation and other netting agreements taken into account. The exposure value of repurchase transactions, securities or commodities lending or borrowing transactions, long settlement transactions and margin lending transactions may be determined either in accordance with Annex 3 or Annex 6.

(4) Where an exposure is subject to funded credit protection, the exposure value applicable to that item may be modified in accordance with Chapter Twelve, Section III.

(5) (Am. – SG, iss. 68 in 2008) The exposure value of credit risk exposures outstanding, as determined by the Commission, with a central counterparty shall be determined in accordance with item 11 of Annex 3, provided that the central counterparty's credit risk exposures with all participants in the arrangements, who conclude contracts with the central counterparty, are fully collateralized on a daily basis.

Art. 107. (1) Each exposure shall be assigned to one of the following exposure classes:

1. claims or contingent claims on central governments or central banks;

2. claims or contingent claims on regional governments or local authorities;

3. claims or contingent claims on administrative bodies and non-commercial undertakings;

4. claims or contingent claims on multilateral development banks;

5. claims or contingent claims on international organizations;

6. claims or contingent claims on institutions;

7. claims or contingent claims on corporates;

8. retail claims or contingent retail claims;

9. claims or contingent claims secured on real estate property;

10. past due items;

11. items belonging to high-risk categories;

12. claims in the form of covered bonds;

13. securitisation positions;

14. short-term claims on institutions and corporates;

15. claims on collective investment undertakings ("CIU"); or

16. other items.

(2) To be eligible for the retail exposure class referred to in para 1 item 8, an exposure shall meet the following conditions:

1. the exposure shall be either to an individual person or persons, or to a small or medium sized entity;

2. the exposure shall be one of a significant number of exposures with similar characteristics such that the risks associated with such lending are substantially reduced;

3. (Am. – SG, iss. 28 in 2009) the total amount owed to the investment intermediary and parent undertakings and its subsidiaries, including any past due exposure, by the obligor person or group of connected persons shall not exceed the BGN equivalence of EUR 1 000 000. The investment intermediary shall take reasonable steps to acquire this knowledge. The total amount owed shall not include claims or contingent claims secured on residential real estate collateral;

(3) The present value of retail minimum lease payments is eligible for the retail exposure class.

(4) Securities shall not be eligible for the retail exposure class.

Art. 108. (1) The investment intermediary shall calculate any risk-weighted exposure amount, unless deducted from own funds, by applying risk weights based on the exposure class to which the exposure is assigned and to the extent specified in Annex 4, its credit quality. Credit quality of an exposure may be determined by reference to the credit assessments of External Credit Assessment Institutions ("ECAIs") or the credit assessments of Export Credit Agencies.

(2) The risk-weighted exposure value shall be calculated multiplying the exposure value by the risk weight specified or determined in accordance with this Section.

(3) The risk-weighted exposure amounts for exposures to institutions shall be calculated by application of the method based on the credit quality of the central government of the jurisdiction in which the institution is incorporated or the method based on the credit quality of the counterparty institution in accordance with Annex 6.

(4) Where an exposure is subject to credit protection, the risk weight applicable to that item may be modified in accordance with Chapter Twelve, Section III.

(5) Risk-weighted exposure amounts for securitised exposures shall be calculated in accordance with Chapter Twelve, Section IV.

(6) Exposures, the calculation of risk-weighted exposure amounts for which is not otherwise provided for under this Section, shall be assigned a risk-weight of 100%.

(7) With the exception of exposures representing elements of the own funds, stated under Art. 6 para 2 and 3 and Art. 7 para 1, the deputy chairman may exempt from the requirements of paragraph 1 of this Article the exposures of an investment intermediary to a counterparty which is its parent undertaking, its subsidiary, a subsidiary of its parent undertaking or an undertaking linked by a relationship of control, provided that the following conditions are met:

1. the counterparty is an investment intermediary or a financial holding company, financial institution, asset management company or ancillary services undertaking subject to appropriate prudential requirements to their activities;

2. the reports of the counterparty and of the investment intermediary are consolidated on the basis of full consolidation;

3. the counterparty is subject to the same risk evaluation, measurement and control procedures as the investment intermediary;

4. the counterparty is established in the Republic of Bulgaria, or other Member State where the investment intermediary is established;

5. there is no current or foreseen economic or legal impediment to the prompt transfer of own funds or repayment of liabilities from the counterparty to the investment intermediary.

(8) Where the conditions under para 7 are met, a risk weight of 0% shall be assigned to the relevant exposures by the investment intermediaries.

(9) With the exception of exposures representing elements of the own funds referred to in Art. 6 para 2 and 3 and Art. 7 para 1, the deputy chairman may exempt the investment intermediary from the requirements of paragraph 1 of this Article the exposures to counterparties which are members of the same institutional protection scheme, provided that the following conditions are met:

1. the requirements set out in para 7 item 1, 4 and 5 have been met;

2. the investment intermediary and the counterparty have entered into contractual relations, ensuing from contractual or statutory liability arrangements, which protect them and in particular ensures their liquidity and solvency to avoid bankruptcy in the cases where necessary; the scheme of contractual arrangements is an institutional protection scheme;

3. the arrangements under item 2 ensure that the protection schemes will be able to grant support necessary under its commitment from funds readily available to them;

4. the institutional protection scheme disposes of reliable systems for the monitoring and classification of risk (which gives a complete overview of the risk situations of all the individual members and the institutional protection scheme as a whole);

5. the institutional protection scheme conducts its own risk review which is communicated to the individual members;

6. the institutional protection scheme draws up and publishes an annual financial statement, comprising at least of the balance sheet, the profit-and-loss account, as well as the risk report, concerning the institutional protection scheme as a whole;

7. members of the institutional protection scheme are obliged to give advance notice of at least 24 months if they wish to end their participation therein;

8. the multiple use of elements eligible for the calculation of own funds as well as any inappropriate creation of own funds between the members of the institutional protection scheme shall be eliminated;

9. the institutional protection scheme shall be based on a membership of investment intermediaries of a predominantly homogeneous business profile; and

10. the systems referred to in item 4 are approved by the relevant supervisory authority and they are monitored at regular intervals by the relevant competent authorities.

(10) Where the conditions under para 9 are met, the investment intermediaries shall assign to the relevant exposures a risk weight of 0%.

Art. 109. (1) An external credit assessment may be used to determine the risk weight of an exposure in accordance with Article 108 only if the ECAI which provides it has been recognized as eligible for those purposes by the Commission.

(2) The Commission shall recognize an ECAI as eligible for the purposes of Article 108 only if they are satisfied that its assessment methodology complies with the requirements of objectivity, independence, ongoing review and transparency, and that the resulting credit assessments meet the requirements of credibility and transparency. For the recognition the Commission shall take into account the technical criteria set out in item 2 of Annex 4.

(3) (Am. – SG, iss. 68 in 2008) In the cases when an ECAI has been recognized as eligible by a relevant competent supervisory authority of a Member State, the Commission may recognize that ECAI as eligible without carrying out its own actions for its recognition according para 2.

(4) The Commission shall make publicly available the information related to the recognition process and a list of eligible ECAIs.

Art. 110. (1) The deputy chairman shall determine, taking into account the criteria set out in item 2 of Annex 4, the credit quality steps that are to be associated with the relevant credit assessment of an eligible ECAI.

(2) (Am. – SG, iss. 68 in 2008) In the cases when a relevant competent authority from a Member State has made the determination of the relevant credit quality steps for a credit assessment of an eligible ECAI according para 1, the deputy chairman may recognize that qualification without performing separate actions for the relevant credit quality steps determination.

(3) The ECAI credit assessments shall be used by the investment intermediary consistently for the calculation of risk-weighted exposure amounts.

(4) Investment intermediaries shall use only solicited credit assessments. However, with the permission of the deputy chairman, they may use unsolicited assessments.

Section Two

Internal Ratings Based Approach

Art. 111. (1) Investment intermediaries may use the Internal Ratings Based Approach ("IRB Approach") to calculate their risk-weighted exposure amounts, after obtaining the approval of the deputy chairman.

(2) The deputy chairman shall give approval under para 1 if the investment intermediary verifies that the system for the management and rating of credit risk exposures is sound and implemented with integrity and that it meets the following standards in accordance with Section IV of Annex 5:

1. the rating system provides for a meaningful assessment of obligor and transaction characteristics, a meaningful differentiation of risk and accurate and consistent quantitative estimates of risk;

2. internal ratings and default and loss estimates used in the calculation of capital requirements and associated systems and processes play an essential role in the risk management and decision-making process, and in the credit approval, internal capital allocation and corporate governance functions of the investment intermediary;

3. (Am. – SG, iss. 68 in 2008) the investment intermediary has a credit risk management and control unit responsible for its rating system that is independent and free from undue influence;

4. the investment intermediary collects and stores all relevant data to provide effective support to its credit risk measurement and management process;

5. the investment intermediary documents the set up by it internal rating system, its design and validates it.

(3) Where an EU parent investment intermediary and its subsidiaries or an EU parent financial holding company and its subsidiaries use the IRB Approach on a unified basis, the deputy chairman may allow the minimum requirements according Section IV of Annex 5 to be met by the parent and its subsidiaries considered together.

(4) To obtain permission for the use of the IRB Approach for internal risk measurement and management purposes, the investment intermediary must have applied that approach which meets to a large extent the minimal requirements according Section IV of Annex No. 5, for a period of at least three years.

(5) An investment intermediary applying for the use of own estimates of LGDs and/or conversion factors shall file with the Commission an application, enclosing documents, attesting that it has been estimating these parameters for at least three years in a manner that

was broadly consistent with the minimum requirements for use of own estimates of those parameters set out in Section IV of Annex N 5.

(6) If an investment intermediary which has been given a permission to use the IRB Approach, ceases to comply with the requirements set out in this Section, it shall either present to the Commission a plan for a timely return to compliance or demonstrate that the effect of non-compliance is immaterial.

(7) When the IRB Approach is intended to be used by the EU parent investment intermediary and its subsidiaries, or by the EU parent financial holding company and its subsidiaries, the competent authorities of the different Member States shall cooperate as provided for in Article 168.

Art. 112. (1) Without prejudice to the provisions of Article 116, the parent undertakings and its subsidiaries shall implement the IRB Approach for all their exposures.

(2) Subject to the approval of the deputy chairman, including an approved plan presented by the investment intermediary, implementation of the IRB Approach may be carried out sequentially across the different exposure classes, referred to in Article 113, within the same business unit or across different business units in the same group.

(3) The provision of para 2 shall also apply for the use of own estimates of LGDs or conversion factors for the calculation of risk weights for exposures to central governments and central banks, institutions and corporates.

(4) In the case of the retail exposure class referred to in Art. 113, implementation may be carried out sequentially across the categories of exposures to which the different correlations according item 1.2.1 – 1.2.4 of Section I in Annex N 5 are applied.

(5) Implementation of the IRB Approach shall be done by the investment intermediary within a reasonable period of time approved by the deputy chairman.

(6) The implementation of the IRB Approach under para 1 – 4 shall be carried out according rules containing strict requirements, determined by the deputy chairman and ensuring that the possibility of applying the IRB Approach is not used selectively with the purpose of achieving reduced minimum capital requirements in respect of those exposure classes or business units that are yet to be included in the IRB Approach or in the use of own estimates of LGDs and/or conversion factors.

(7) Investment intermediaries using the IRB Approach for any exposure class shall at the same time use the IRB Approach for the equity exposure class.

(8) Investment intermediaries which have obtained permission under Article 111 to use the IRB Approach under para 1-3 and Art. 116, shall not revert to the use of standardization method except for demonstrated good cause and subject to the approval of the deputy chairman.

(9) Investment intermediaries which have obtained permission under Article 114 para 9 to use own estimates of LGDs and conversion factors under para 1 – 3 and Art. 116, shall not revert to the use of LGD values and conversion factors referred to in Article 114 para 8 except for demonstrated good cause and subject to the approval of the deputy chairman.

Art. 113. (1) The investment intermediary shall assign each exposure to one of the following exposure classes:

1. claims or contingent claims on central governments or central banks;
2. claims or contingent claims on institutions;
3. claims or contingent claims on corporates;
4. retail claims or contingent retail claims;
5. equity claims;
6. securitisation positions;
7. other non credit-obligation assets.

(2) The following exposures shall be treated as exposures to central governments and central banks:

1. exposures to regional governments or local authorities, public sector entities which are treated as exposures to central governments under Chapter Twelve, Section 1;

2. exposures to Multilateral Development Banks and International Organizations which attract a risk weight of 0% under Chapter Twelve, Section I;

(3) The following exposures shall be treated as exposures for claims or contingent claims to institutions:

1. exposures to regional governments and local authorities which are not treated as exposures to central governments under Chapter Twelve, Section 1;

2. exposures to Public Sector Entities which are treated as exposures to institutions under Chapter Twelve, Section 1;

3. exposures to Multilateral Development Banks which do not attract a 0% risk weight under Chapter Twelve, Section 1.

(4) To be eligible for the retail exposure class referred to in para 1 item 4, exposures shall meet the following criteria:

1. they shall be either to an individual person or persons;

2. (Am. – SG, iss. 28 in 2009) the exposure is to a small or medium sized entity, provided in the latter case that the total amount owed to the investment intermediary and the parent undertaking and its subsidiaries, including any past due exposure, by the obligor person or group of connected persons, but excluding claims or contingent claims secured on residential real estate collateral, shall not exceed the BGN equivalent of EUR 1 000 000.

3. the exposures are treated, for the purposes of risk management, consistently over time and in a similar manner;

4. the exposure is not managed just as individually as exposures in the corporate exposure class and it represents one of a portfolio of significant number of similarly managed exposures.

(5) The following exposures shall be classed as equity exposures:

1. non-debt exposures conveying a subordinated, residual claim on the assets or income of the issuer;

2. debt exposures the economic substance of which is similar to the exposures specified in item 1.

(6) Within the corporate exposure class under para 1 item 3, investment intermediaries shall separately identify as specialized lending exposures, exposures which possess the following characteristics:

1. the exposure is to an entity which was created specifically to finance and/or operate physical assets;

2. the contractual arrangements give the lender a substantial degree of control over the assets and the income that they generate;

3. the primary source of repayment of the obligation to the investment intermediary is the income generated by the assets being financed.

(7) Any credit obligation not assigned to the exposure classes referred to in para 1 item 1, 2 4, 5 and 6 shall be assigned to the exposure class referred to in para 1 item 3.

(5) The methodology used by the investment intermediary for assigning exposures to different exposure classes under para 1 shall be appropriately and consistently applied over a long period of time.

Art. 114. (1) The risk-weighted exposure amounts for credit risk for exposures belonging to one of the exposure classes referred to in Art. 113 para 1 item 1-5 shall, unless deducted from own funds, be calculated in accordance with item 1, Section I of Annex N 5.

(2) The risk-weighted exposure amounts for dilution risk for purchased receivables shall be calculated according to item 2, Section I of Annex N 5. Where an investment intermediary has full recourse in respect of purchased receivables for default risk and for dilution risk, to the seller of the purchased receivables, these exposures shall be treated as a collateralized.

(3) The calculation of risk-weighted exposure amounts shall be based on risk parameters: Probability of Default (PD), Loss Given Default (LGD), maturity (M) and exposure value of the exposure. PD and LGD may be considered separately or jointly, in accordance with the requirements under Section II of Annex N 5.

(4) The calculation of risk-weighted exposure amounts for credit risk for all exposures belonging to the exposure class referred to in Art. 113 para 1 shall be calculated in accordance with the provisions of item 1.3, Section I of Annex N 5, subject to approval of the deputy chairman. The deputy chairman shall issue approval for use of the models in item 1.3.3 of Section I, Annex N 5, if they meet the minimal requirements set out in item 4, Section IV of Annex N 5.

(5) The calculation of risk weighted exposure amounts for credit risk for specialized lending exposures may be calculated in accordance with item 1.1.4, Section I of Annex N 5, and the Commission shall give instructions for the assignment of risk weights to those exposures. The methodology for assignment of risk weights to the individual exposures shall be approved by the deputy chairman.

(6) For risk weighting of exposures belonging to the exposure classes referred to in Art. 113 para 1 item 1-4, the investment intermediary shall provide their own estimates of PDs while complying with the requirements under Art. 111 and Section IV of Annex N 5.

(7) For risk weighting of exposures belonging to the exposure class referred to in Art. 113 para 1 item 4, the investment intermediary shall provide own estimates of LGDs and conversion factors in accordance with Article 111 and Section IV of Annex N 5.

(8) For risk weighting of exposures referred to in Art. 113 para 1 item 1-3, the investment intermediary shall apply the LGD values set out in item 1.7 and 1.8, Section II of Annex N 5, and the conversion factors set out in item 1.9, Section III of Annex N 5.

(9) For all exposures belonging to the exposure classes referred to in Art. 113 para 1 item 1-3, subject to approval by the deputy chairman, the investment intermediary may use own estimates of LGDs and conversion factors while complying with the requirements of Article 111 and Section IV of Annex N 5.

(10) For risk-weighing the exposures under Art. 113 para 1 item 6 and the securitised exposures shall apply the provisions of Chapter Twelve Section IV.

(11) Where exposures in the form of a collective investment undertaking (CIU) meet the criteria set out in item 1.15.4 amd 1.15.5 of Annex N 4 and the investment intermediary is aware of all of the underlying exposures of the CIU, the risk-weighted exposure amounts and expected loss amounts shall be established by applying the Internal Ratings Based Approach to the underlying exposures.

(12) Where the investment intermediary does not meet the conditions for using the Internal Ratings Based Approach according para 11, risk weighted exposure amounts and expected loss amounts shall be calculated in accordance with the following approaches:

1. for exposures belonging to the exposure class referred to in Art. 113 para 1 item 5, the approach set out in item 1.3.1, Section I of Annex N 5 shall apply, where the investment intermediary is unable to differentiate between private equity, exchange-traded and other equity exposures, it shall treat the exposures concerned as other equity exposures;

2. for all other underlying exposures, the approach set out in Chapter Twelve, Section I shall apply, subject to the following modifications:

a) the exposures are assigned to the appropriate exposure class and attributed the risk weight of the credit quality step immediately above the credit quality step that would normally be assigned to the exposure,

b) exposures with higher credit quality step to which a risk weight of 150% would normally be attributed, are assigned a risk weight of 200%.

(13) Where exposures in the form of a CIU do not meet the criteria set out in item 1.15.4 and 1.15.5 of Annex N 4, or the investment intermediary is not aware of all of the underlying exposures of the CIU, the investment intermediary shall look through to the underlying exposures and calculate risk-weighted exposure amounts and expected loss amounts in accordance with item 1.3.1, Section I of Annex N 5. If the investment intermediary is unable to differentiate between private equity, exchange-traded and other equity exposures, it shall treat the exposures concerned as other equity exposures.

Art. 115. (1) The expected loss amounts for exposures belonging to one of the exposure classes referred to in Art. 113 para 1 item 1-5 shall be calculated in accordance with item 3, Section I of Annex N 5.

(2) The calculation of expected loss amounts under para 1 shall be based on the same input figures of PD, LGD and the exposure value for each exposure as being used for the calculation of risk-weighted exposure amounts in accordance with Article 114. For defaulted exposures, where investment intermediaries use own estimates of LGDs, expected loss ("EL") shall be calculated on the principle of best estimate in accordance with item 2.4.8 of Section IV in Annex N 5.

(3) The expected loss amounts for securitised exposures shall be calculated in accordance with Chapter Twelve, Section IV.

(4) The expected loss amount for exposures belonging to the exposure class referred to in Art. 113 para 1 item 7 shall be zero.

(5) The expected loss amounts for dilution risk of purchased receivables shall be calculated in accordance with the provisions of item 3.7, Section I of Annex N 5.

(6) The expected loss amounts for exposures referred to in Article 114 para 11-13 shall be calculated in accordance with item 3, Section I of Annex N 5.

Art. 116. (1) Subject to the approval of the deputy chairman, an investment intermediary applying the IRB Approach in the calculation of risk-weighted exposure amounts and expected loss amounts for one or more exposure classes may apply standardized method in respect of:

1. the exposure class referred to in Art. 113, para 1, item 1 and 2, where the number of material counterparties is limited and it would be unduly burdensome to implement a rating system for such limited number of counterparties;

2. exposures in companies with non-significant in size business as well as exposure classes that are immaterial in terms of size and risk profile;

3. exposures to the government of the Republic of Bulgaria and to local authorities or administrative bodies, provided that following requirements are met:

a) there is no difference in risk between the exposures because of specific statutory acts;

b) exposures to the central government are assigned a 0% risk weight under Chapter Twelve, Section I.

4. exposures to a counterparty which is an investment intermediary's parent undertaking, its subsidiary or a subsidiary of the parent undertaking provided that the counterparty is an institution or a financial holding company, financial institution, asset management company or undertaking for ancillary services for some of the above stated, subject to appropriate prudential requirements to their activities, or is a undertaking linked with relations of control and the exposures among the intermediaries meet the provisions of Art. 108 para 9;

5. equity exposures to entities whose credit obligations qualify for a 0% risk weight under Chapter Twelve, Section I, including those publicly sponsored entities where a zero risk weight is applied;

6. equity exposures incurred under legislative programmes to promote specified sectors of the economy that provide significant subsidies for the investment to the investment intermediary and involve some form of government oversight and restrictions on the equity investments. The restriction is up to 10% of the initial and supplementary capital;

7. State guarantees pursuant to item 52.6 of Annex N 6.

(2) The equity exposure class shall be considered material if their aggregate value, excluding equity exposures incurred under para 1 item 7, exceeds on average over the preceding year, 10% of the own funds. If the number of those equity exposures is less than 10 individual holdings, that threshold under the preceding sentence shall be 5% of the investment intermediary's own funds.

Section III

Credit Risk Mitigation

Art. 117. (1) For the purposes of this Section, "lending investment intermediary" shall mean an investment intermediary which has the exposures in question, whether or not deriving from a loan or another action resulting in receivable.

(2) (Am. – SG, iss. 68 in 2008) Investment intermediaries using the Standardised Approach under Chapter Twelve, Section I or the IRB Approach under Chapter Twelve, Section II, but not using their own estimates of LGD and conversion factors under Art. 114 and 115, may recognise credit risk mitigation in accordance with the provisions of this Section in the calculation of risk-weighted exposure amounts for the purposes of Art. 21 or as relevant expected loss amounts for the purposes of the calculation referred to in Art. 7, para 2 and para 5, item 6.

Art. 118. (1) The technique used to provide the credit protection together with the actions and steps taken and procedures and policies implemented by the lending investment intermediary shall be such as to result in credit protection arrangements which are legally effective and enforceable in all relevant jurisdictions.

(2) The lending investment intermediary shall take all appropriate steps to ensure the effectiveness of the credit protection arrangements and to address related risks.

(3) In the case of funded credit protection, to be eligible for recognition the assets relied upon shall be sufficiently liquid and their value over time sufficiently stable to provide appropriate certainty as to the credit protection achieved having regard to the approach used to calculate risk-weighted exposure amounts and to the degree of recognition allowed. Eligibility shall be limited to the assets set out in points 8, 9 and 10 of Annex N 6.

(4) In the case of funded credit protection, the lending investment intermediary shall have the right to liquidate or retain, in a timely manner, the assets from which the credit protection derives in the event of the default, insolvency or bankruptcy of the obligor, or other credit event set out in the transaction documentation. Where appropriate, the same actions shall be taken against the custodian holding the collateral. The degree of correlation between the value of the assets relied upon for protection and the credit quality of the obligor shall not be too great.

(5) In the case of unfunded credit protection, to be eligible for recognition the party giving the undertaking shall be sufficiently reliable, and the protection agreement legally effective and enforceable in the relevant jurisdictions, to provide appropriate certainty as to the credit protection achieved having regard to the approach used to calculate risk-weighted exposure amounts and to the degree of asset recognition allowed. Eligibility shall be limited to the protection providers and types of protection agreement set out in item 19 and 20 of Annex N 6.

(6) In providing credit protection, the minimum requirements to recognition of credit protection set out in Annex N 6 shall be complied with.

Art. 119. (1) Where the requirements of Article 118 are met the method of calculation of risk-weighted exposure amounts, and, as relevant, expected loss amounts, may be modified in accordance with the provisions of item 19-63 of Annex N 6.

(2) No exposure in respect of which credit risk mitigation is obtained shall produce a higher risk-weighted exposure amount or expected loss amount than an otherwise identical exposure in respect of which there is no credit risk mitigation.

(3) Where the risk-weighted exposure amount already takes account of credit protection under Chapter Twelve, Section I or Chapter Twelve, Section II, as relevant, the credit protection under Art. 115-118 shall not be recognized.

Chapter IV

Securitization

Art. 120. Where investment intermediaries use the Standardized Approach according Chapter Twelve, Section I for the calculation of risk-weighted exposure amounts for the exposure class to which the securitised exposures would be assigned under Article 104, they shall calculate the risk-weighted exposure amount for a securitisation position in accordance with item 6.1 – 6.2 of Annex No. 7. In all other cases, it shall calculate the risk-weighted exposure amount in accordance with item 6.1 and 6.3 of Annex No. 7.

Art. 121. (1) Where significant credit risk associated with securitised exposures has been transferred from the originator investment intermediary to another entity in accordance with the terms of item 2-4 of Annex No. 7, then that investment intermediary shall:

1. in the case of a traditional securitisation, exclude from its calculation of risk-weighted exposure amounts, and, as relevant, expected loss amounts, the exposures which it has securitised;

2. in the case of a synthetic securitisation, calculate risk-weighted exposure amounts, and, as relevant, expected loss amounts, in respect of the securitised exposures in accordance with the provisions of item 2-4 of Annex N 7.

(2) Where paragraph 1 applies, the originator investment intermediary shall calculate the risk-weighted exposure amounts prescribed in Annex N 7 for the positions that it may hold in the securitisation.

(3) Where the originator investment intermediary fails to transfer significant credit risk through securitization in accordance with para 1, it need not calculate risk-weighted exposure amounts for any positions it may have in the securitisation in question.

Art. 122. (1) To calculate the risk-weighted exposure amount of a securitisation position, risk weights shall be assigned to the exposure value of the position, based on the credit quality of the position.

(2) The extent of credit quality under para 1 shall be determined on the basis of a recognized credit rating agency or by another way, set out in Annex N 7.

(3) Where there is an exposure of the investment intermediary to different tranches in a securitisation, the exposure to each tranche shall be considered a separate securitisation position.

(4) The providers of credit protection to securitisation positions shall be considered to hold positions in the securitisation.

(5) Securitisation positions shall include exposures to a securitisation arising from interest rate or currency derivative contracts.

(6) Where a securitisation position is subject to funded or unfunded credit protection, the risk-weight to be applied to that position shall be determined in accordance with Chapter Twelve, Section III, in conjunction with Annex N 7.

(7) (Am. – SG, iss. 68 in 2008) For the purposes of Art. 21, the risk-weighted exposure amounts shall be included in the investment intermediary's total of risk-weighted exposure amounts, subject to the conditions of Art. 7 para 2 and para 5 item 6.

Art. 123. (1) An ECAI credit assessment may be used to determine the risk weight of a securitisation position in accordance with Article 122 only if the ECAI has been recognized as eligible by the Commission.

(2) The Commission shall recognize an ECAI as eligible if the requirements laid down in Article 109 and the technical criteria in item 2 of Annex N 4 are satisfied, ECAI has a demonstrated ability in the area of securitisation, and its assessments are adequately reliable and accepted by the market participants.

(3) If an ECAI has been recognized by a relevant competent authority in a Member State as appropriate, the Commission may recognize the same ECAI without performing separately actions concerning its recognition according para 2.

(4) The Commission shall make publicly available the information related to the recognition process and a list of eligible ECAIs.

(5) To be used for the purposes of paragraph 1, a credit assessment of an eligible ECAI shall comply with the principles of credibility and transparency as elaborated in item 5 of Annex N 7.

Art. 124. (1) For the purposes of applying risk weights to securitisation positions, the deputy chairman shall determine with which of the credit quality steps set out in Annex N 7 the relevant credit assessments of an eligible ECAI are to be associated.

(2) Where a relevant competent authority in a Member State has determined credit quality steps for credit assessments of an eligible ECAI under paragraph 1, the deputy chairman may recognize that qualification without performing separate actions for determination of the associated credit quality steps.

Art. 125. (1) Where there is a securitisation of revolving exposures subject to an early amortisation provision, the originator investment intermediary shall calculate additional risk-weighted exposure amounts in respect of the risk that the levels of credit risk to which given position is exposed may increase following the operation of the early amortisation provision.

(2) A "revolving exposure" shall be an exposure whereby customers' outstanding balances are permitted to fluctuate based on their decisions to borrow and repay, up to an agreed limit.

(3) An “early amortisation provision” shall be a contractual clause which requires, on the occurrence of defined events, investors' positions to be redeemed before the originally stated maturity of the securities issued.

Art. 126. (1) An originator investment intermediary which has made use of Article 121 in the calculation of risk-weighted exposure amounts or a sponsor investment intermediary shall not, with a view to reducing potential or actual losses to investors, provide support to the securitisation beyond its contractual obligations.

(2) If an originator investment intermediary or a sponsor investment intermediary fails to comply with paragraph 1, the deputy chairman shall require them to hold capital against all of the securitised exposures as if they had not been securitised.

(3) The investment intermediary shall disclose publicly the circumstance that it has provided non-contractual support and the impact of having done so on the required own funds.

Chapter Thirteen

MINIMUM CAPITAL REQUIREMENTS IN RELATION TO THE OPERATIONAL RISK AND QUALIFYING HOLDING

Section I
Operational Risk

Art. 127. (1) (Suppl. – SG, iss. 68 in 2008) Operational risk is the risk of loss resulting from inadequate or failed internal processes, errors of people or systems or from internal events, including legal risk.

(2) Investment intermediaries shall hold own funds against operational risk calculated in accordance with the approaches set out in Art. 128 - 130.

(3) (Am. – SG, iss. 68 in 2008) An investment intermediary that has started to apply the Standardized Approach for determination of capital requirement, set out in Art. 129, shall not revert to the use of the Basic Indicator Approach set out in Art. 128. The application of the Basic Indicator Approach shall be possible as an exception, subject to obtained approval by the deputy chairman and for demonstrated good cause by the investment intermediary.

(4) (Suppl. – SG, iss. 68 in 2008) An investment intermediary that has started to apply the Advanced Measurement Approach for determination of capital requirement under Art. 130 shall not revert to the use of the approaches set out in Art. 128 and 129. The application of the approaches under Art. 128 and 129 shall be possible as an exception, subject to obtained approval by the deputy chairman and for demonstrated good cause by the investment intermediary.

(5) (Suppl. – SG, iss. 68 in 2008) The deputy chairman may allow investment intermediaries to use a combination of approaches for determination of capital requirement in accordance with item 4 of Annex 8.

Art. 128. (Am. – SG, iss. 68 in 2008) The capital requirement for operational risk under the Basic Indicator Approach shall be a certain percentage of the value of the used indicator determined according item 1 of Annex No. 8.

Art. 129. (1) (Suppl. – SG, iss. 68 in 2008) Under the Standardized Approach for determination of capital requirement for operational risk, investment intermediaries shall divide their activities into a number of business lines as set out in item 2 of Annex N 8.

(2) For each business line, they shall calculate a capital requirement for operational risk as a certain percentage of the value of a relevant indicator.

(3) The capital requirement for operational risk under the Standardized Approach shall be the sum of the capital requirements for operational risk across all individual business lines.

(4) The parameters for the Standardized Approach are set out in item 2 of Annex 8. To qualify for use of the Standardized Approach, investment intermediaries shall meet the criteria set out in item 2 of Annex 8.

Art. 130. (1) (Am. – SG, iss. 68 in 2008) Subject to the deputy chairman's approval, investment intermediaries may use Advanced Measurement Approaches for operational risk measurement, based on their own systems for measurement of that risk.

(2) The investment intermediary shall satisfy the Commission that it meets the qualifying criteria for the application of the method according para 1, set out in item 3 of Annex 8.

(3) (Suppl. – SG, iss. 68 in 2008) When an Advanced Measurement Approach for operational risk measurement is used by an EU parent investment intermediary and its subsidiaries or by the subsidiaries of an EU parent financial holding company, the relevant competent authorities shall cooperate closely as provided for in Art. 136, Art. 142 para 3 and 4 and Chapter Seventeen, Section II.

(4) (Am. and suppl. – SG, iss. 68 in 2008) Where an EU parent investment intermediary and its subsidiaries or the subsidiaries of an EU parent financial holding company use an Advanced Measurement Approach for operational risk measurement on a unified basis, the deputy chairman may allow the criteria under item 3 in Annex 8 to be met by the parent and its subsidiaries considered together.

Section II

Qualifying Holding

Art. 131. (1) An investment intermediary may not have a qualifying holding the amount of which exceeds 15% of its own funds in an undertaking which is neither an investment intermediary, other financial institution, undertaking carrying on ancillary activities or undertaking with other similar activity.

(2) The total amount of an investment intermediary's qualifying holdings in the undertakings stated in para 1 may not exceed 60% of its own funds.

(3) The limits laid down in paragraphs 1 and 2 may be exceeded only in exceptional circumstances. Upon occurrence of circumstance under sentence one, the deputy chairman may require an investment intermediary either to increase its own funds or to take other equivalent measures.

(4) In calculating the limits under para 1 and 2 the investment intermediary shall not include in the qualifying holding shares held temporarily with the purpose of financial assistance of the undertaking during a financial reconstruction or rescue operation, as well as holdings arising in underwriting or in transactions on the investment intermediary's own name but on behalf of clients. Shares which are not financial fixed (uncurrent) assets shall also not be included in the calculation.

Art. 132. (1) In the calculation of the limits under Art. 131 para 1 and 2 the investment intermediary shall not include in the qualifying holding the shares and holdings held in insurance and reinsurance companies.

(2) (Am. – SG, iss. 68 in 2008) The limits laid down in Art. 131 para 1 and 2 shall not apply where the amount by which the qualifying holdings exceeding those limits shall be covered by own funds and the value of these own funds shall not be included in the calculation of capital requirements under Article 19. If both the limits laid down in Art. 131 para 1 and 2 are exceeded, the amount to be covered by own funds shall be equal to the greater of the two values.

Chapter Fourteen

CAPITAL REQUIREMENTS ON CONSOLIDATED BASIS

Section I

Requirements on Consolidated Basis

Art. 133. (1) (Am. – SG, iss. 68 in 2008) A parent investment intermediary shall comply, to the extent and in the manner prescribed in Article 163, with its obligations for cover of capital requirements laid down in Art. 19, Art. 131 para 1-3, Art. 142 para 3 and 4 and for the risk associated with the large exposures under Chapter Nine on the basis of its consolidated financial situation.

(2) (Am. – SG, iss. 68 in 2008) An investment intermediary controlled by a parent financial holding company in a Member State shall comply, to the extent and in the manner prescribed in Article 163, with its obligations for cover of capital requirements laid down in Art. 19, Art. 131 para 1-6 and Art. 142 para 3 and 4 and for the risk associated with the large exposures under Chapter Nine on the basis of the consolidated financial position of that financial holding company.

(3) Where more than one investment intermediary is controlled by a parent financial holding company in a Member State, para 2 shall apply only to the investment intermediary over which the Commission exercises supervision on a consolidated basis in accordance with Art. 162.

Art. 134. (1) EU parent investment intermediary shall fulfil its obligations under Chapter Fifteen, Section III on the basis of its consolidated financial situation.

(3) An investment intermediary supervised by EU parent financial holding company shall fulfil the obligations laid down in Chapter Fifteen, Section III on the basis of the consolidated financial situation of that holding company.

(3) Significant subsidiaries of EU parent investment intermediary and of EU financial holding company shall disclose the information specified in Art. 152 para 7, on an individual or sub-consolidated basis.

Art. 135. (1) An investment intermediary, financial institution or ancillary services undertaking which is a subsidiary or in whose capital a participation is held need not be included in the consolidation:

1. (Am. – SG, iss. 68 in 2008) where the undertaking concerned is with a legal seat in a third country where there are legal impediments to the provision of the necessary information;

2. (Am. – SG, iss. 68 in 2008) where, in the opinion of the Commission, the undertaking concerned is of negligible interest with respect to the objectives of the exercised supervision on consolidated basis over the investment intermediary and where the total amount of the assets of the undertaking concerned is less than the smaller of the following two amounts:

a) the BGN equivalence of EUR 10 000 000;

b) (Am. – SG, iss. 68 in 2008) one percent (1%) of the total amount of the assets of the parent undertaking or the undertaking that holds the participation,

3. where, in the opinion of the Commission the consolidation of the financial position of the undertaking concerned would be inappropriate or misleading with respect to the objectives of the exercised supervision on consolidated bases over the investment intermediary.

(2) If, in the cases referred to in para 1 item 2, several undertakings meet the above set criteria, they shall be included in the consolidation where collectively they are of non-negligible interest with respect to the objectives of the exercised supervision.

(3) (Am. – SG, iss. 68 in 2008) A subsidiary investment intermediary shall meet its obligations for cover of capital requirements under Art. 19, Art. 131 para 1-3 and Art. 142 para 3 and 4 and for the risk associated with the large exposures under Chapter Nine on a sub-consolidated basis if it or its parent undertaking where it is a financial holding company, have an investment intermediary, financial institution or an asset management company as a subsidiary in a third country, or hold a participation in such an undertaking.

(4) (Am. and suppl. – SG, iss. 68 in 2008) The parent undertakings and their subsidiaries, obligated under this Ordinance to meet the capital obligations laid down in Art. 136 on a consolidated or sub-consolidated basis, must ensure that their arrangements, processes and mechanisms are consistent and well-integrated and that any data and information relevant to the purpose of supervision can be produced.

Section II

Application of the Capital Requirements on Consolidated Basis

Art. 136. (1) (Am. – SG, iss. 68 in 2008) Where the Commission exercises supervision over a group on a consolidated basis, it may allow the capital requirements not to be applied on a consolidated basis in the cases where:

1. each investment intermediary from a Member State which is a part of such group calculates its of own funds according to Art. 10 para 1;

2. all investment intermediaries in such group meet the requirements of Art. 23 para 2 and 3;

3. (Am. – SG, iss. 68 in 2008) each investment intermediary from a Member State, which is a part of such group meets the capital requirements imposed in Art. 19 and 23 on an individual basis and at the same time deducts from its own funds any contingent liability in favour of other investment intermediaries, financial institutions, asset management companies and ancillary services undertakings, which would otherwise be consolidated;

4. any financial holding company from a Member State which is the parent financial holding company of any investment intermediary in such a group holds capital, equal to the sum of:

a) the positions of own funds under Art. 6 para 2 and 3 and Art. 7 para 1;

b) the full book value of any holdings, subordinated claims and other positions of the own funds as referred to in Art. 6 and 7 in investment intermediaries, financial institutions, asset management companies and ancillary services undertakings which would otherwise be consolidated;

c) the total amount of any contingent liability in favour of investment intermediaries, financial institutions, asset management companies and ancillary services undertakings which would otherwise be consolidated.

(2) Where the criteria in para 1 are met, an investment intermediary from a Member State shall have systems in place for monitoring and control of the sources of capital and funding of all financial holding companies, investment intermediaries, financial institutions, asset management companies and ancillary services undertakings within the group.

(3) With the Commission's permission, the capital of financial holding companies from a Member State which are the parent financial holding company of an investment intermediary in such group, may be of value lower than the value calculated under para 1 item 4, but not lower than:

1. (Am. – SG, iss. 68 in 2008) the sum according Art. 19 and 23 of the capital requirements imposed on an individual basis to investment intermediaries, financial institutions, asset management companies and ancillary services undertakings which would otherwise be consolidated, and

2. the total amount of any contingent liabilities of the financial holding company in favour of investment intermediaries, financial institutions, asset management companies and ancillary services undertakings which would otherwise be consolidated.

(4) For the purposes of para 2, the capital requirements to investment intermediaries, financial institutions, asset management companies and ancillary services undertakings of third countries are equal to the minimum capital requirements.

Art. 137. (1) The investment intermediaries in a group which have been granted the waiver provided for in Article 136, the capital requirements which they must meet to be on individual and not on consolidated basis, shall notify the Commission of the risks which could undermine their financial position, including those associated with the composition and sources of their capital and funding. If the Commission then considers that the financial position of such investment intermediary is not adequately protected, it may obligate it to take measures for its improvement including, if necessary, to limit the transfer of capital from it to group entities.

(2) Where the Commission has issued the permission under Art. 136, the group shall take other appropriate measures to asses, measure and monitor the risks of the whole group, namely large exposures, including any undertakings from a third country.

(3) Where the Commission waives the application of capital requirements on a consolidated basis provided for in Art. 136, the requirements according Art. 142 para 3 and 4, Chapter Fifteen, Section III and the requirements under Art. 155 to the supervision over the investment intermediaries shall be applied on individual basis.

Art. 138. (1) The deputy chairman may exempt an investment intermediary from the consolidated capital requirement, provided that all the investment intermediaries in the group meet the requirements of Art. 23 para 2 and the group does not include credit institutions.

(2) In the cases under para 1, a parent investment intermediary in a Member State shall be required to provide own funds at a consolidated level which are always more than or equal to the higher of the following two sums, calculated on the basis of the parent investment intermediary's consolidated financial position and in compliance with the the requirements of Section III.

1. (Am. – SG, iss. 68 in 2008) the sum of the capital requirements contained under Art. 21 and Art. 19 para 1 item 1 and 2

2. the amount prescribed in Article 24.

(3) In the cases under para 1, an investment intermediary controlled by a financial holding company shall be required to provide own funds at a consolidated level which are always more than or equal to the higher of the following two sums, calculated on the basis of the financial holding company's consolidated financial position and in compliance with the requirements of Section III.

1. (Am. – SG, iss. 68 in 2008) the sum of the capital requirements contained in Art. 21 and Art. 19, para 1, item 1 and 2;

2. the amount prescribed in Article 24.

Art. 139. (1) The deputy chairman may exempt an investment intermediary from the consolidated capital requirements, provided that all the investment intermediaries in the group meet the requirements of Art. 23 para 2 and 3 and the group does not include credit institutions.

(2) (Am. – SG, iss. 68 in 2008) In the cases under para 1, the own funds of a parent investment intermediary from a Member State at a consolidated level must always be more than or equal to the sum of the capital requirements under Art. 21 and Art. 19 para 1 item 1 and 2, and the amount under Art. 24, calculated on the basis of the parent investment intermediary's consolidated financial position and in compliance with the requirements of Section III.

(3) (Am. – SG, iss. 68 in 2008) In the cases under para 1, an investment intermediary controlled by a financial holding company shall be required to provide own funds at a consolidated level which are always more than or equal to the sum of the capital requirements under Art. 21 and Art. 19 para 1 item 1 and 2, and the amount prescribed in Art. 24, calculated on the basis of the financial holding company's consolidated financial position and in compliance with the requirements of Section III.

Section III

Calculation of the Capital Requirements on Consolidated Basis

Art. 140. (1) (Am. – SG, iss. 28 in 2009) Where the waiver of the capital requirements on a consolidated basis provided for in Article 136 is not exercised, the deputy chairman may, for the purpose of calculating the capital requirements set out in Chapter Six and Chapter Ten, for the exposures to clients set out in Chapter Nine and Annex 9 on consolidated basis permit positions in the trading book of one investment intermediary to offset positions in the trading book of another investment intermediary according to the rules set out in Chapter Six, Nine and Eleven and Annex 9.

(2) The deputy chairman may also allow foreign-exchange positions in one investment intermediary to offset foreign-exchange positions in another investment intermediary in accordance with the rules set out in Chapter Eight and/or Chapter Eleven, as well as commodities positions in one investment intermediary to offset commodities positions in another investment intermediary in accordance with the rules set out in Chapter Ten and/or Chapter Eleven.

(3) The deputy chairman may permit offsetting of the trading book and of the foreign-exchange and commodities positions against such positions of undertakings located in third countries, subject to the simultaneous fulfilment of the following conditions:

1. such undertakings have been authorized in a third country and either satisfy the definition of credit institution or are recognized investment intermediaries from a third country;

2. such undertakings comply, on an individual basis, with the capital adequacy requirements equivalent to the requirements under this Ordinance;

3. no regulations exist in the third country in question which might significantly affect the transfer of funds among the undertakings within the group.

(4) The deputy chairman may also allow the offsetting provided for in para 1 and 2 between undertakings within a group that have been authorized in the Member State in question provided that:

1. there is a satisfactory allocation of capital within the group;

2. the regulatory, legal or contractual framework in which the undertakings operate is such as to guarantee mutual financial support within the group.

(5) The deputy chairman may allow the offsetting provided for in para 1 and 2 between undertakings within a group that fulfil the conditions imposed in para 4 and any undertaking included in the same group which has been authorised in another Member State, provided that that undertaking is obliged to fulfil the capital requirements imposed in Art.19, 23 and Art. 83 para 1 on an individual basis.

Art. 141. In the calculation of the own funds on consolidated basis, the consolidated sums in the financial statements about the elements under Art. 6 and 7 shall be used according the provisions of Chapter Sixteen, Section II.

Chapter Fifteen
RISK MANAGEMENT AND CAPITAL VALUATION. REPORTING AND CONTROL OF THE INVESTMENT INTERMEDIARIES' CAPITAL ADEQUACY AND LIQUIDITY

Section I
Risk Management and Capital Valuation

Art. 142. (1) The investment intermediary shall develop internal governance arrangements, which settle the organizational structure and include well defined and transparent lines of responsibility, effective processes to identify, manage and monitor the risks it is or might be exposed to, and adequate internal control mechanisms, including sound administrative and accounting procedures.

(2) The arrangements, processes and mechanisms shall be comprehensive and proportionate to the nature, scale and complexity of the investment intermediary's activities as well as shall comply with the following criteria of risk treatment:

1. with regard to the management – rules have been adopted for allocation of the responsibilities among the persons working under a contract for the investment intermediary and for prevention of conflicts of interest;

2. in relation to consideration of the risk, strategies and policies have been adopted for taking up, managing, monitoring and mitigating the risks to which the investment intermediary is or might be exposed, including those posed by the macroeconomic environment.

3. with regard to the credit risk or the counterparty risk:

a) consistent and well-defined criteria and the process have been developed for approving, amending, renewing, and re-financing of credits;

b) an effective system has been implemented of ongoing administration and monitoring of the various credit risk-bearing portfolios and exposures, including for identifying and managing problem credits and for making adequate value adjustments and provisions;

c) diversification of credit portfolios shall be adequate given the investment intermediary's target markets and overall credit strategy.

4. with regard to the residual risk - written policies and procedures have been adopted for efficient monitoring and control of credit risk mitigation techniques, if they show lower efficiency than the expected;

5. (Am. – SG, iss. 28 in 2009) with regard to the concentration risk – policies and procedures have been developed for monitoring and control of the concentration risk arising from exposures to counterparties, groups of connected counterparties, and counterparties in the same economic sector, geographic region or from the same activity or commodity, as well as the risk associated with large indirect credit exposures (e.g. to a single collateral issuer);

6. with regard to the securitization risk:

a) policies have been adopted for monitoring and evaluation of the risk arising from securitisation transactions in relation to which the investment intermediary is an originator or sponsor, to ensure that the economic substance of the transaction is fully reflected in the risk assessment and management decisions;

b) liquidity plans have been developed to address both scheduled and early amortization, where the investment intermediary is an originator of revolving securitisation transactions involving early amortisation provisions.

7. with regard to the market risk - policies and processes have been developed for the measurement and management of all material sources of market risks;

8. with regard to risk arising from potential changes in interest rates - systems have been implemented to evaluate and manage the risk arising from potential changes in interest rates as they affect an investment intermediary's portfolio related activities;

9. with regard to the operational risk - policies and processes have been developed to evaluate and manage the operational risk, contingency plans to operate on an ongoing basis and limit losses in the event of severe business disruption; for the purposes of those policies and processes, the investment intermediary shall define the operational risk's scope;

10. with regard to the liquidity risk:

a) policies and processes have been developed for the measurement and management of the net funding positions and requirements on an ongoing and forward liquidity;

b) alternative scenarios have been developed and the assumptions underpinning decisions concerning the net funding position shall be reviewed regularly;

c) contingency plans to deal with liquidity crises shall be in place.

(3) An investment intermediary shall develop reliable and efficient arrangements and processes for maintenance of the value, type and allocation of the internal capital that are necessary for adequate cover of the risks to which it is exposed.

(4) The investment intermediary shall make a periodic review of the arrangements and processes under para 3 to show that they are adequate to the nature, scale and complexity of its activity.

(5) The internal governance arrangements under para 1 and the arrangements and processes under para 3 shall be adopted by the investment intermediary's management board and shall be filed with the Commission within a 14-day period after the obtaining of a license to pursue the business of an investment intermediary.

Section II

Reporting

Art. 143. (1) The investment intermediary shall on ongoing basis monitor its capital adequacy and liquidity, performing daily revaluation according Art. 15 and 16 of its trading book positions and preparing a daily report on the capital adequacy and liquidity on the basis of the balance sheet and the analytical turnover report. Revaluation of the non-trading book's positions shall be made by the same methods at least once monthly, as of the last business day of the relevant month.

(2) (Am. – SG, iss. 68 in 2008) The reports under para 1, the information on market prices, parameters and methods for securities valuation and other data on the basis of which the capital adequacy and liquidity are determined shall be kept at least 5 years on paper, magnetic, optical or other technical media under the conditions and the procedure of Chapter Six of the Accountancy Act, and an archive copy shall be made on external media.

Art. 144. (1) The investment intermediary shall submit to the Commission by the 10th day of the next month after the expiry of the reporting period:

1. each month - accounts and income statement as of the last day of the preceding month and a report on capital adequacy and liquidity in the cases when it has obtained a license to pursue business under Art. 4 para 1 and 4;

2. (Am. – SG, iss. 68 in 2008) half-yearly, accounts and income statement as of the last date of the half-year and a report on capital adequacy and liquidity in the cases when it has obtained a license to pursue business under Art. 4 para 5.

(2) The internal control mechanisms, the administrative and accounting procedures of the investment intermediaries shall permit the verification at any time by the Commission of their compliance with the requirements and rules of capital adequacy under this Ordinance.

(3) The investment intermediaries under Art. 4 para 1 and 4 which draw up consolidated reports shall file with the Commission half-yearly financial statements on consolidated basis along with a 6-months report on the capital adequacy and liquidity on consolidated basis by 15 August, and within 180 days after the fiscal year closing – an annual report on capital adequacy and liquidity on consolidated basis.

(4) Investment intermediaries must notify the Commission of the cases, where the counterparties that have concluded repurchase agreements, reverse repurchase agreements or securities lending transactions default on their obligations under these agreements and transactions, without delay but not later than the next business day after the date of default.

(5) An investment intermediary shall file with the Commission within 90 days after the fiscal year closing, an annual financial statement certified by a registered auditor and a consolidated financial statement certified by a registered auditor, if they draw up such, within 180 days after the fiscal year closing.

(6) The information under this Chapter shall be filed with the Commission on a magnetic media in determined by the deputy chairman format or by e-mail. On request of the deputy chairman, an investment intermediary shall present this information also on paper.

(7) On the deputy chairman's request, investment intermediaries shall present additional data and clarifications on the reports, including analytical check-ups on each position, as well as reports on capital adequacy and liquidity, balance sheets, income statements, analytical turnover reports and additional information for shorter periods.

Art. 145. (Am. – SG, iss. 68 in 2008) The investment intermediary shall inform the Commission latest by the next working day:

1. after the date on which the amount of its own funds is below 110 % of the required minimum under Art. 19 para 2;
2. after the date it does not meet the requirements for capital adequacy and liquidity under this Ordinance;
3. after the date of arising of exposure under Art. 77 para 2;

Art. 146. (1) For the purposes of ongoing reporting and control of its financial positions with adequately high accuracy, the investment intermediary must have at any time the necessary hardware equipment and software.

(2) Written information on the hardware equipment and software under para 1 shall be presented to the Commission within a 14-day period after the effectuation of the decision for entry of the company in the commercial register, or change in the subject of activity, after the obtaining of a license to pursue the business of an investment intermediary.

(3) Information on the changes in the software shall be submitted in the Commission within a 7-day period after making the changes.

(4) In the event that the equipment and software do not create adequate possibility for timely accurate and comprehensive monitoring and supervision of the financial situation of an investment intermediary, the deputy chairman may give obligatory guidance.

Section III

Disclosure of Information

Art. 147. (1) An investment intermediary shall disclose to the public:

1. information about its objectives and policies in relation to risk management, separately for every risk, which shall include:

a) the strategies and processes of management of various categories risks;

b) (Suppl. – SG, iss. 68 in 2008) the structure and organization of the risk management and control unit or other relevant actions;

c) the scope and nature of the systems for reporting and measuring the risk;

d) the actions in the area of risk hedging and its mitigation, also the strategies and processes of monitoring the constant efficiency of the hedging processes and of those mitigating it.

2. information regarding the scope of application of this Ordinance, including:

a) business name of the investment intermediary which makes disclosure of information;

b) an outline of the differences on the basis of consolidation for accounting and prudential purposes, with a brief description of the entities that are:

aa) fully consolidated;

bb) proportionally consolidated;

cc) deducted from own funds on the basis of consolidation; or

dd) neither consolidated nor deducted;

c) any current or foreseen material practical or legal impediment to the prompt transfer of own funds or repayment of liabilities among the parent undertaking and its subsidiaries;

d) the aggregate amount by which the actual own funds are less than the required minimum in all subsidiaries not included in the consolidation, and the name or names of such subsidiaries;

3. information regarding the own funds which includes:

a) summary information on the terms and conditions and the main features of all own funds items and components thereof;

b) the amount of the original own funds, with separate disclosure of all positive items and deductions;

c) the total amount of additional own funds, and own funds as defined in Art. 8;

d) elements deducted from original and additional own funds, with separate disclosure of items referred to in Article 7 para 5 item 5;

e) total own funds, net of deductions and limits laid down in Article 7 para 6-7.

4. (Am. – SG, iss. 68 in 2008) information on compliance with the requirements under Art. 19 and Art. 142 para 3 and 4 which shall include:

a) summary of the investment intermediary's approach to assessing the adequacy of its internal capital to support current and future activities;

b) for an investment intermediary calculating the risk-weighted exposure amounts in accordance with Chapter Twelve, Section I - the amount representing 8 % of the risk-weighted exposure amounts for each of the exposure classes specified in Article 107;

c) for investment intermediaries calculating risk-weighted exposure amounts in accordance with Chapter Twelve, Section II - the amount representing 8 % of the risk-weighted exposure amounts for each of the exposure classes specified in Article 113; for the retail exposure class, this requirement applies to each of the categories of exposures to which the different correlations indicated in Appendix N 5 correspond; for the equity exposure class, this requirement applies to:

aa) each of the approaches provided in item 1.3, Section I of Annex N 5;

bb) exchange traded exposures, private equity exposures in sufficiently diversified portfolios, and other exposures;

cc) exposures subject to supervisory transition regarding capital requirements;

d) (Am. – SG, iss. 68 in 2008) minimum capital requirements calculated in accordance with Article 19 item 1 and 2;

e) minimum capital requirements calculated in accordance with Chapter Thirteen, Section I, and disclosed separately.

5. information regarding the exposure to counterparty credit risk as defined in Section I of Appendix 3 which shall include:

a. description of the methodology used to calculate internal capital and credit limits for counterparty credit exposures;
b. description of policies for recognition of the held collateral and establishing credit reserves;
c. description of policies with respect to wrong-way risk exposures;
d. description of the impact of the amount of collateral the investment intermediary would have to provide given a downgrade in its credit rating;
e. gross positive fair value of contracts, netting benefits, netted current credit exposure, collateral held and net derivatives credit exposure; net derivatives credit exposure is the credit exposure on derivatives

transactions after considering both the benefits from legally enforceable netting agreements and collateral arrangements;

f. measures for calculation of the exposure value under the methods set out in Appendix 3;

g. the notional value of credit derivative hedges used for protection, and the distribution of current credit exposure by types of credit exposure;

h. credit derivative transactions (notional), segregated between use for the credit institution's own credit portfolio, as well as in its intermediation activities, including the distribution of the credit derivatives products used, broken down further by protection bought and sold within each product group;

i. the estimate of coefficient α if the investment intermediary has received an approval to estimate it.

6. information regarding the exposure to credit risk and dilution risk:

a) the definitions of "past due" and "impaired" positions for accounting purposes;

b) a description of the approaches and methods adopted for determining value adjustments and provisions;

c) the total amount of exposures after accounting offsets without taking into account the effects of credit risk mitigation, and the average amount of the exposures over the period broken down by different types of exposure classes;

d) the geographic distribution of the exposures, broken down in significant areas by material exposure classes, and further details, if appropriate;

e) the distribution of the exposures by industry or counterparty type, broken down by exposure classes, and further details, if appropriate;

f) the residual maturity breakdown of all the exposures, broken down by exposure classes, and further details, if appropriate;

g) for significant industry or counterparty type, the amount of:

aa) impaired exposures and past due exposures, provided separately;

bb) value adjustments and provisions;

cc) charges for value adjustments and provisions during the period;

h) the amount of the impaired exposures and past due exposures, provided separately, broken down by significant geographical areas including, if practical, the amounts of value adjustments and provisions related to each geographical area;

i) the reconciliation of changes in the value adjustments and provisions for impaired exposures, shown separately. The information shall comprise:

aa) a description of the type of value adjustments and provisions;

bb) the opening balances;

cc) the amounts taken against the provisions during the period;

dd) the amounts set aside or reversed for estimated probable losses on exposures during the period, any other adjustments including those determined by exchange rate differences, business combinations, acquisitions and disposals of subsidiaries, and transfers between provisions;

ee) the closing balances;

7. for an investment intermediary calculating the risk-weighted exposure amounts in accordance with Chapter Twelve, Section I, information for each of the exposure classes specified in Article 107 as follows:

(a) the names of the nominated ECAIs and ECAs and the reasons for any changes;

(b) the exposure classes for which each ECAI or ECA is used;

(c) a description of the process used to transfer the issuer and issue credit assessments given by ECAIs and ECAs onto items not included in the trading book;

(d) the association of the external rating of each nominated ECAI or ECA with the credit quality steps prescribed in Annex 4; this information needs not be disclosed if the investment intermediary complies with the standard association published by the Commission;

(e) the exposure values and the exposure values after credit risk mitigation associated with each credit quality step prescribed in Annex N 4, as well as those deducted from own funds.

8. for an investment intermediary calculating the risk-weighted exposure amounts in accordance with Annex N 5, information about the exposures assigned to each category indicated in Table 1 of Annex N 5, or to each risk weight mentioned in Annex N 5.

9. (Am. – SG, iss. 68 in 2008) for an investment intermediary calculating the capital requirements in accordance with Article 19 item 1 and 2, information about those requirements separately for each risk referred to in those provisions.

10. for an investment intermediary which calculates its capital requirements in accordance with Chapter Eleven, information about:

a) each sub-portfolio covering:

aa) the characteristics of the models used;

bb) a description of stress testing applied to the sub-portfolio;

cc) a description of the approaches used for back-testing and validating the accuracy and consistency of the internal models and the procedures of their implementation;

b) the scope of the approved by the deputy chairman model;

c) a description of the extent and methodologies for compliance with the requirements set out in Art. 12, 14 – 16 and 18.

11. information on operational risk, including:

a) the approaches for the assessment of own funds requirements for operational risk;

b) a description of the used by the investment intermediary methodology set out in Section I of Chapter Thirteen, including a description of relevant internal and external factors considered in the measurement approach. In the case of partial use, the scope and coverage of the different methodologies used.

12. information regarding the exposures in equities not included in the trading book, covering:

a) the differentiation between exposures based on their objectives, including for capital gains relationship and strategic reasons, and an overview of the accounting techniques and valuation methodologies used, including key assumptions and practices affecting valuation and any significant changes in these practices;

b) the balance sheet value, fair value and, for the exchange-traded equities, a comparison to the market price where it is materially different from the fair value;

c) the types, nature and amounts of exchange-traded equity exposures, private equity exposures in sufficiently diversified portfolios, and other exposures;

d) the realized gains or losses arising from sales and liquidations in the period;

e) the total unrealized gains or losses, the total latent revaluation gains or losses, and any of these amounts included in the original or additional own funds.

13. information on their exposure to interest rate risk on positions not included in the trading book:

a) the nature of the interest rate risk and key assumptions, including assumptions regarding loan prepayments and behavior of clients of non-maturity deposits, and frequency of measurement of the interest rate risk;

b) the variation in earnings, economic value or other relevant measure used by the management body for upward and downward rate shocks according to the method for measuring the interest rate risk, broken down by currency.

14. for an investment intermediary calculating risk weighted exposure amounts in accordance with Chapter Twelve, Section IV information including:

a) a description of the investment intermediary's objectives in relation to securitisation activity;

b) the roles played by the investment intermediary in the securitisation process;

c) extent and scope of the investment intermediary’s participation in application of the securitisation process;

d) the approaches used to calculate risk weighted exposure amounts for the securitisation activities;

e) a summary of the accounting policies for securitisation activities, including:

aa) whether the transactions are treated as sales or financings;

bb) the recognition of gains on sales;

cc) the key assumptions for valuing retained interests;

dd) the treatment of synthetic securitisation if this is not covered by other accounting policies;

f) the names of the ECAIs used for securitisations and the types of exposure for which each agency is used;

g) the total outstanding amount of exposures securitised by the investment intermediary and subject to the securitisation framework (broken down into traditional and synthetic), by exposure type;

h) for exposures securitised by the investment intermediary and subject to the securitisation framework, a breakdown by exposure type of the amount of impaired and past due exposures securitised, and the losses recognized by the investment intermediary during the period;

i) the aggregate amount of securitisation positions retained or purchased, broken down by exposure type;

j) the aggregate amount of securitisation positions retained or purchased, broken down into assigned risk weight; positions that have been risk weighted at 1 250% or deducted shall be disclosed separately;

k) the amount of securitised revolving exposures segregated by the originator's interest and the investors' interest;

l) a summary of the securitisation activity in the period, including the amount of exposures securitised (by exposure type), and recognized gain or loss on sale by exposure type.

(2) The information on the value adjustments and provisions under para 1 item 1 which are reflected directly on the income statement shall be disclosed separately.

Art. 148. (1) An investment intermediary calculating the risk-weighted exposure amounts in accordance with Chapter Twelve, Section II shall disclose the following information:

1. scope of the issued by the deputy chairman approval of approach or approved transition;
2. an explanation and review of:

a) the structure of internal rating systems and relation between internal and external ratings;

b) the use of internal estimates other than for calculating risk-weighted exposure amounts in accordance with Chapter Twelve, Section II;

c) the process for managing and recognizing credit risk mitigation;

d) the control mechanisms for rating systems, including a description of their independence and accountability, and rating systems review;

3. a description of the internal ratings process, provided separately for each exposure class, as follows:

a) national governments and central banks;

b) institutions;

c) corporate, including SMEs, financing of investment projects and purchased corporate receivables;

d) retail, for each of the categories of exposures to which the different correlations indicated in item 1.2.1 – 1.2.4 in Section I of Annex N 5 correspond;

e) equities;

4. the exposure values for each of the exposure classes specified in Article 113; exposures to central governments and central banks, institutions and corporates where investment intermediaries use own estimates of LGDs or conversion factors for the calculation of risk-weighted exposure amounts shall be disclosed separately from exposures for which the investment intermediaries do not use such estimates;

5. with the purpose of diversification of the credit risk for each of the exposure classes (central governments and central banks, institutions, corporate and equity) and across a sufficient number of obligor grades (including default), the investment intermediary shall disclose the following information:

a) the total exposures (for the exposure classes to central governments and central banks, institutions and corporate, the sum of outstanding loans and exposure values for undrawn commitments; for equities - the outstanding amount);

b) in the cases where the investment intermediary uses own LGD estimates - the exposure-weighted average LGD in percentage;

c) the exposure-weighted average risk weight;

d) in the cases where the investment intermediary uses own estimates of conversion factors - the amount of undrawn off-balance sheet commitments and exposure-weighted average exposure values for each exposure class;

6. for the retail exposure class and for each of the categories as defined under para 1 item 3 letter “d”, either the disclosures under para 1 item 5 (if applicable, on a pooled basis), or an analysis of exposures (outstanding loans and exposure values for undrawn commitments) against a sufficient number of EL grades to allow for a meaningful differentiation of credit risk;

7. the actual value adjustments in the preceding period for each exposure class (for retail, for each of the categories as defined under para 1 item 3 letter “d” and how they differ from past periods;

8. a description of the factors that impacted on the incurred losses in the preceding period (for example, if an investment intermediary registered higher than average default rates, or higher than average LGDs and conversion factors);

9. the investment intermediary's estimates against actual outcomes over a historical longer period; at a minimum, this shall include information on estimates of losses for a past period against actual losses in each exposure class (for retail, for each of the categories as defined under para 1 item 3 letter "d") over a period sufficient to allow for a meaningful assessment of the performance of the internal rating processes for each exposure class; where appropriate, the investment intermediaries shall further decompose this to provide analysis of PD and, and in the cases when it uses own estimates of LGDs and/or conversion factors, LGD and conversion factor outcomes against estimates provided in the quantitative risk assessment disclosures above.

(2) The information under Art. 148 para 1 item 3 shall include data about the types of exposures included in the exposure class, the definitions, methods and data for estimation and validation of PD and, if applicable, LGD and conversion factors, including assumptions employed in the calculation of these variables, and the descriptions of material deviations from the definition of default as set out in Annex N 5, including the broad segments affected by such deviations.

(3) An investment intermediary using different credit risk mitigation techniques shall disclose the following information:

1. the policies and processes for, and an indication of the extent to which the entity makes use of, on- and off-balance sheet netting;

2. the policies and processes for collateral valuation and management;

3. a description of the main types of collateral taken by the investment intermediary;

4. the main types of guarantor and credit derivative counterparty and their creditworthiness;

5. information about market or credit risk concentrations within the credit mitigation taken;

6. for an investment intermediary calculating risk-weighted exposure amounts in accordance with Chapter Twelve, Section I and II, but not providing own estimates of LGDs or conversion factors in respect of the exposure class, separately for each exposure class, the total exposure value (where applicable, on- or off-balance sheet netting) that is covered, after the application of volatility adjustments, by eligible financial collateral, and other eligible collateral; and

7. for an investment intermediary calculating risk-weighted exposure amounts in accordance with Chapter Twelve, Section I and II, separately for each exposure class, the total exposure (after, where applicable, on- or off-balance sheet netting) that is covered by guarantees or credit derivatives; for the equity exposure class, this requirement applies to each of the approaches provided in item 1.3 in Section I of Annex N 5.

(4) An investment intermediary using the approach set out in Chapter Thirteen, Section I for the calculation of their own funds requirements for operational risk, shall disclose a description of the use of collateral for the purpose of mitigating the risk.

Art. 149. The investment intermediary shall disclose information about the recognized by the deputy chairman instruments under Chapter Twelve, Sections II and III.

Art. 150. The investment intermediary shall adopt written rules for compliance with the requirements to disclosure of information under this Chapter, as well as rules for assessment of the adequacy of the disclosed information, including for their approval and frequency.

Art. 151. The investment intermediary shall, on request by small, medium-sized or other undertaking, candidate for credit, explain in writing the rating awarded to them.
The costs related to the request shall correspond to the credit applied for.

Art. 152. (1) An investment intermediary may omit one or more of the disclosures listed in Art. 147, if that information is immaterial.

(2) Information shall be regarded as material if its omission or misstatement could change or influence the assessment or decision of a user relying on that information for the purpose of making economic decisions.

(3) Investment intermediaries may not disclose publicly a part of the information required under Art. 147 and Art. 148 in case that such information is a professional secret or confidential.

(4) The information shall be regarded as professional secret if its public disclosure may harm the investment intermediary's competitive position. That information may relate to products or systems which, if shared with competitors, would render an investment intermediary's investments therein less valuable.

(5) The information shall be regarded as confidential where the investment intermediary has undertaken a commitment to a customer or other counterparty to keep its confidentiality.

(6) The investment intermediary shall state the fact that specific items of information are not disclosed according para 3, the reason for non-disclosure, publishing simultaneously more general information about that required to be disclosed, in case that the information is not a trade secret or confidential.

(7) The disclosure on consolidated basis under Art. 147 para 1 item 3 and 4 shall be provided pursuant to Art. 134 para 1 - 3.

Art. 153. (1) An investment intermediary shall publish the disclosures required under Article 147 and 148 on an annual basis at a minimum.

(2) The investment intermediary shall establish the need for more frequent disclosure of a part or the whole information of the envisaged under para 1, in accordance with the volume and scope of its activity, the carrying out of activity in other states, participation in other financial sectors, presence on the international financial markets and participation in systems of payment, settlement and clearing, and in particular the need for disclosure of information under Art. 147 para 1 item 3 letters “b” and “e”, item 4 letters “b” - “e” and the other information which is subject to prompt change.

(3) Investment intermediaries shall disseminate the information under para 1 through their web sites, and on request they shall also present it on paper bearer to their customers and interested persons.

(4) It will be considered that the investment intermediary has met its obligation for disclosure of information under this Section, where it has disclosed equivalent information for accounting, legal and other purposes.

(5) If the disclosed information is not included in the investment intermediary’s financial statements, it must state where that information could be found.

Chapter Fifteen
SUPERVISION AND COOPERATION

Section I
Supervision

Art. 154. (1) For the issue of the permissions and approvals under this Ordinance, an application shall be filed with the Commission, to which evidence shall be enclosed for compliance with the relevant requirements.

(2) On the grounds of the submitted documents the Commission, or the deputy chairman, shall establish the extent to which the requirements to the issue of the requested permission or approval have been met. If the provided data or documents have deficiencies or irregularities, or additional information or proof are required for the data correctness, the Commission, or the deputy chairman, shall forward to the applicant a notification for the established deficiencies or irregularities, or for the demanded additional information and documents and shall set the term for their removal.

(3) If the notification under para 2 is not accepted at the indicated by the applicant address for correspondence, the term for their submission shall start running from the placing of the notification at especially designated for the purpose location in the Commission’s building. The latter circumstance shall be verified by a report drawn up by officials determined by an order of the Commission’s Chairman.

(4) The Commission, or the deputy chairman, shall pronounce on the application within 14 days of its receiving, and where additional data and documents have been required – from their receipt. The deputy chairman shall inform in writing the applicant of the taken decision within 3 days after its pronouncing.

(5) In the cases under Art. 95 the term of the deputy chairman's pronouncement shall be 30 days after the receiving of the application.

Art. 155. (1) The deputy chairman shall review the arrangements, strategies, processes and mechanisms implemented by the investment intermediary in its activity for compliance with the requirements of this Ordinance and shall evaluate the risks to which it is or might be exposed according the following criteria:

1. the results of the stress test carried out by the investment intermediary applying an IRB approach;

2. the exposure to and management of concentration risk by the investment intermediary, including its compliance with the requirements laid down in Chapter Nine;

3. the robustness, suitability and manner of application of the policies and procedures by the investment intermediary for the management of the residual risk associated with the use of recognized credit risk mitigation techniques;

4. the extent to which the own funds held by an investment intermediary in respect of assets which it has securitised are adequate having regard to the economic substance of the transaction, including the degree of risk transfer achieved;

5. the exposure to and management of liquidity risk by the investment intermediary;

6. the impact of diversification effect and how such effect is factored into the risk measurement system;

7. the results of stress tests carried out by the investment intermediary using an internal model to calculate market risk capital requirements under Art. 95.

(2) The deputy chairman shall also monitor whether an investment intermediary has provided implicit support to a securitisation program. If an investment intermediary is found to have provided implicit support to the securitization program, the deputy chairman shall take appropriate measures against its future support, which is to prevent transfer of risk by the investment intermediary.

(3) On the basis of the review and evaluation referred to in paragraph 1, the deputy chairman shall determine whether the arrangements, strategies, processes and mechanisms implemented by the investment intermediaries and the own funds held by them ensure a sound management and coverage of the risks. For the purpose, the deputy chairman shall estimate whether the corrections and processes used for valuation of the trading book positions allow the investment intermediary to sell or hedge these positions within a short-term period, without this resulting in material losses in normal market conditions.

(4) The periodicity and intensity of the review and evaluation referred to in paragraph 1 shall be determined by the size of the relevant investment intermediary, its significance for the financial system, the nature, scope and complexity of its activity. The review shall be made at least once annually.

(5) The review and evaluation under para 1 shall include the exposure of the investment intermediary's non-trading book to interest rate risk. The deputy chairman may impose appropriate measures on an investment intermediary whose economic value declines by more than 20% of its own funds as a result of a sudden and unexpected changes in the interest rates set by the Bulgarian National Bank and applied to all investment intermediaries.

Art. 156. (1) When establishing that an investment intermediary offends the provisions of this Ordinance, the deputy chairman may:

1. obligate the investment intermediary to increase its own funds;
2. require change in the arrangements, processes, mechanisms and strategies under Art. 142 para 1 and 3;
3. obligate the investment intermediary to apply a specific provisioning policy or treatment of assets in terms of own funds requirements;
4. restrict or prohibit the investment intermediary to execute specific transactions, activities or operations;
5. obligate the investment intermediary to mitigate the risks inherent in specific transactions, activities or operations.

(2) (Am. – SG, iss. 68 in 2008) The measure under para 1 item 1 shall be imposed on an investment intermediary which does not meet the requirements laid down in Art. 19 and Art. 142 para 1 and 3, or in the cases when the deputy chairman has established that the arrangements, processes, mechanisms and strategies do not ensure stable management and cover of the risks according Art. 155 par 3 and the imposition of other measures under para 1 is unlikely to result in their improvement within an appropriate timeframe.

Art. 157. (1) (Am. – SG, iss. 28 in 2009) In the case under Art. 145 item 2 the investment intermediary shall within 5 days from occurrence of the inconsistency submit for approval by the Commission a restructuring program with a period for bringing its capital adequacy and liquidity in compliance with the provisions of the Ordinance not longer than 3 months.

(2) The restructuring program shall contain:

1. description of the violation;
2. the reasons that led to violation of the investment intermediary's capital adequacy and liquidity;
3. concrete measures to bring its financial situation in compliance with the requirements of the law and this Ordinance, which have to be adequate to the perpetrated violation, as well as the deadline for their implementation;
4. documents evidencing that the proposed restructuring program, respectively the envisaged measures, have been approved by the members of the competent body according the company's constituent acts;
5. report on capital adequacy and liquidity, balance sheet and income statement of the investment intermediary as of the date of the offence;
6. forecast report on the capital adequacy and liquidity, balance sheet and income statement of the investment intermediary as of the date on completion of the program.

(3) The Commission shall pronounce on the application for approval of the restructuring program within a 14-day period from filing all required documents, and within a 3-day period from taking the decision it shall send a written notification to the investment intermediary.

(4) (New – SG, iss. 68 in 2008) When within the term under para 1 the investment intermediary has brought its capital adequacy and liquidity in compliance with the ordinance requirements, it shall notify the Commission of it latest on the next business day. In such case it shall provide the information under para 2, item 1, 2 and 5 as well as a report on capital adequacy and liquidity, a balance sheet and income statement as from the date of bringing its capital adequacy and liquidity in compliance with the requirements of the Ordinance.

(5) (Prev. para 4 – SG, iss. 68 in 2008) During the period of the restructuring program's execution the investment intermediary may not distribute dividends and other incomes and shall carry over the full amount of profit, after it is levied with the due taxes, to the Reserve Fund.

Art. 158. (Am. – SG, iss. 28 in 2009) Under Art. 118 para 1 of the Markets in Financial Instruments Act (MFIA), including also in the event of any suspicion that the moneys accounted for at cash-desk by the investment intermediary, or its other assets do not satisfy the requirements, the deputy chairman shall determine the assets structure, which the investment intermediary must maintain within a given period.

Art. 159. (1) Authorized by the deputy chairman officials may conduct inspections for compliance with the provisions of this Ordinance, including on-site, by comparing the data from the reports on the capital adequacy and liquidity with the data of the financial and operational accounting of the investment intermediary, with the available cash, other assets and collaterals, as well as the equipment and software.

(2) The results of the inspection shall be reflected in Report of Findings, containing at least:

1. name of report and the body conducting the inspection;
2. date and time of the report's issue;
3. full name of the preparer and his/her position;
4. data about the investment intermediary – business name, seat and registered office, registration number in the Commission, etc.;
5. factual and legal grounds for the report's issue;
6. the findings established;
7. description of the received documents.

(3) (Am. – SG, iss. 28 in 2009) The report shall be delivered to the person representing the investment intermediary against signature.

Art. 160. (1) The Commission shall disclose the following information:

1. the provisions of laws, regulations, administrative rules and general guidance in the field of regulation and supervision of the investment intermediaries' activities;
2. the manner of exercise by the Commission of the options and discretions available in Community legislation;
3. the general criteria and methodologies used by the Commission in the supervisory review and evaluation referred to in Article 155 para 1;
4. aggregate statistical data on key aspects of the exercised by the Commission supervision over the investment intermediaries' activities, while complying with the provisions concerning professional secret under Art. 24 and 25 of the Financial Supervision Commission Act.

(2) The disclosures provided for in para 1 shall enable a meaningful comparison of the approaches adopted by the Commission with those adopted by the competent authorities of the other Member States.

(3) The Commission shall publish the disclosures in a uniform format, which shall be available on the Commission's web site and shall be updated regularly.

Section II
Supervision on a Consolidated Basis

Art. 161. (1) The Commission shall exercise supervision on a consolidated basis over the investment intermediaries, groups, financial holding companies and the mixed-activities holding companies under the provisions of this Ordinance.

(2) The persons, appointed for members of the financial holding company's management body shall be of good repute and have professional qualification and experience, required to direct the holding company's operation.

Art. 162. (1) The Commission shall exercise supervision on a consolidated basis in the cases where:

1. the parent undertaking is a parent investment intermediary with a registered office in the Republic of Bulgaria or an authorized in the Republic of Bulgaria EU parent investment intermediary;

2. the parent undertaking of an investment intermediary authorized in the Republic of Bulgaria is a parent financial holding company from a Member State, or an EU parent financial holding company set up in a Member State;

(2) Where a parent financial holding company set up in the Republic of Bulgaria, or an EU parent financial holding company set up in the Republic of Bulgaria is the same parent undertaking of investment intermediaries, authorized in two or more Member States, one of which is authorized in the Republic of Bulgaria, the supervision on a consolidated basis shall be exercised by the Commission.

(3) Where parent undertakings are financial holding companies set up in different Member States and have as subsidiaries investment intermediaries authorized in each of these States, the Commission shall exercise supervision on a consolidated basis if the investment intermediary with the largest balance sheet total has been authorized in the Republic of Bulgaria.

(4) Where more than one investment intermediary authorized in different Member States has as its parent the same financial holding company and none of these investment intermediaries have been authorized in the Member State in which the financial holding company was set up, supervision on a consolidated basis shall be exercised by the Commission, if the investment intermediary with the largest balance sheet total has been authorized in the Republic of Bulgaria. Such investment intermediary shall be considered as controlled by an EU parent financial holding company.

(5) By common agreement with the competent authorities of the relevant Member States, the Commission may waive the criteria referred to in para 2-4 if their application would be inappropriate with a view to the investment intermediaries participating in the financial holding company and the relative importance of their activities in the different countries. The competent authority which shall exercise supervision on a consolidated basis will be specified in the agreement. Before the conclusion of the agreement the Commission shall give the investment intermediary with the largest balance sheet total, the parent investment intermediary in a Member State, or an EU investment intermediary, as appropriate, an opportunity to state its opinion within a set by the Commission period.

(6) On request of a competent authority from a Member State, the Commission may participate in consultations and sign agreements on the determination of an authority which will exercise supervision on a consolidated basis according para 5. In such case the Commission may undertake the exercising of supervision on a consolidated basis, without the conditions under para 2-4 to be available.

(7) The Commission shall notify the European Commission of the agreements concluded under para 6 according which it will exercise supervision on a consolidated basis.

Art. 163. (1) All investment intermediaries and financial institutions which are subsidiaries of a parent undertaking, in the preparation of the consolidated financial statements for the purposes of the supervision on a consolidated basis shall apply full consolidation.

(2) Where the liability of a parent undertaking, holding a share of the capital in a subsidiary, is limited to the owned by it capital, with a view to the liabilities of the other shareholders and unit holders and their solvency, the Commission may also apply an approach of proportional consolidation. The liability of the other shareholders and unit holders must be clearly defined and verified to the Commission on the basis of written agreements.

(3) The Commission shall decide which of the approaches under para 1 and 2 to apply in respect to a parent undertaking and other undertakings which are not linked by a control relationship, but on the grounds of a contract between them or according their Articles of Association have common management bodies, or the members of their management and supervisory bodies are one and the same during the relevant fiscal year and until the drawing up of the consolidated financial statement.

(4) Proportional consolidation shall be applied to the participations of a parent undertaking in investment intermediaries and financial institutions managed by an undertaking included in the consolidation together with one or more undertakings not included in the consolidation, where those undertakings' liability is limited to the share of the capital they hold.

(5) In cases other than those under para 1-4, the persons subject to consolidation apply the equity method. The application of the method by the undertakings concerned shall not be deemed included in the supervision on a consolidated basis exercised by the Commission.

Art. 164. (1) In cases other than those under Art. 163, the Commission shall take a decision on the method of consolidation in the cases where:

1. in its opinion an investment intermediary exercises a significant influence over another investment intermediary or financial institution, but without holding participation or being in relationships of control with these institutions;

2. two or more investment intermediaries or financial institutions are placed under single management other than pursuant to a contract or clauses of their memoranda or Articles of Association.

(2) Where the Commission exercises supervision on a consolidated basis according Art. 162 over an ancillary services undertaking and asset management company, the method of consolidation shall apply in the manner and according the provisions of para 1 and Art.163.

Art. 165. (1) In exercising supervision on a consolidated basis over an EU parent investment intermediary and an investment intermediary controlled by an EU parent financial holding company, the Commission shall carry out the following tasks:

1. coordination of the gathering and dissemination of relevant or essential information in going concern and emergency situations;

2. planning and coordination of supervisory activities in going concern as well as in emergency situations, including in relation to the supervision under Art. 155, in cooperation with the relevant competent authorities.

(2) In the case under para 1, an EU parent investment intermediary and the subsidiaries of an EU parent financial holding company shall file an application for approval, or authorization according to Art. 111, Art. 114 para 9, Art. 130 para 1 and Section VI of Annex No. 3 with the Commission.

(3) The Commission shall cooperate and consult with the competent authorities of the other Member States in relation to the issue of the authorization and determination of its conditions and terms with the purpose of reaching common decision. The Commission shall forthwith send to the relevant competent authorities a copy of the application and all annexes thereto and within a 6-month period of its receiving shall perform the required activities for reaching a common decision with the competent authorities of the other Member States. The decision of the Commission and the competent authorities of the Member States shall be reasoned and sent to the applicant within a 7-day period after its issue.

(4) In case that the Commission and the competent authorities of the other Member States fail to reach a common decision, the Commission shall pronounce at its own discretion within one month after the expiration of the term under para 3, taking into account the opinions of the other competent authorities. The decision of the Commission shall be reasoned and sent to the applicant within a 7-day period after its issue.

(5) The Commission shall participate in consultations on request of a competent authority from another Member State in relation to filed with it application under para 2. The Commission may take a joint decision with the competent authority of the relevant Member State within a 6-month period after the receiving of the application and all attached thereto documents. The decision of the relevant competent authority shall be binding on the Commission regardless of whether it participated in the decision-making.

(6) The provisions under para 2-5 shall also apply to the applications of an EU parent investment intermediary and its subsidiaries or by the subsidiaries of an EU parent financial holding company for the issue of approval to use the internal risk-management methods according Art. 95 para 1.

Art. 166. (1) Where an emergency situation arises within a group which potentially jeopardizes the stability of the financial system in the Republic of Bulgaria or in any other Member States where entities of the group have been authorized, the Commission, when exercising supervision on a consolidated basis shall alert the competent authorities of the relevant Member States, their central banks or other authorities pursuing the money policy of those states.

(2) If for the purposes of supervision on a consolidated basis, exercised by the Commission, information is needed which has already been given to another competent authority, in order to prevent duplication of reporting to the various authorities, the Commission may request it from the relevant competent authority.

Art. 167. (1) For the purposes of the supervision on a consolidated basis, the Commission shall conclude written coordination and cooperation arrangements with the competent authorities from the other Member States. Under the arrangements of sentence one, the

Commission may undertake the performance of ancillary tasks, and procedures may be envisaged for decision-making and for coordination with other competent authorities.

(2) Where an investment intermediary that has been authorized in the Republic of Bulgaria is a subsidiary of an investment intermediary authorized in another Member State, by virtue of agreement with the competent authority of the investment intermediary – parent undertaking, the Commission may delegate to it the responsibility to supervise the investment intermediary – subsidiary.

(3) Subject to agreement with a competent authority from a Member State, the Commission may assume the responsibility for the exercising of supervision over an investment intermediary from a Member State, which is a subsidiary of an investment intermediary authorized in the Republic of Bulgaria.

(4) The Commission shall notify the European Commission of the conclusion and content of the agreements under para 2 and 3.

Art. 168. (1) The Commission, on request or on its own initiative, shall provide to the relevant competent authorities of the Member States any information which is essential for the exercise of their supervisory tasks.

(2) Information referred to in the first subparagraph shall be regarded as essential if it could materially influence the assessment of the financial soundness of an investment intermediary or financial institution in another Member State. The essential information shall include the following items:

1. identification of the group structure of all major investment intermediaries in a group, as well as of the competent authorities exercising supervision over the investment intermediaries in the group;

2. procedures for the collection of information from the investment intermediaries in a group;

3. adverse developments in investment intermediaries or in other entities of a group, which could seriously affect the investment intermediaries' operation;

4. sanctions and measures taken by the Commission, respectively the deputy chairman in accordance with this Ordinance, including the imposition of an additional capital charge or limitation on the use of Advanced Measurement Approach in the calculation of the capital requirements for operational risk under Art. 130.

(3) Whenever the Commission exercises supervision on a consolidated basis over an EU parent investment intermediary and an investment intermediary controlled by an EU parent financial holding company, the Commission shall provide the necessary information to the other competent authorities from Member States which supervise its subsidiaries, taking account of the significance of the subsidiaries within the financial system in the relevant Member State.

(4) Whenever the Commission exercises supervision over an investment intermediary controlled by an EU parent investment intermediary, authorized in another Member State, the Commission may request from the authority responsible for consolidated supervision in the relevant Member State the information it needs about the application of the approaches and methodologies for management and assessment of the risks by the investment intermediary, which may already be available to that authority.

(5) On request of a competent authority from a Member State supervising an investment intermediary controlled by an EU parent investment intermediary, authorized in the Republic of Bulgaria, over which the Commission exercises supervision on a consolidated basis, the Commission shall provide the required information under para 4 which it has available.

(6) Prior to taking a decision, which is of importance for the supervisory tasks of another competent authority from a Member State, the Commission shall consult with the competent supervisory authority, where the decision relates to:

1. changes in the shareholder, organizational or management structure of an investment intermediary in a group, which require the approval or authorization of the Commission;

2. sanctions and measures taken by the Commission, or the deputy chairman, under this Ordinance, including the imposition of an additional capital charge under or limitation on the use of Advanced Measurement Approach in the calculation of the own funds.

(7) In the case under para 6 item 2 the Commission shall hold consultations also with the competent authority, exercising supervision on a consolidated basis.

(8) The Commission may decide not to hold the consultations under para 6 in cases of urgency or where such consultations may jeopardize the effectiveness of the decisions. In this case, the Commission shall, without delay, inform the competent authorities.

(9) On request of a competent authority from a Member State, the Commission will give its opinion on the decisions of the competent authorities from a Member State under para 6.

(10) Where the Commission exercises supervision on a consolidated basis, it may request from the subsidiaries in Member States of an investment intermediary authorized in the Republic of Bulgaria, or a financial holding company set up in the Republic of Bulgaria, over which the Commission does not exercise supervision on a consolidated basis according Art. 135 para 1 item 2 and 3, information which is needed for the exercising of the supervision under Art. 169.

(11) Where a competent authority of a Member State has excluded from the supervision on a consolidated basis an investment intermediary authorized in the Republic of Bulgaria, which is a subsidiary of an investment intermediary or financial holding company from a Member State, the Commission may request from the parent undertaking information which may facilitate the exercising of the supervision over the investment intermediary - subsidiary.

(12) A subsidiary of an investment intermediary authorized in a Member State, or of a financial holding company, set up in a Member States, which has been excluded from the supervision on a consolidated basis, shall provide to the competent authority of the Member State exercising supervision on a consolidated basis, the information it needs to perform its supervisory tasks.

(13) An investment intermediary or financial holding company which is a parent undertaking of an investment intermediary authorized in a Member State and which has been excluded from the supervision on a consolidated basis according Art. 135 para 1 item 2 and 3 shall provide the relevant competent authority of the Member State with the necessary information for the exercising of the supervision over the investment intermediary - subsidiary.

Art. 169. (1) Where the parent undertaking of one or more investment intermediaries authorized in the Republic of Bulgaria, is a mixed-activity holding company, the Commission by approaching the mixed-activity holding company and its subsidiaries either directly or via investment intermediaries subsidiaries, shall require them to supply any information which would be relevant for the purpose of the consolidated supervision over the investment intermediaries subsidiaries.

(2) The Commission may carry out, independently or by appointed for the purpose persons, on-the-spot inspections to verify information received under para 1.

(3) If a mixed-activity holding company or one of its subsidiaries is not situated in the Republic of Bulgaria, the verification under para 2 shall be carried out in accordance with Art. 173.

(4) The Commission's powers for collection of information under para 1 or the possession thereof does not in any way result in any duty for exercising supervision on independent base over the mixed-activity holding company and those of its subsidiaries which are not investment intermediaries, or over its subsidiaries which have not been included in the scope of the supervision on a consolidated base.

Art. 170. (1) Where the Commission exercises supervision on a consolidated basis over one or more investment intermediaries, authorized in the Republic of Bulgaria, whose parent undertaking is a mixed-activity holding company, the Commission shall exercise general supervision over transactions between the investment intermediaries on one side and the mixed-activity holding company and its subsidiaries on the other.

(2) The investment intermediaries under para 1 must have in place adequate risk management processes and internal control mechanisms, including reporting and accounting procedures, in order to identify, measure, monitor and control transactions with their parent mixed-activity holding company and its subsidiaries. The procedures under this paragraph shall be subject to periodical overview by the deputy chairman.

(3) Beside the notification of large exposures under Art. 77 to the mixed-activity holding company and its undertakings, the investment intermediaries under para 1 shall inform the Commission about any significant transaction with them latest by the next working day after its conclusion. The notifications under this paragraph shall be subject to periodical overview by the deputy chairman.

(4) (Am. – SG, iss. 68 in 2008) In case that the intra-group transactions are a threat to the financial position of the investment intermediaries under para 1, the deputy chairman shall take appropriate measures.

Art. 171. (1) Where the Commission exercises supervision on a consolidated basis over a parent undertaking which is not set up in the Republic of Bulgaria, the Commission may request the competent authority in the Member State where it is set up, to collect from such undertaking information which would be necessary for the exercising of the supervision on a consolidated basis and to provide the information to it.

(2) Where the parent undertaking is set up in the Republic of Bulgaria, but the Commission does not exercise supervision on a consolidated basis, on request of the competent authority responsible for the exercising of consolidated supervision, the Commission shall ask the parent undertaking for any information which would be relevant for the purposes of supervision on a consolidated basis and shall transmit it to that authority.

(3) (Am. – SG, iss. 68 in 2008) The Commission's powers to collect information under para 1, or the possession of that information shall not in any way result in a duty to exercise supervision on individual basis over the parent undertaking when it is a financial holding company, financial institution or ancillary services undertaking.

Art. 172. (1) Where supervision is exercised on a consolidated basis over investment intermediaries, financial holding companies or mixed-activity holding companies, having as subsidiaries one or more credit institutions, the Commission shall cooperate and exchange information with the Bulgarian National Bank.

(2) The Commission shall maintain a list of the financial holding companies over which it exercises supervision on a consolidated basis and which are parent undertakings controlling investment intermediaries, and shall provide this list to the competent authorities of the other Member States and to the European Commission, notifying them of any changes made in it.

Art. 173. (1) On request by a competent authority from a Member State, the Commission shall verify specific information concerning an investment intermediary, a financial holding company, a financial institution, an ancillary services undertaking, a mixed-activity holding company, or its subsidiary, authorized or set up in the Republic of Bulgaria. The verification may be carried out by the Commission itself, by the competent authority that made the request to carry it out, with its participation or by an external auditor or expert.

(2) The Commission may ask a competent authority of a Member State to verify certain information about an investment intermediary, a financial holding company, a financial institution, an ancillary services undertaking, a mixed-activity holding company, or its subsidiary, authorized or set up in the relevant Member State. The Commission may, if it so wishes, carry out the verification itself or to participate in its conducting.

Art. 174. (1) Where an investment intermediary, authorized in the Republic of Bulgaria, is a subsidiary of an investment intermediary or a financial holding company, the head office of which is in a third country, and is not subject to supervision on a consolidated basis by the Commission or by another competent authority from a Member State, the Commission shall verify whether the investment intermediary-subsidiary is subject to supervision on a consolidated basis which is equivalent to that governed by the principles laid down in this Ordinance.

(2) The Commission shall carry out the verification under para 1 on its initiative, at the request of the parent undertaking or of a subsidiary from the Republic of Bulgaria or another Member State, whose activity is subject to authorization and shall consult the competent authorities exercising supervision over these entities.

(3) When carrying out the verification specified in the first paragraph and prior to taking a decision, the Commission shall take into account the opinion of the European Commission as to whether the arrangements for supervision on a consolidated basis of the relevant third country are likely to achieve the objectives of supervision on a consolidated basis according the *acquis communitare.*

(4) If it establishes that no consolidated supervision is exercised or the supervision exercised does not meet the provisions of this Ordinance, the Commission may apply in respect to the investment intermediary – subsidiary appropriate supervisory techniques to achieve the objectives of supervision on a consolidated basis of the investment intermediary.

(5) The Commission shall apply the supervisory techniques under para 4 after consultations with the other competent authorities from Member States supervising the entities under para 1, as well as with the competent third-country supervisory authority.

(6) The Commission shall participate in consultations on request by a competent authority of a Member State in the cases when that authority intends to apply supervisory techniques for the achievement of the objectives of supervision on a consolidated basis according para 4.

(7) In relation to the supervisory techniques under para 4, the Commission may require the establishment of a financial holding company whose head office is to be on the territory of the Republic of Bulgaria or another Member State, and in respect to which to apply the provisions on consolidated supervision provided for in this Ordinance.

(8) The Commission shall notify the European Commission and the other competent authorities involved, of the supervisory techniques undertaken under para 4.

Section III
Cooperation

Art. 175. (1) The Commission shall cooperate with the competent supervisory authorities of the Member States in the performance of its oversight duties provided for in this Ordinance, including where investment services and activities are provided through a branch or on the basis of the freedom to provide services.

(2) The Commission may request from the competent authority of a Member State information which it needs for exercising the supervision over the capital adequacy of the investment intermediaries, including for verification for compliance of their activity with the requirements of this Ordinance.

(3) On request by a relevant competent authority from a Member State, the Commission shall supply all the information, which will be used by the competent authority in the exercising of its supervisory powers regarding the capital adequacy of investment intermediaries, including for verification of their compliance with the legislation of the Member State.

Chapter Seventeen
COERCIVE ADMINISTRATIVE MEASURES. ADMINISTRATIVE PENAL PROVISIONS

Art. 176. (1) (Am. – SG, iss. 28 in 2009) The Commission, or the deputy chairman, may impose a coercive administrative measure under the procedure of Art. 118 of the Markets in Financial Instruments Act (MFIA) in case of any offence of the provisions of this Ordinance.

(2) (Am. – SG, iss. 28 in 2009) In case of non-compliance with the imposed coercive administrative measure under para 1, any person who commits or admits the commitment of an offence shall be penalized according Art. 127 of the MFIA.

Art. 177. (1) (Am. – SG, iss. 28 in 2009) The persons who commit offences of the Ordinance, as well as the persons who admit the commitment of such offences shall be penalized according Art. 127 of the MFIA, unless they are subject to more heavy punishment.

(2) The acts for established violations are drawn up by an authorized by the deputy chairman official, and the penal warrants are issued by the deputy chairman.

(3) The establishment of violations, the issue, appeal against and enforcement of the penal warrants are done under the Administrative Violations and Sanctions Act.

ADDITIONAL PROVISIONS

§ 1. For the purposes of this Ordinance:

1. “Group” exists where the parent undertaking is an investment intermediary and has as subsidiaries other investment intermediaries, credit institutions and/or financial institutions;
2. "Financial holding company" means a financial institution, the subsidiary undertakings of which are either exclusively or mainly investment intermediaries or other financial institutions, at least one of such subsidiaries being an investment intermediary, and which is not a mixed financial holding company within the meaning of **§** 1 item 14 of the Additional Provisions of the Supplementary Supervision over the Financial Conglomerates Act (SSFCA);
3. "Parent financial holding company in a Member State" means a financial holding company which is not itself a subsidiary of an investment intermediary or credit institution authorized in the same Member State, or of a financial holding company set up in the same Member State;
4. "EU parent financial holding company" means a parent financial holding company in a Member State which is not a subsidiary of an investment intermediary or credit institution authorized in any Member State or of another financial holding company set up in any Member State;
5. "Mixed-activity financial holding company" means a parent undertaking, other than an investment intermediary, financial holding company or mixed-activity financial holding within the meaning of § 1 item 14 of the Additional Provisions of the Supplementary Supervision over the Financial Conglomerates Act (SSFCA), the subsidiaries of which include at least one investment intermediary;
6. (Am. – SG, iss. 68 in 2008) “Clearing member" means a member of an exchange or a clearing house which has a direct contractual relationship with the central counterparty (market guarantor);
7. “Preferred stock with accumulated dividend” is a stock with fixed dividend where if the amount of the dividend for the given year has not been paid in full, its remainder shall be due in the next years until its full payment.
8. (Am. – SG, iss. 68 in 2008) “Movable and immovable assets” means assets classified as “fixed (non-current) tangible assets”, directly related to the services and activities under Art. 5 para 2 and 3 of the MFIA, including:
    a) buildings and office premises;
    b) motor vehicles;
    c) office equipment

9. (Am. – SG, iss. 68 in 2008) “Intangible objects”, respectively “fixed (non-current) intangible assets” directly related to the services and activities under Art. 5 para 2 and 3 of the MFIA means:

a) program products, related to the activities;

b) patents, licenses and know-how, provided that they are required for the normal pursuance the business of an investment intermediary;

c) state fee for incorporation of the company and state fee for the issue of a license to pursue the business of an investment intermediary.

10. (Am. – SG, iss. 68 in 2008) “Financial instruments" means any contract that gives rise to both a financial asset of one party and a financial liability or equity instrument of another party. They include primary financial or money instruments and derivative financial instruments, whose value is determined by the price of the underlying financial instrument and the percent, index or price of another underlying asset, including as a minimum the instruments indicated in Art. 3 of the MFIA;

11. "Repurchase agreement" and "reverse repurchase agreement" means any agreement in which an investment intermediary, or its counterparty, transfers securities, commodities or guaranteed rights relating to title to securities or commodities where that guarantee is issued by a recognised exchange which holds the rights to the securities or commodities, under which agreement the commitment is undertaken for their repurchase (or substitute with securities or commodities of the same description) at a specified price on a future date specified, or to be specified, by the transferor. The transferer may not transfer or pledge a particular security or commodity to more than one counterparty at one time. The agreement is a repurchase agreement for the party selling the securities or commodities and a reverse repurchase agreement for the party buying them;

12. “Dilution risk” means the risk that the amount receivable is reduced through cash or non-crash credits to the obligor;

13. “Overheads” means amount of the accrued costs of amortisation, rents, obligatory insurances, taxes and charges for real estate, remunerations of the members of the management and supervisory bodies and other expenses which do not depend on the volume of the performed activity;

14. “Subsidiary” means a legal entity controlled by another legal entity (a parent undertaking). Legal entities which are subsidiary to the subsidiary undertaking, are also considered subsidiaries of the ultimate parent undertaking;

15. “Parent undertaking” means a legal entity which exercises control over one or more undertakings (subsidiaries);

16. "Parent investment intermediary in a Member State" means an investment intermediary which has another investment intermediary, credit or a financial institution as a subsidiary or which holds a participation in such an institution, and which is not itself a subsidiary of another investment intermediary or credit institution authorized in the same Member State, or of a financial holding company set up in the same Member State;

17. "EU parent investment intermediary" means a parent investment intermediary in a Member State which is not a subsidiary of another investment intermediary or a credit institution, authorized in any Member State, or of a financial holding company set up in any Member State;

18. "Warrant" means a security which gives the holder the right to purchase an underlying asset at a stipulated price until or at the expiry date of the warrant and which may be settled by the delivery of the underlying itself or by cash settlement;
19. “Convertible” means a security which, at the option of the holder, may be exchanged for another security;
20. "Delta" means a coefficient reflecting the expected change in an option price as a proportion of a small change in the price of the instrument underlying the option;
21. "Over-the-counter (OTC) derivative instruments" means the contracts indicated in Annex No. 10, other than those to which exposure value amount of zero is assigned according item 8 in Section II of Annex No. 3.
22. “Institution” means the credit institutions and investment intermediaries.

23. (Am. – SG, iss 68 in 2008) “Recognized third-country investment intermediary” means a legal entity from a third country, which is authorized under its national legislation to perform services and activities indicated in Art. 5 para 2 and 3 of the MFIA and over it/its activity at least as stringent supervision is exercised as envisaged in the MFIA and this Ordinance;

24. “Ancillary services undertaking" means an undertaking whose main activity is owning and administration of property, provision of services for information processing or other such activity, which is ancillary to the major activity of one or more investment intermediaries;

25. “Public sector entities” means non-commercial administrative bodies responsible to central governments or regional governments, local authorities or to authorities that in the view of the Commission exercise the same responsibilities as regional and local authorities, non-commercial undertakings owned by central governments that have explicit guarantee arrangements, and may include self-administered bodies governed by law that are under public supervision;

26. (Am. – SG, iss. 28 in 2009) “Group of connected persons” means:

a) two or more natural or legal persons who, unless it is shown otherwise, constitute a single risk because one of them, directly or indirectly, has control over the other or others in the group; or

b) two or more natural or legal persons between whom there is no relationship of control as set out in point (a) but who are to be regarded as constituting a single risk because they are so interconnected that, if one of them were to experience financial problems, the other or all of the others would be likely to encounter repayment difficulties.

27. “Control” exists where one entity (the parent undertaking):

a) holds more than a half of the votes at the general meeting of another legal entity (subsidiary); or
b) is entitled to appoint more than a half of the members of the governing or the control body of another legal entity (subsidiary) and is at the same time a shareholder or a partner in such entity; or
c) is entitled to exercise a decisive influence on a legal entity (subsidiary) by virtue of a concluded with such entity contract or of its basic instrument or articles of association, if this is admissible according the legislation, applicable to the subsidiary, or;
d) is a shareholder or a partner in a company, and:

aa) more than a half of the members of the management or control body of such legal entity (subsidiary), who performed the relevant functions in the preceding and current fiscal year and until the time of preparation of the consolidated financial statements, have been appointed only as a result of the exercising of his/her voting right; or bb) who controls independently by virtue of a contract with other shareholders or partners in such legal entity (subsidiary) more than half of the votes in the general meeting of this legal entity; or

e) may otherwise exercise decisive influence over the decision-taking in relation to the operation of another legal entity (subsidiary).

In the cases under letters “a” and “b” and “d” to the votes of the controlling entity shall be added also the votes of its subsidiaries over which it exercises control, as well as the votes of persons, acting in their own name, but for its account or for the account of its subsidiary.

In the cases under letters “a” and “b” and “d” from the votes of the controlling entity shall be deducted the votes of the shares hold for the account of a person which is neither the controlling entity, not its subsidiary, as well as the votes of the shares that are subject of a pledge if the rights attaching to them are exercised by order and to the interest of the pledgor.

In the cases under letters “a” and “d” from the votes of the controlling entity shall be deducted the votes of the shares owned by the subsidiary itself by a person controlled by it, or by a person who acts on his behalf but for the account of the controlling entity and the subsidiary.

28. “Participation” means participation within the meaning of § 1 item 12 of the Additional Provisions of the Supplementary Supervision over Financial Conglomerates Act.

29. “Qualifying holding” means any direct or indirect holding of a person which represents 10% or more of the capital or of the voting rights in the undertaking’s general meeting, or where the holding of shares or units from the capital or the voting rights in the general meeting makes it possible to exercise significant influence over the management of the undertaking.

30. (Am. – SG, iss. 68 in 2008) "Stock financing" means positions where physical stock has been sold on the basis of a forward contract and the cost of funding has been locked in until the date of completion of the forward sale.

31. "Securities or commodities lending" and "securities or commodities borrowing" means any transaction in which an investment intermediary or its counterparty transfers securities or commodities against appropriate collateral, subject to a commitment that the borrower will return equivalent securities or commodities at some future date or when requested to do so by the transferor. The transaction represents securities or commodities lending for an investment intermediary transferring securities or commodities and securities or commodities borrowing for an investment intermediary to which they are transferred;

32. “Probability of default (PD)” means the probability of default of a counterparty over one year period;

33. “Loss” for the purposes of Chapter Twelve means economic loss, including material discount effects and material direct and indirect costs associated with collecting on the instrument;

34. (Am. – SG, iss. 68 in 2008) “Loss given default (LGD) means the ratio of the loss on an exposure due to default of counterparty to the counterperty’s amount outstanding at default;

35. “Conversion factor” means the ratio of the currently undrawn amount of a commitment that will be drawn and outstanding at default to the currently undrawn amount of the commitment. The extent of commitment shall be determined by the advised limit, unless the unadvised limit is higher.

36. “Expected loss (EL)” for the purposes of Chapter Twelve shall mean the ratio of the amount expected to be lost on an exposure from a potential default of a counterparty or dilution over a one year period to the amount outstanding at default;

37. “Credit risk mitigation” means a technique used by an investment intermediary to reduce the credit risk associated with an exposure or exposures which the intermediary continues to hold;

38. “Funded credit protection” means a technique of credit risk mitigation where the reduction of the credit risk on the exposure of an investment intermediary derives from the right of the investment intermediary – in the event of default of the counterparty or on the occurrence of other specific credit events relating to the counterparty – to liquidate, or to obtain transfer or appropriation of, or to retain certain assets or amounts, or to reduce the amount of the exposure to, or to replace it with, the amount of the difference between the amount of the exposure and the amount of a claim on the intermediary.

39. “Unfunded credit protection” means a technique of credit risk mitigation where the reduction of the credit risk on the exposure of an investment intermediary derives from the undertaking of a third party to pay an amount in the event of the default of the borrower or on the occurrence of other specified credit events;

40. “Solicited credit rating” is a rating awarded by a credit rating agency to an entity which has made before that a request for rating .

41. "Recognized exchanges" means exchanges which meet the following conditions:

(a) they function regularly;

(b) they have rules, issued or approved by the appropriate authorities of the home country of the exchange, defining the conditions for the operation and of access to it, as well as the conditions that shall be satisfied by a contract before it can effectively be dealt on the exchange;

(c) they have a clearing mechanism whereby contracts listed in Annex N 10 are subject to daily margin requirements which, in the opinion of the competent authorities, provide appropriate protection.

42. “Securitisation” means a transaction or scheme, whereby the credit risk associated with an exposure or pool of exposures is tranched, having the following characteristics:

(a) payments in the transaction or scheme are dependent upon the performance of the exposure or pool of exposures; and

(b) The subordination of tranches determines the distribution of losses during the ongoing life of the transaction or scheme;

43. “Traditional securitisation” means a securitisation evolving the economic transfer being securitised to a securitisation special purpose entity which issues securities while complying with the following requirements:

a) it shall be accomplished by the transfer of the ownership of the securitised exposures from the originator institution or through sub-participation;

b) the securities issued do not represent payment obligations of the originator;

44. “Synthetic securitisation” means a securitisation where the tranching is achieved by the use of credit derivatives or guarantees, and the pool of exposures is not removed from the balance sheet of the originator institution;

45. “Tranche” means a contractually established segment of the credit risk associated with the securitised exposures, where a position in the same segment entails a risk of credit loss different from that a position of the same amount in each other such segment, without taking account of credit protection provided by third parties to the holders of positions in the segment or in other segments;

46. “Securitized position” means an exposure to a securitisation;

47. “Originator” means an entity which, either itself or through related entities, directly or indirectly, was involved in the original agreement which created the obligations or potential obligations of the debtor or potential debtor giving rise to the exposure being securitised. Originator is also an entity which purchases a third party’s exposures onto its balance sheet and then securitises them;

48. “Sponsor” means an institution other than an originator institution that establishes and manages an asset-backed commercial paper programme or other securitisation scheme that purchases exposures from third party entities;

49. “Credit enhancement” means a contractual arrangement whereby the credit quality of a position in a securitisation is improved in relation to what it would have been if the enhancement had not been provided, including the enhancement provided by more junior tranches in the securitisation and other types of credit protection;

50. “Securitisation special purpose entity (SSPE) means a corporation trust or other entity, other than credit institution, organised for carrying on a securitisation or securitisations and for which the following is met:

a) the activities of the entity are limited only to carrying out of securitisation;

b) the structure of the entity is intended to isolate the obligations of the SSPE from those of the originator institution;

c) the holders of the beneficial interests have the right to pledge or exchange those interests without restrictions;

51. (New – SG, iss. 68 in 2008) “Material losses for the current period” means losses at amount representing more than 50 percent of the fixed overheads;

52. (New – SG, iss. 68 in 2008) “Market price” means easily accessible price of the position’s closure, obtained from an independent source, such as an exchange price, a price from a market information system and a quote by an independent broker of good repute. In the cases when the valuated instrument is admitted to or traded on more than one trading venue, this shall be the price announced by the trading venue at which the largest volume has been traded for the relevant day.

53. (New – SG, iss. 68 in 2008) “Market value” means the value of a position calculated on the basis of market prices.

§ 2. (Cancelled – SG, iss. 68 in 2008)

TRANSITIONAL AND FINAL PROVISIONS

§ 3. This Ordinance supersedes Ordinance No. 6 of 22 October, 2003 on the capital adequacy and liquidity of investment intermediaries, issued by the Chairman of the Financial

Supervision Commission (prom. SG iss. 101 in 2003; am. and suppl. iss. 9 in 2004; am. iss. 61 in 2004; am. and suppl. iss. 105 in 2004; am. iss. 8 in 2008; am. and suppl. iss. 17 in 2006).

§ 4. (1) Investment intermediaries calculating the risk-weighted exposure amounts to cover the counterparty credit risk according the provisions of Chapter Twelve Section II, shall maintain own funds in compliance with the provisions of Art. 25, Art. 133-141 which shall always be higher or equal to the amounts indicated under para 3, 4 and 5.

(2) Investment intermediaries which use an Advanced Measurement Approach in the calculation of the capital requirements for operational risk under Art. 130 shall maintain own funds in compliance with the provisions of Art. 25, Art. 133-141 which shall always be higher or equal to the amounts indicated under para 4 and 5.

(3) In the first twelve-month period after 31 Dec., 2006 – 95% of the minimal amount of the own funds which would be required under Ordinance No. 6 in 2003 on the capital adequacy and liquidity of investment intermediaries.

(4) In the second twelve-month period after 31 Dec., 2006 – 90% of the minimal amount of the own funds which would be required under Ordinance No. 6 in 2003 on the capital adequacy and liquidity of investment intermediaries.

(5) In the third twelve-month period after 31 Dec., 2006 – 80% of the minimal amount of the own funds which would be required under Ordinance No. 6 in 2003 on the capital adequacy and liquidity of investment intermediaries.

(6) The compliance with the requirements under para 3-5 shall be on the basis of the own funds' amount, adjusted in whole with the purpose of reflecting the differences in the calculation of the own funds in accordance with Ordinance No. 6 in 2003 on the capital adequacy and liquidity of investment intermediaries and the calculation of the own funds under this Ordinance, arising from the different treatment of the expected and unexpected losses under Chapter Twelve, Section II.

§ 5. (1) (Am. – SG, iss. 68 in 2008) By 31 December, 2011 investment intermediaries for which Art. 23 para 2 and 3 do not apply, may chose not to apply the capital requirements under Art. 19 para 1 item 3 in case that their trading book shall never exceed the BGN equivalence of 50 million euro and the average number of employees during the fiscal year shall not be more than 100 persons.

(2) In the cases under para 1, the capital requirements shall be equal at least to the lower of the following amounts:

1. (Am. – SG, iss. 68 in 2008) the capital requirements under Art. 19 para 1 item 3; and

2. 12/88 of the higher of the following amounts:

a) (Am. – SG, iss. 68 in 2008) the amount of the capital requirements under Art. 21 and Art. 19 para 1 item 1 and 2, and

b) the amount set in accordance with Art. 23, without accounting for the limitations under Art. 23 para 5.

(3) The amount under para 2 item 2 letter "b" shall be recalculated at least once yearly.

(4) The capital requirements to investment intermediaries shall satisfy the minimum required own capital under Ordinance No. 6 in 2003 on the capital adequacy and liquidity of

investment intermediaries, unless such reduction is reasonably justified with decrease in the volume of the intermediary's activity.

§ 6. By 31 Dec., 2012 investment intermediaries for which the business lines related to "trade and sale" represent at least 50% of the total amount of all business lines calculated according Art. 23 and item 2.1 – 2.4 of Annex No. 8, shall apply a rate of 15% to the indicator for line "trade and sale".

§ 7. Investment intermediaries that have been granted a license to purse business as an investment intermediary before the coming into effect of the Ordinance shall prepare and file with the Commission the arrangements, processes and mechanisms under Art. 142 para 5 within a period by 31 January, 2007.

§ 8. This Ordinance has been issued on the grounds of § 16 para 1, in relation to Art. 56 para 4, 6 and 7 of the LPOS and was adopted by Decision No. 67-H from 17 October, 2006 by the Financial Supervision Commission.

§ 9. The Financial Supervision Commission shall give guidance on the Ordinance implementation.

§ 10. This Ordinance comes into effect as of 1 January, 2007.

Annex 1 to Chapter VI

Table 1

Categories	Specific risk capital charge
Debt securities which would qualify for credit quality step 1 or which would receive a 0% risk weight under the rules provided for in chapter 12, section I and issued by: central governments as well as guaranteed by them; central banks; international organizations; multilateral development banks; Member States' regional government or local authorities	0%
Debt securities which would qualify for credit quality step 2 or 3 under the rules provided for in chapter 12, section I and issued by: central governments, as well as guaranteed by them by central banks international organizations multilateral development banks Member States' regional governments or local authorities.	0,25% (residual term to final maturity 6 months or less) 1,00% (residual term to final maturity greater than 6 and up to and including 24 months) 1,60% (residual term to final maturity exceeding 24 months)

Debt securities issued or guaranteed by institutions which would qualify for credit quality step 1 or 2 under the rules provided for in chapter 12, section I Debt securities issued or guaranteed by institutions which would qualify for credit quality step 3 under the rules provided for in item 1.6.6 of Annex 4. Debt securities issued or guaranteed by corporates which would qualify for credit quality step 1 or 2 under the rules provided for in chapter 12, section I. Other qualifying items	
Debt securities which would qualify for credit quality step 4 or 5 under the rules provided for in chapter 12, section I and issued by: central governments, as well as guaranteed by them; central bank; international organizations; multilateral development banks; Member States' regional governments or local authorities. Debt securities issued or guaranteed by institutions which would qualify for credit quality step 3 under the rules provided for in item 1.6.4 of Annex 4. Debt securities issued or guaranteed by corporates which would qualify for credit quality step 3 or 4 under the rules provided for in chapter 12, section I Exposures for which a credit assessment by a nominated ECAI is not available	8,00%
Debt securities which would qualify for credit quality step 6 under the rules provided for in chapter 12, section I and issued by: central governments, as well as guaranteed by them; central banks; international organizations; multilateral development banks; Member States' regional governments or local authorities. Debt securities issued or guaranteed by corporates which would qualify for credit quality step 5 or 6 under the rules provided for in chapter 12, section I	12,00%

Table 2

Zone	Maturity band		Weighting (in %)	Assumed interest rate change (in %)
	Coupon of 3% or more	Coupon of less than 3%		

1	0 ≤ 1 month	0 ≤ 1 month	0,00	-
	> 1 ≤ 3 months	> 1 ≤ 3 months	0,20	1,00
	> 3 ≤ 6 months	> 3 ≤ 6 months	0,40	1,00
	> 6 ≤ 12 months	> 6 ≤ 12 months	0,70	1,00
2	> 1 ≤ 2 years	> 1,0 ≤ 1,9 years	1,25	0,90
	> 2 ≤ 3 years	> 1,9 ≤ 2,8 years	1,75	0,80
	> 3 ≤ 4 years	> 2,8 ≤ 3,6 years	2,25	0,75
3	> 4 ≤ 5 years	> 3,6 ≤ 4,3 years	2,75	0,75
	> 5 ≤ 7 years	> 4,3 ≤ 5,7 years	3,25	0,70
	> 7 ≤ 10 years	> 5,7 ≤ 7,3 years	3,75	0,65
	> 10 ≤ 15 years	> 7,3 ≤ 9,3 years	4,50	0,60
	> 15 ≤ 20 years	> 9,3 ≤ 10,6 years	5,25	0,60
	> 20 years	> 10,6 ≤ 12,0 years	6,00	0,60
		> 12,0 ≤ 20,0 years	8,00	0,60
		> 20 years	12,50	0,60

Table 3

Zone	Modified duration (in years)	Assumed interest (change in %)
1	> 0 ≤ 1,0	1.0
2	> 1,0 ≤ 3,6	0.85
3	> 3,6	0.7

Table 4

working day 0	100%
working day 1	90%
working days 2 to 3	75%
working day 4	50%

working day 5	25%
after working day 5	0%.

Formula 1

Modified duration = Duration (D) / (1 + r),

$$D = \left(\left(\sum_{t=1}^{m} \left((t\,C_t) / \left((1+r)^t \right) \right) \right) / \left(\sum_{t=1}^{m} \left((C_t) / \left((1+r)^t \right) \right) \right) \right)$$

where:

R = yield to maturity

C_t = cash payment in time t

M = total maturity

Annex 2
to Chapter 12, Section I

CLASSIFICATION OF OFF-BALANCE-SHEET ITEMS

1. Full risk:

(a) Guarantees issued by institutions having the character of credit substitutes;

(b) Credit derivatives;

(c) Acceptances;

(d) Endorsements on bills not bearing the name of another credit institution;

(e) Transactions with recourse;

(f) Irrevocable standby letters of credit having the character of credit substitutes;

(g) Assets purchased under outright forward purchase agreements;

(h) Forward forward deposits;

(i) The unpaid portion of partly-paid shares and securities;

(j) Asset sale and repurchase agreements;

(k) Other items also carrying full risk.

2. Medium risk:

(a) Documentary credits issued and confirmed;

(b) Warranties and indemnities (including tender, performance, customs and tax bonds) and guarantees not having the character of credit substitutes;

(c) Irrevocable standby letters of credit not having the character of credit substitutes;

(d) Undrawn credit facilities (agreements to lend, purchase securities, provide guarantees or acceptance facilities) with an original maturity of more than one year;

(e) Note issuance facilities (NIFs) and revolving underwriting facilities (RUFs);

(f) Other items also carrying medium risk.

3. Medium/low risk:

3. Documentary credits in which underlying shipment acts as collateral and other self-liquidating transactions,

4. Undrawn credit facilities (agreements to lend, purchase securities, provide guarantees or acceptance facilities) with an original maturity of up to and including one year which may not be cancelled unconditionally at any time without notice or that do not effectively provide for automatic cancellation due to deterioration in a borrower's creditworthiness;

5. Other items also carrying medium/low risk.

4. Low risk:

(a) Undrawn credit facilities (agreements to lend, purchase securities, provide guarantees or acceptance facilities) which may be cancelled unconditionally at any time without notice, or that do effectively provide for automatic cancellation due to deterioration in a borrower's creditworthiness. Retail credit lines may be considered as unconditionally cancellable if the terms permit the credit institution to cancel them to the full extent allowable under consumer protection and related legislation;

(b) Other items not carrying risk.

Annex 3
to Chapter VII

(Am. – SG, iss. 68 in 2008) The Treatment of Counterparty Credit Risk in Relation to Derivative Instruments Transactions, Repurchase Transactions, Securities or Commodities Lending/Borrowing Transactions, Long Settlement Transactions and Margin Lending Transactions

I. For the purposes of this Annex the following definitions shall apply:

1. **"Counterparty Credit Risk"** means the risk that the counterparty to a transaction could default before the final settlement of the transaction's cash flows.

2. (Am. – SG, iss. 68 in 2008) **"Central counterparty"** means an entity that legally carries out activity as an intermediary between the counterparties to contracts traded within one or more financial markets, becoming the buyer to every seller and the seller to every buyer.
3. **"Long Settlement Transactions"** mean transactions where a counterparty undertakes to deliver a security, a commodity, or a foreign exchange amount against cash, other financial instruments, or commodities, (or vice versa), within a term that is contractually specified as longer than the market standard term for this particular transaction and its duration is at least five business days after the date on which the investment intermediary enters into the transaction.
4. "**Margin Lending Transactions**" mean transactions in which an investment intermediary extends credit in connection with the purchase, sale, carrying or trading of securities. These transactions do not include other loans that are secured by securities collateral.
5. **"Netting Set"** means a group of transactions with a single counterparty that is subject to a legally enforceable bilateral netting arrangement and for which netting is recognized under item VII of this Annex and Chapter Twelve, Section III. Each transaction that is not subject to a legally enforceable bilateral netting arrangement, which is recognized under this Annex, should be interpreted as its own netting set.
6. **"Risk Position"** means a risk number that is assigned to a transaction under the Standardized Method for calculation of counterparty credit risk set out following a predetermined algorithm.
7. **"Hedging Set"** means a group of risk positions from the transactions within a single netting set for which only their balance is relevant for determining the exposure value under the Standardized Method for calculation of counterparty credit risk.
8. **"Margin Agreement"** means a contractual agreement or provisions of an agreement under which one counterparty shall supply collateral to a second counterparty when an exposure of that second counterparty to the first counterparty exceeds a specified level.
9. **"Margin Threshold"** means the largest amount of an exposure that remains outstanding until one party has the right to call for collateral in relation to margin agreements.
10. **"Margin Period of Risk"** means the time period from the last exchange of collateral covering a netting set of transactions with a defaulting counterpart until that counterpart is closed out and the resulting market risk is re-hedged.
11. **"Effective Maturity"** under the Internal Model Method, for a netting set with maturity greater than one year, means the ratio of the sum of expected exposure over the life of the transactions in the netting set discounted at the risk-free rate of return divided by the sum of expected exposure over one year in a netting set discounted at the risk-free rate. This effective maturity may be adjusted to reflect rollover risk by replacing expected exposure with effective expected exposure for forecasting horizons under one year.
12. **"Cross-Product Netting"** means the inclusion of transactions of different product categories within the same netting set pursuant to the Cross-Product Netting rules set out in this Annex.
13. **"Current Market Value"** means the net market value of the portfolio of transactions within the netting set with counterparty. Both positive and negative market values are used in computing current market value.
14. **"Distribution of Market Values"** means the forecast of the probability distribution of net market values of transactions within a netting set by some future date (the forecasting horizon), made on the basis of the realized market value of those transactions up to the present time.

15. **"Distribution of Exposures"** means the forecast of the probability distribution of market values that is generated by setting forecast instances of negative net market values equal to zero.

16. **"Risk-Neutral Distribution"** means a distribution of market values or exposures at a future time period where the distribution is calculated using market implied values such as implied volatilities.

17. **"Actual Distribution"** means a distribution of market values or exposures at a future time period where the distribution is calculated using historic or realized values such as volatilities calculated using past price or rate changes.

18. **"Current Exposure"** means the larger of zero or the market value of a transaction or portfolio of transactions within a netting set with a counterparty that would be lost upon the default of the counterparty, assuming no recovery on the value of those transactions in bankruptcy.

19. **"Peak Exposure"** means a high percentile of the distribution of exposures at any particular future date before the maturity date of the longest transaction in the netting set.

20. **"Expected Exposure"** means the average of the distribution of exposures at any particular future date before the longest maturity transaction in the netting set matures.

21. **"Effective Expected Exposure"** at a specific date means the maximum expected exposure that occurs at that date or any prior date. Alternatively, it may be defined for a specific date as the greater of the expected exposure at that date, or the effective exposure at the previous date.

22. **"Expected Positive Exposure"** means the weighted average over time of expected exposures where the weights are the proportion that an individual expected exposure represents of the entire time interval. When calculating the minimum capital requirements, the average is taken over the first year or, if all the contracts within the netting set mature within less than one year, over the time period of the longest maturity contract in the netting set.

23. **"Effective Expected Positive Exposure"** means the weighted average over time of effective expected exposure, where the weights are the proportion that an individual expected exposure represents of the entire time interval. The average is defined on the basis of the first year, or, if all the contracts within the netting set mature within less than one year, over the time period of the longest maturity contract in the netting set

24. **"Credit Valuation Adjustment"** means an adjustment to the mid-market valuation of the portfolio of transactions with a counterparty. This adjustment reflects the market value of the credit risk due to any failure to perform on contractual agreements with a counterparty. This adjustment may reflect the market value of the credit risk of the counterparty or the market value of the credit risk of both the investment intermediary and the counterparty.

25. **"One-Sided Credit Valuation Adjustment"** means a credit valuation adjustment that reflects the market value of the credit risk of the counterparty to the investment intermediary, but does not reflect the market value of the credit risk of the investment intermediary to the counterparty.

26. **"Rollover Risk"** means the amount by which expected positive exposure is understated when future transactions with a counterpart are expected to be conducted on an ongoing basis. The additional exposure generated by those future transactions is not included in calculation of expected positive exposure.

27. **"General Wrong-Way Risk"** arises when the probability of default of counterparties is positively correlated with general market risk factors.

28. **"Specific Wrong-Way Risk"** arises when the exposure to a particular counterparty is positively correlated with the probability of default of the counterparty due to the nature of the transactions with the counterparty. An investment intermediary shall be considered to be

exposed to Specific Wrong-Way Risk if the future exposure to a specific counterparty is expected to be high when the counterparty's probability of default is also high.

II. Choice of Method

1. The investment intermediary defines the exposure value of the agreements described in Annex 10 applying one of the following methods:
1.1.Mark-to-market method

1.2.Original exposure method

1.3.Standardized method

1.4.Internal model method

2. An investment intermediary which is not eligible for the treatment set out in art. 19, para 4, shall not be permitted to apply the original exposure method. The original exposure method may not be used for determination of the exposure value for the contracts listed in item 3 of Annex 10.
3. The simultaneous use of the methods under item 1 shall be allowed within a financial group but not within a separate legal entity. The combined use of the methods set out in item 1, sub-items 1.1. and 1.3. within a single legal entity shall be allowed where one of the methods is used for the cases set out in item 37 of this Annex.
4. Subject to the approval of the deputy chairman, the investment intermediary may use the internal model method under this Annex for determination of the exposure value for:
4.1. the contracts listed in Annex 10

4.2. repurchase transactions

4.3. securities or commodities lending or borrowing transactions,

4.4. margin lending transactions

4.5. long settlement transactions.

5. When an investment intermediary purchases credit derivative protection against a non-trading book exposure, or against a counterparty credit risk exposure, it may compute its capital requirement for the hedged asset in accordance with items 54 - 57 of Annex 6, or subject to the approval of the deputy chairman in accordance with item 1.1.2 in Section I of Annex 5. In these cases, the exposure value for counterparty credit risk for these credit derivatives is set to zero.
6. The exposure value for counterparty credit risk from sold credit default swaps in the non-trading book, where they are treated as credit protection provided by the investment intermediary and subject to a capital requirement for credit risk for the full notional amount, is set to zero.
7. Under all methods set out in item 1, the exposure value for a given counterparty is equal to the sum of the exposure values calculated for each netting set with that counterparty.
8. An exposure value of zero for counterparty credit risk shall be attributed to the contracts set out in item 4, if all the following requirements have been simultaneously met:
8.1. the contracts have been concluded with a central counterparty;

8.2. the contracts have been confirmed by a central counterparty;

8.3. all central counterparty credit risk exposures with all participants in its arrangements have been fully collateralized on a daily basis.

9. Exposures arising from long settlement transactions can be determined using any of the methods set out in item 1 regardless of the methods chosen for treating the transactions set out in item 4.1 to 4.4.
10. In calculating capital requirements for long settlement transactions, investment intermediaries that use the internal model approach set out in Chapter Twelve, Section II may assign the risk weights under the standardized approach set out in Chapter 12, Section I on a permanent basis and irrespective of the materiality of such positions.
11. Where the methods set out in item 1.1 and 1.2, are used, the investments intermediaries must verify before the deputy chairman that the notional amount to be taken into account is an appropriate measure for the risk inherent in the contract. Where, for instance, the contract provides for a multiplication of cash flows, the notional amount must be adjusted in order to take into account the effects of the multiplication on the risk structure of that contract.

III. Mark-to-market Method

12. For the purpose of calculating the counterparty credit risk exposure where the mark-to market method is used, the investment intermediary determines the exposure value by summing the current replacement cost and the potential future credit exposure.
13. Where the market value is a positive figure, the current replacement cost is equal to the market value and where the market value is equal to zero or is a negative figure, the current replacement cost shall be assumed to be zero.
14. The current replacement cost of a netting set of contracts is the sum of the current market values of these contracts.
15. The potential future credit exposure is obtained by multiplying the contracts notional principle amounts with the percentages in Table 1.

Table 1

Residual maturity	Interest-rate contracts	Contracts concerning foreign-exchange rates and gold	Contracts concerning equities	Contracts concerning precious metals except gold	Contracts concerning commodities other than precious metals
One year or less	0%	1%	6%	7%	10%
Over one year, not exceeding five years	0,5%	5%	8%	7%	12%
Over five years	1,5%	7,5%	10%	8%	15%

Notes:

1. Contracts which do not fall directly within one of the five categories indicated in this table shall be treated as “Contracts concerning commodities other than precious metals”.
2. For contracts with multiple exchanges of principal, the percentages have to be multiplied by the number of remaining exchanges still to be made according to the contract.

3. For contracts that are structured to settle outstanding exposure following specified payment dates and where the terms are reset such that the market value of the contract is zero on these specified dates, the residual maturity would be equal to the time until the next reset date. In the case of interest-rate contracts that meet these criteria and have a remaining maturity of over one year, the percentage shall be no lower than 0,5%.
4. To obtain a figure for potential future credit exposure in the case of total return swap credit derivatives and credit default swap credit derivatives, the nominal amount of the instrument is multiplied by the following percentages

4.1. where the reference obligation is one that if it gave rise to a direct exposure of the investment intermediary it would be a qualifying item for the purpose of Chapter Six – 5%;

4.2. where the reference obligation is one that if it gave rise to a direct exposure of the investment intermediary, it would not be a qualifying item for the purposes of Chapter Six – 10%;

5. In the case of credit default swap, an investment intermediary the exposure of which arising from the swap represents a long position in the underlying shall be permitted to use a figure of 0% for potential future credit exposure, unless the credit default swap is subject to closeout upon the insolvency of the entity the exposure of which arising from the swap represents a short position in the underlying, even though the underlying has not defaulted.
6. Where the credit derivative provides protection in relation to n-th to default amongst a number of underlying obligations, which of the percentage figure prescribed above is to be applied is determined by the obligation with the n-th lowest credit quality determined by whether the commitment undertaken by the investment intermediary would be an exposure with mitigated risk.

16. For the purpose of calculating the potential future credit risk exposure the deputy chairman may allow investment intermediaries to apply the percentages in Table 2 instead of those prescribed in Table 1 provided that the investment intermediaries make use of the option set out in article 94 for contracts relating to commodities other than gold within the meaning of item 3 of Annex 10.

Table 2

Residual maturity	Precious metals (except gold)	Base metals	Agricultural products (softs)	Other, including energy products
One year or less	2%	2,5%	3%	4%
Over one year, not exceeding five years	5%	4%	5%	6%
Over five years	7,5%	8%	9%	10%

IV. Original Exposure Method

17. Where the original exposure method is used for determination of the exposure value, the notional principal amount of each instrument is multiplied by the percentages given in Table 3.

Table 3

Original maturity	Interest-rate contracts	Contracts concerning foreign-exchange rates and gold
One year or less	0,5%	2%
Over one year, not exceeding five years	1%	5%
Over five years	1%	3%

Note:

1. In the case of interest-rate contracts, the investment intermediaries may, subject to the consent of the deputy chairman, choose either original or residual maturity.

V. Standardized Method

18. The standardized method can be used only for OTC derivatives and long settlement transactions.
19. The exposure value shall be calculated separately for each netting set in accordance with the following formula:

$$ExpVal = \beta * \max\left(CMV - CMC; \sum_j \left|\sum_i RPT_{ij} - \sum_l RPC_{lj}\right| * CCRM_j\right),$$

where:

CMV = current market value of the portfolio of transactions within the netting set with a counterparty gross of collateral, that is, where:

$$CMV = \sum_i CMV_i$$

where:

CMVi = the current market value of transaction i;

CMC = the current market value of the collateral assigned to the netting set, that is, where:

$$CMC = \sum_l CMC_l$$

where:

CMC_l = the current market value of collateral l;

i = index designating transaction;

l = index designating collateral;

j = index designating hedging set category. These hedging sets correspond to risk factors for which risk positions of opposite sign can be offset to yield a net risk position on which the exposure measure is then based;

RPTij = risk position from transaction i with respect to hedging set j;

RPTlj = risk position from collateral l with respect to hedging set j;

CCRMj = CCR Multiplier set out in Table 5 with respect to hedging set j;

β = 1.4.

20. Collateral received from counterparty has a positive sign and collateral posted to a counterparty has a negative sign. Collateral that is recognised for this method is confined to the collateral that is eligible under item 10 of Annex 6 and Art. 68.

21. When an OTC derivative transaction with a linear risk profile stipulates the exchange of a financial instrument for a payment, the payment part is referred to as the payment leg.

22. Transactions that stipulate the exchange of payment against payment consist of two payment legs corresponding to the contractually agreed gross payments. Transaction with payment legs in a single currency shall be treated as a transaction with one payment leg corresponding to the netting payment.

23. For payment legs with a remaining maturity of less than one year, the investment intermediary may disregard the interest rate risk for the purposes of the following calculations.

24. Transactions with a linear risk profile form composite positions as follows:

24.1. Transactions with equities (including equity indices), gold, other precious metals or other commodities as the underlying financial instruments are mapped to a risk position in the respective equity (or equity index) or commodity (including gold and other precious metals) and an interest rate risk position for the payment leg. If the payment leg is denominated in a foreign currency, it is additionally mapped to a risk position in the respective currency;

24.2. Transactions with a linear risk profile with a debt instrument as the underlying instrument are mapped to an interest rate risk position for the debt instrument and another interest rate risk position for the payment leg. Transactions with a linear risk profile that stipulate the exchange of payment against payment, including foreign exchange forwards, are mapped to an interest rate risk position for each of the payment legs. If the underlying debt instrument is denominated in a foreign currency, the debt instrument is mapped to a risk position in this currency. If a payment leg is denominated in foreign currency, the payment leg is again mapped to a risk position in this currency.

25. The exposure value assigned to a foreign exchange basis swap transaction is zero.

26. The size of a risk position from a transaction with linear risk profile is as follows:

26.1. For an underlying asset which is not a debt instrument - the effective notional value (market price multiplied by quantity) of the underlying financial instruments or commodity converted to leva;

26.2. For an underlying asset which is a debt instrument and for payment legs - is the effective notional value of the outstanding gross payments (including the notional principle amount) converted to leva and multiplied by the modified duration of the debt instrument, or payment leg, respectively.

26.3. For a credit default swap - is the notional principle value of the reference debt instrument multiplied by the remaining maturity of the credit default swap.

27. The size of a risk position from an OTC derivative with a non-linear risk profile is as follows:

27.1. For an underlying asset which is not a debt instrument - the delta equivalent effective notional value of the financial instrument that underlies the transaction;

27.2. For an underlying asset which is a debt instrument and for payment legs - the delta equivalent effective notional value of the financial instrument or payment leg multiplied by the modified duration of the debt instrument, or payment leg, respectively.

28. For the determination of risk positions, collateral received from a counterparty is to be treated as a claim on the counterparty under a derivative contract (long position) that is due

today, while collateral posted is to be treated like an obligation to the counterparty (short position) that is due today.

29. Investment intermediaries may use the following formulae to determine the size and sign of a risk position:

29.1. For all instruments other than debt instruments:

$$ENV = p_{ref} * \frac{\partial V}{\partial p},$$

where:

ENV is the effective notional value or the delta equivalent notional value

Pref = price of the underlying instrument, expressed in the reference currency;

V = value of the financial instrument (in the case of an option this is the option price and in the case of a transaction with a linear risk profile this is the value of the underlying instrument itself);

p = price of the underlying instrument, expressed in the same currency as V;

29.2. For debt instruments and the payment legs of all transactions:

$ENVMD = \frac{\partial V}{\partial r}$, where:

$ENVMD$ - is the effective notional value multiplied by the modified duration, or delta equivalent notional value multiplied by the modified duration;

V = value of the financial instrument (in the case of an option this is the option price and in the case of a transaction with a linear risk profile this is the value of the underlying instrument itself or of the payment leg, respectively). If V is denominated in a currency other than the reference currency, the derivative must be converted into the reference currency by multiplication with the relevant exchange rate.

r = interest rate level.

30. The risk positions are to be grouped into hedging sets. For each hedging set, the absolute value amount of the sum of the resulting risk positions is computed. This sum is termed the "net risk position" and is represented by:

$$\left| \sum_i RPT_{ij} - \sum_l RPC_{lj} \right|$$

in the formulae set out in item 19.

31. For interest rate risk positions from money deposits received from the counterparty as collateral, from payment legs and from underlying debt instruments, to which according to Table 1 of Annex 1 a capital charge of 1,60% or less applies, there are six hedging sets for each currency, as set out in Table 4 below. Hedging sets are defined by a combination of the criteria "maturity" and "referenced interest rates".

Table 4

	Government referenced interest rates	Non-government referenced interest rates
Maturity	Up to 1 year	Up to 1 year
Maturity	From 1 to 5 years	From 1 to 5 years
Maturity	Over 5 years	Over 5 years

32. For interest rate risk positions from underlying debt instruments or payment legs for which the interest rate is linked to a reference interest rate that represents a general market interest level, the remaining maturity is the length of the time interval up to the next re-adjustment of the interest rate. In all other cases, it is the remaining life of the underlying debt instrument or in the case of a payment leg, the remaining life of the transaction.
33. (Am. – SG, iss. 68 in 2008) There is a separate hedging set for each issuer of a reference debt instrument that underlies a credit default swap.
34. (Am. – SG, iss. 68 in 2008) For interest rate risk positions from money deposits that are posted with a counterparty as collateral when that counterparty does not have debt obligations of low specific risk outstanding and from underlying debt instruments, to which according to Table 1 of Annex 1 a capital charge of more than 1,60% applies, an individual hedging set is separated for each issuer of the reference debt instrument. Risk positions that arise from debt instruments of a certain issuer, or from reference debt instruments of the same issuer that are emulated by payment legs, or that underlie a credit default swap, may be assigned to the same hedging set.
35. Underlying financial instruments other than debt instruments shall be assigned to the same respective hedging sets only if they are identical or similar instruments. In all other cases they shall be assigned to separate hedging sets. The similarity of instruments is established as follows:
35.1. for equities, similar instruments are those of the same issuer. An equity index is treated as a separate issuer;
35.2. for precious metals, similar instruments are those of the same metal. A precious metal index is treated as a separate precious metal;
35.3 for electric power, similar instruments are those delivery rights and obligations that refer to the same peak or off-peak load time interval within any 24-hour interval;
35.4. for commodities, similar instruments are those of the same commodity. A commodity index is treated as a separate commodity.
36. The counterparty credit risk multipliers for the different hedging set categories are set out in Table 5 below:

Table 5

	Hedging set categories	Multiplier
1.	Interest Rates	0,2%

2.	Interest Rates for risk positions from a reference debt instrument that underlies a credit default swap and to which a capital charge of 1.60%, or less, applies under Table 1 of Annex 1	0,3%
3.	Interest Rates for risk positions from a debt instrument or reference debt instrument to which a capital charge of more than 1.60% applies under Table 1 of Annex 1	0,6%
4.	Exchange Rates	2,5%
5.	Items of equipments for Electric Power supply	4%
6.	Items in gold	5%
7..	Items in equity	7%
8.	Items in precious metals (except gold)	8,5%
9.	Other Commodities (excluding precious metals and electricity power)	10%
10.	Underlying instruments of OTC derivatives that are not in any of the above categories	10%

Underlying instruments of OTC derivatives, as referred to in point 10 of Table 5, shall be assigned to separate individual hedging sets for each category of underlying instrument.

37. For transactions with a non-linear risk profile or for payment legs and transactions with debt instruments as underlying for which an investment intermediary cannot determine the delta or the modified duration, respectively, with an instrument model for determining the minimum capital requirements for market risk, the investment intermediary shall use the mar-to market method. Netting shall not be recognized (that is, the exposure value shall be determined as if there were a netting set that comprises just the individual transaction).

38. An investment intermediary shall have internal procedures to verify that, prior to including a transaction in a hedging set, the transaction is covered by a legally enforceable netting contract that meets the requirements set out in this Annex.

39. An investment intermediary that makes use of collateral to mitigate its counterparty credit risk shall have internal procedures to verify that, prior to recognizing the effect of collateral in its calculations, the collateral meets the legal certainty standards set out in Annex 6.

VI. Internal Model Method

40. Subject to the approval of the deputy chairman, an investment intermediary may use the Internal Model Method to calculate the exposure value for the transactions in item 4.1 -

4.5. Notwithstanding item 3, investment intermediaries may choose not to apply this method to exposures that are immaterial in size and risk.
41. Subject to the approval of the deputy chairman, implementation of the Internal Model Method may be carried out sequentially across different transaction types, and during this period an investment intermediary may use the standardized method or the mark-to market method
42. For all OTC derivative transactions and for long settlement transactions for which an investment intermediary has not received approval to use the Internal Model Method, the investment intermediary shall use the standardized method or the mark-to market method. Combined use of these two methods is permitted on a permanent basis within a group. Combined use of these two methods within a legal entity is only permitted where one of the methods is used for the cases set out in item 37.
43. An investment intermediary which has obtained permission to use the internal model method shall not revert to the use of the remaining methods, except for demonstrated good cause and subject to approval of the deputy chairman.
44. If an investment intermediary ceases to comply with the requirements for the internal model method use, it shall either present to the deputy chairman a plan for a timely return to compliance or demonstrate to the deputy chairman that the effect of non-compliance is immaterial.

Exposure value

45. For the purposes of this method, the exposure value shall be measured at the level of the netting set. The model shall specify the forecasting distribution for changes in the market value of the netting set attributable to changes in market variables, such as interest rates, or foreign exchange rates. The model shall then compute the exposure value for the netting set at each future date given the changes in the market variables. For margined counterparties, the model may also capture future collateral movements.
46. Investment intermediaries may include eligible financial collateral as defined in item 10 of Annex 6 and Art. 68 in their forecasting distributions for changes in the market value of the netting set, if the collateral meets the quantitative, qualitative and data requirements of the internal model method.
47. The exposure value shall be calculated as the product of α times Effective Expected Positive Exposure.
48. The alpha (α) coefficient shall be 1.4 and Effective Expected Positive Exposure shall be computed by estimating expected exposure (EEt) as the average exposure at future date t, where the average is taken across possible future values of relevant market risk factors. The model estimates expected exposure at a series of future dates t1, t2, t3, etc.
49. The Effective Expected Exposure shall be computed recursively in accordance with the following formulae:

$EEE_{tk} = \max(EEE_{tk-1}; EE_{tk})$,

where:

EEE_{tk} - Effective Expected Exposure at time t_k;

EE_{tk} - Expected Exposure at time t_k;

t_0 - Current date;

EEE_{t0} is equal to the current exposure.

50. The Effective Expected Positive Exposure is the average Effective Expected Exposure during the first year of future exposure. If all contracts in the netting set mature within less than one year, Expected Positive Exposure is the average of Expected Exposure until all contracts in the netting set mature. Effective Expected Positive Exposure is computed as a weighted average of Effective Expected Exposure using the following formulae:

$$EEPE = \sum_{k=1}^{m} EEE_{tk} * \Delta t_k ,$$

where:

$EEPE$ - Effective Expected Positive Exposure;

$\Delta t_k = t_k - t_{k-1}$ - the time period expressed as a difference between two dates;

t_m - the time period till the maturity date of the contract with the longest term but not exceeding one year.

51. The Effective Expected Exposure and the peak exposure measures shall be calculated based on a distribution of exposures that accounts for the possible non-normality of the distribution of exposures.

52. Investment intermediaries may calculate the value of the exposure in a manner, other than that indicated in item 47, if the method of measure is more conservative and the obtained by it value for every counterparty is not less than that obtained under item 47.

53. (Am. – SG, iss. 68 in 2008) The deputy chairman may permit investment intermediaries to use their own estimates of α-coefficient, where α shall equal the ratio of internal capital from a full simulation of counterparty credit risk exposure across counterparties (numerator) and internal capital based on Expected Positive Exposure (denominator). The α-coefficient may not be less than 1.2. In the denominator, Expected Positive Exposure shall be used as if it were a fixed outstanding amount. Investment intermediaries shall demonstrate that their internal estimates of α capture in the numerator material sources of stochastic dependency of distribution of market values of transactions or of portfolios of transactions across counterparties. Internal estimates of α=coefficients shall take account of the number of exposures in the portfolios.

54. (Am. – iss. 68 in 2008) An investment intermediary shall ensure that the numerator and denominator of α-coefficient are computed in a consistent manner with respect to the modelling methodology, parameter specifications and portfolio composition. The approach used shall be based on the investment intermediary's internal capital approach, be well documented and be subject to independent validation. In addition, investment intermediaries shall review their estimates on at least a quarterly basis, and more frequently when the composition of the portfolio varies over time. Investment intermediaries shall also assess the model risk.

55. Where appropriate, volatilities and correlations of market risk factors used in the joint simulation of market and credit risk should be conditioned on the credit risk factor to reflect potential increases in volatility or correlation in an economic downturn.

56. If the netting set is subject to a margin agreement, the Expected Positive Exposure shall be one of the following EPE measures:

56.1. Effective Expected Positive Exposure without taking into account the margin agreement;
56.2. The threshold, if positive, under the margin agreement plus an add-on that reflects the potential increase in exposure over the margin period of risk. The add-on is computed as the expected increase in the netting set's exposure beginning from a current exposure of zero over the margin period of risk. A floor of five business days for netting sets consisting only of repo-style transactions subject to daily remargining and daily mark-to-market, and ten business days for all other netting sets is imposed on the margin period of risk used for this purpose;
56.3 The Expected Positive Exposure measure, if the model captures the effects of margining and subject to the approval of the deputy chairperson for this purpose.
57. An investment intermediary’s Expected Positive Exposure model shall meet the requirements set out in items 58 to 84.
58. The investment intermediary shall have a counterparty credit risk control unit which:

58.1. shall be responsible for the design and implementation of a management system for this type of risk, including the initial and on-going validation of the model;
58.2. (Am. – SG, iss. 68 in 2008) controls input data completeness and produces and analyses reports on the output of the investment intermediary’s risk measurement model, including an evaluation of the relationship between measures of risk exposure and credit and trading limits;
58.3. (Am. – SG, iss. 68 in 2008) shall be independent from the front-office;
58.4. shall be adequately staffed and shall report directly to the senior management;
58.5. work shall be an integral part of the day-to-day process of planning, monitoring and controlling the credit risk and the overall risk profile of the investment intermediary.
59. (Am. – SG, iss. 68 in 2008) An investment intermediary must have counterparty credit risk management policies, processes and systems that are reliable and comprehensive. The counterparty credit risk management framework shall include the identification, measurement, management, approval and internal reporting of counterparty credit risk.
60. An investment intermediary's risk management policies shall take account of market, liquidity, and legal and operational risks that can be associated with counterparty credit risk. The investment intermediary shall not undertake business with a counterparty without assessing its creditworthiness and shall take due account of settlement and pre-settlement credit risk. These risks shall be managed as comprehensively as practicable at the counterparty level (aggregating counterparty credit risk exposures with other credit exposures) and at the firm-wide level.
61. (Am. – SG, iss. 68 in 2008) The management bodies and senior management shall be actively involved in the counterparty credit risk control process and shall regard this as an essential aspect of the investment intermediary’s business. Senior management shall be aware of the limitations and assumptions of the model used and the impact these can have on the reliability of the output data. Senior management shall also consider the uncertainties of the market environment and operational issues and be aware of how these are reflected in the model.
62. (Am. – SG, iss. 68 in 2008) The investment intermediary’s daily reports prepared on exposures to counterparty credit risk shall be reviewed by a level of management with sufficient seniority and authority to enforce both reductions of positions taken by individual credit managers or traders, and reductions in the investment intermediary's overall counterparty credit risk exposure.
63. (Am. – SG, iss. 68 in 2008) A counterparty credit risk management system shall be used in conjunction with internal credit and trading limits. These limits shall be related to the investment intermediary's risk measurement model in a manner that is consistent over time

and that is well explained to the officials who manage credit positions or trade and to the senior management.

64. A counterparty credit risk management system shall include measuring daily and intra-day usage of credit lines. The investment intermediary shall measure current exposure gross and net of collateral. At portfolio and counterparty level, the investment intermediary shall calculate and monitor peak exposure or potential future exposure at the confidence interval chosen by it, taking into account large or concentrated positions, including by groups of related counterparties, by industry, by market, etc.

65. An investment intermediary shall have a routine and rigorous program of stress testing in place as a supplement to the counterparty credit risk analysis based on the day-to-day output of the risk measurement model. The results of this stress testing shall be reviewed periodically by senior management and shall be reflected in the counterparty credit risk policies and limits. Where stress tests reveal particular vulnerability to a given set of circumstances, the investment intermediary shall take steps to manage those risks appropriately.

66. An investment intermediary shall have a routine in place for ensuring compliance with a documented set of internal policies, controls and procedures concerning the operation of the counterparty credit risk management system. This system shall be well documented and shall provide an explanation of the empirical techniques used to measure counterparty credit risk.

67. An investment intermediary shall conduct an independent review of its counterparty credit risk management system regularly through its own internal auditing process. This review shall include both the activities of the business units referred to in point 58.3 and of the independent counterparty credit risk control unit. A review of the overall counterparty credit risk management process shall take place at regular intervals and shall specifically address, at a minimum:

67.1. the adequacy of the documentation of the counterparty credit risk management system and process;

67.2. the organization of the counterparty credit risk control unit;

67.3. the integration of counterparty credit risk measures into daily risk management;

67.4. (Am. – SG, iss. 68 in 2008) the approval process for risk valuation models and systems used by front and back-office personnel;

67.5. the validation of any significant change in the counterparty credit risk measurement process;

67.6. the scope of counterparty credit risk captured by the risk measurement model;

67.7. the integrity of the management information system;

67.8. the accuracy and completeness of counterparty credit risk data;

67.9. the verification of the consistency, timeliness and reliability of data used to run models, including the independence of such data sources;

67.10. the accuracy and appropriateness of volatility and correlation assumptions;

67.11. the accuracy of valuation and risk transformation calculations;

67.12. the verification of the model's accuracy through frequent back-testing.

Use test

68. The distribution of exposures generated by the model used to calculate effective expected positive exposure shall be closely integrated into the day-to-day counterparty credit

risk management process. The model's output shall accordingly play an essential role in the credit approval, counterparty credit risk management, internal capital allocation and corporate governance of the investment intermediary.

69. An investment intermediary shall have a track record in the use of models that generate a distribution of exposures to counterparty credit risk. Thus, the investment intermediary shall demonstrate that it has been using a model to calculate the distributions of exposures upon which the expected positive exposure calculation is based that meets the minimum requirements set out in this Annex for at least one year prior to approval by the deputy chairman.

70. The model used to generate a distribution of exposures to counterparty credit risk shall be part of a counterparty credit risk management framework that includes the identification, measurement, management, approval and internal reporting of counterparty credit risk. This framework shall include the measurement of usage of credit lines (aggregating counterparty credit risk exposures with other credit exposures) and internal capital allocation. The investment intermediary shall measure current exposure gross and net of collateral depending on the case. The use test is satisfied if an investment intermediary uses other counterparty credit risk measures, such as peak exposure or potential future exposure, based on the distribution of exposures generated by the same model to compute expected positive exposure.

71. (Am. – SG, iss. 68 in 2008) An investment intermediary shall have the systems capability to estimate expected exposure daily, unless it demonstrates to the deputy chairman that its exposures to counterparty credit risk warrant less frequent calculation. The investment intermediary shall compute expected exposure along a time profile of forecasting horizons that adequately reflects the time structure of future cash flows and maturity of the contracts and in a manner that is consistent with the materiality and composition of the exposures.

72. Exposure shall be measured, monitored and controlled over the life of all contracts in the netting set (not just to the one year horizon). The investment intermediary shall have procedures in place to identify and control the risks for counterparties where the exposure rises beyond the one-year horizon. The forecast increase in exposure shall be an input into the investment intermediary's internal capital model.

73. (Am. – SG, iss. 68 in 2008) An investment intermediary shall have in place sound stress testing processes for use in the assessment of capital adequacy for counterparty credit risk. The results obtained from the stress testing shall be compared with the measure of expected positive exposure and considered by the investment intermediary as part of the conditions under article 142, para 3 and 4. Stress testing shall also involve identifying possible events or future changes in economic conditions that could have unfavourable effects on an investment intermediary's credit exposures and an assessment of the investment intermediary's ability to withstand such changes.

74. (Am. – SG, iss. 68 in 2008) The investment intermediary shall stress test its counterparty credit risk exposures, including jointly stressing market and credit risk factors. Stress tests of counterparty credit risk shall consider concentration risk (to a single counterparty or groups of counterparties), correlation risk across market and credit risk, and the risk that liquidating the counterparty's positions could move the market.

75. Investment intermediaries shall give due consideration to exposures that give rise to a significant degree of General Wrong-Way Risk.

76. Investment intermediaries shall have procedures in place to identify, monitor and control cases of Specific Wrong-Way Risk, beginning at the inception of a transaction until its final settlement.

77. The model for estimation of the expected positive exposure shall reflect transaction terms and specifications in a timely, complete, and conservative fashion, including at least the

contract notional amounts, maturity, reference assets, the existing netting and margining arrangements, adhering to the following conditions:
77.1. (Am. – SG, iss. 68 in 2008) the transaction terms and specifications shall be maintained in a database that is subject to formal and periodic audit;
77.2. the process for recognizing netting arrangements shall require signoff by legal staff to verify the legal enforceability of netting and be input into the database by an independent unit;
77.3. the transmission of transaction terms and specifications data to the model shall also be subject to internal audit. The investment intermediary shall possess a process which compares the model and source data systems to verify on an ongoing basis that transaction terms and specifications are being reflected in the expected positive exposure estimation correctly.
78. When using the model the following requirements should be met in relation to the used data:
78.1. The current exposures are computed on the basis of current market data

78.2. (Am. – SG, iss. 68 in 2008) When using historical data to estimate volatility and correlations, at least three years of historical data shall be used and shall be updated quarterly or more frequently if market conditions warrant. The data shall cover a full range of economic conditions, such as a full business cycle.
78.3. (Am. – SG, iss. 68 in 2008) The prices supplied by the different structural units shall be validated by an independent unit and fed into the model in a timely and complete fashion, and maintained in a database subject to formal and periodic audit.
78.4. An investment intermediary shall also have a well-developed data integrity process to clean the data of erroneous and/or anomalous observations.
78.5. To the extent that the model relies on proxy market data, including, for new products, where three years of historical data may not be available, internal policies shall identify suitable proxies and the investment intermediary shall demonstrate empirically that the proxy provides a conservative representation of the underlying risk under adverse market conditions.
78.6. If the model includes the effect of collateral on changes in the market value of the netting set, the investment intermediary shall have adequate historical data to model the volatility of the collateral.
79. The model shall be subject to a validation process. The process shall be clearly articulated in investment intermediaries' policies and procedures and specifies the kind of testing needed to ensure model integrity and identify conditions under which assumptions are violated and may result in an understatement of expected positive exposure. The validation process shall include a review of the comprehensiveness of the model.
80. An investment intermediary shall monitor the appropriate risks and have processes in place to adjust its estimation of expected positive exposure when those risks become significant which includes:
80.1. Identification and management of the exposures to specific wrong-way risk;

80.2. Comparison on a regular basis between the estimate of expected positive exposure over one year with expected positive exposure over the life of the exposure which takes into account the whole duration of the exposure when the exposure has a rising risk profile after one year;
80.3. Comparison on a regular basis between the replacement cost (current exposure) and the realized exposure profile for exposures with a residual maturity below one year.
81. Prior to including a transaction in a netting set, an investment intermediary shall have internal procedures to verify that the transaction is covered by a legally enforceable netting contract that meets the requirements set out in this Annex.

82. An investment intermediary that accounts for the effect of collateral in the calculations for mitigation of its counterparty credit risk shall have internal procedures to verify that the collateral meets the legal certainty standards set out in Annex 6.
83. An investment intermediary's expected positive exposure model shall meet the following validation requirements:
83.1. the qualitative validation requirements set out in Chapter XI;
83.2. interest rates, foreign exchange rates, equity prices, commodities, and other market risk factors shall be forecast over long time horizons for measuring counterparty credit risk exposure. The performance of the forecasting model for market risk factors shall be validated over a long time horizon;
83.3. the pricing models used to calculate counterparty credit risk exposure for a given scenario of future shocks to market risk factors shall be tested as part of the model validation process; pricing models for options shall account for the nonlinearity of option value with respect to market risk factors;
83.4. the expected positive exposure model shall capture transaction-specific information which:
83.4.1. (Am. – SG, iss. 68 in 2008) allows for the aggregation of exposures at the level of the netting set in the calculation of the total exposure of such set; an investment intermediary shall verify that transactions are assigned to the appropriate netting set within the model;
83.4.2. (Am. – SG, iss. 68 in 2008) allows for the capturing of the effects of margining; the model shall take into account both the current and future amount of the margin, the nature of margin agreements (unilateral or bilateral), the frequency of margin calls, the margin period of risk, the minimum threshold of unmargined exposure and the minimum transfer amount. The model shall either include the mark-to-market change in the value of collateral posted or apply the rules set out in Annex 6;
83.5. The model validation process includes static, historical back-testing on representative counterparty portfolios; an investment intermediary shall conduct such back-testing on a number of representative counterparty portfolios (actual or hypothetical); these representative portfolios shall be chosen based on their sensitivity to the material risk factors and correlations to which the investment intermediary is exposed.
84. If back-testing indicates that the model is not sufficiently accurate, then:
1. the model approval shall be revoked; or
2. the capital requirements in accordance with article 156, para 1, item 1 shall be increased; or
3. other appropriate measures shall be imposed to ensure that the model is improved.

VII. Contractual Netting

85. For the purposes of limiting the counterparty credit risk, the deputy chairperson may recognize the following types of contractual netting:
85.1. bilateral contracts for novation between an investment intermediary and its counterparty under which mutual claims and obligations are automatically amalgamated in such a way that this novation fixes one single net amount each time novation applies and thus creates a legally binding, single new contract extinguishing former contractual claims and obligations;
85.2. contractual cross product netting agreements for investment intermediaries that have received approval by the deputy chairman to use the internal model method. Netting across

transactions entered by members of a group is not recognized for the purposes of calculating capital requirements**;**
85.3. other bilateral agreements between an investment intermediary and its counterparty.
86. For the purpose of the contractual netting agreements, "counterparty" means any entity (including natural persons) that has the power to conclude a contractual netting agreement. "Contractual cross product netting agreement" means a written bilateral agreement between an investment intermediary and a counterparty which creates a single contractual (legal) obligation covering a set of bilateral master agreements and transactions belonging to different product categories. Contractual cross product netting agreements do not cover netting other than on a bilateral basis
87. In the meaning of cross product netting, the following are considered different product categories:
1. repurchase transactions, reverse repurchase transactions, securities and commodities lending and borrowing transactions,
2. margin lending transactions,
3. the contracts listed in Annex No. 10.

88. The deputy chairman may recognize contractual netting as counterparty risk-reducing only under the following conditions:
88.1. an investment intermediary must have a contractual netting agreement with its counterparty which creates a single legal obligation, covering all included transactions, such that, in the event of a counterparty's failure to perform owing to default, bankruptcy, liquidation or any other similar circumstance, only one obligation shall be set which shall be the net sum of the amounts at market values of all included transactions;
88.2. an investment intermediary must have made available to the deputy chairman written and reasoned legal opinions to the effect that, in the event of a legal challenge, the relevant courts and competent administrative authorities would find that the investment intermediary's claims and obligations would be limited to the net sum under item 88.1 in accordance with:
88.2.1. the law of the jurisdiction in which the counterparty is incorporated;
88.2.2. the law that governs the individual transactions included in the contractual netting agreement;
88.2.3. the law that governs any contract or agreement necessary to affect the contractual netting;
88.3. an investment intermediary must have procedures in place to ensure that the legal validity and compatibility of its contractual netting with the applicable laws;
88.4. the investment intermediary maintains all required documentation in its files;

88.5. the effects of netting shall be factored into the investment intermediary's measurement of each counterparty's aggregate credit risk exposure and the investment intermediary manages its counterparty credit risk on such a basis;
88.6. credit risk to each counterparty is aggregated to arrive at a single legal exposure across netted transactions. This aggregation shall be factored into credit limit purposes and internal capital purposes.
89. No contract containing a provision which permits a non-defaulting counterparty to make limited payments only, or no payments at all, to the estate of the defaulter, even if the defaulter is a net creditor (a "walkaway" clause), may be recognized as risk-reducing.
90. The contractual cross-product netting agreements shall meet the following criteria:

90.1. the net sum referred to in item 88.1. shall be the net sum of the positive and negative close out values of any included individual bilateral master agreement and of the positive and

negative mark-to-market value of the individual transactions (the "Cross-Product Net Amount");
90.2. the written and reasoned legal opinions referred to in item 88.2. shall address the validity and enforceability of the entire contractual cross-product netting agreement under its terms and the impact of the netting arrangement on the material provisions of any included individual bilateral master agreement.
90.3. the investment intermediary shall have procedures in place under item 88.3. to verify that any transaction which is to be included in a netting set is covered by a legal opinion;
90.4. the investment intermediary shall continue to comply with the requirements for the recognition of bilateral netting and the requirements of Chapter Twelve, Section III for the recognition of credit risk mitigation with respect to each included individual bilateral master agreement and transaction.
91. In order permission to be issued under item 88, the deputy chairman must be satisfied that the contractual netting is legally valid under the applicable law and, if necessary, consults the other competent supervisory authorities.

Effects of recognition of the contractual netting agreements

92. Netting for the purposes of calculation of the exposure values using the mark-to market method shall be recognized as follows:
92.1. for contracts for novation, the replacement cost under items 12 to 15 shall be calculated on the basis of the contracts included in the netting agreement.
92.2. for other netting agreements, the exposure value is sum of the following:

92.2.1. the aggregate amount of the current replacement cost of the contracts included in the netting agreement. When the aggregate amount represents a liability of the investment intermediary, the current replacement cost is equal to zero.
92.2.2. the potential future credit exposure for all the contracts included in the netting agreement, which the investment intermediary may reduce according to the following formula:

$$PCE_{net} = 0.4 * PCE_{gross} + 0.6 * NGR * PCE_{gross} ,$$

where:

PCE_{net} - the reduced (net) figure for potential future credit exposure for all contracts with a given counterparty included in a legally valid bilateral netting agreement
PCE_{gross} - the sum of the figures for potential future credit exposure for all contracts with a given counterparty which are included in a legally valid bilateral netting agreement and are calculated by multiplying their notional principal amounts by the percentages set out in Table 1 of this Annex;
NGR – the ratio between the net replacement cost for all contracts included in the netting agreement with a given counterparty (numerator) and the gross replacement cost for all contracts included in the netting agreement with that counterparty (denominator);
Perfectly matching contracts included in the netting agreement may be taken into account as a single contract with a notional principal equivalent to the net receipts. Perfectly matching contracts are forward foreign-exchange contracts or similar contracts in which a notional principal is equivalent to cash flows if the cash flows fall due on the same value date and fully or partly in the same currency.
93. When using the original exposure method:

93.1. perfectly matching contracts included in the netting agreement may be taken into account as a single contract with a notional principal equivalent to the net receipts, the notional principal amounts are multiplied by the percentages given in Table 3.
93.2. for all other contracts included in a netting agreement, the percentages applicable may be reduced as indicated in Table 6.

Table 6

Original maturity	Interest-rate contracts	Foreign-exchange contracts
One year or less	0,35%	1,50%
More than one year but not more than two years	0,75%	3,75%
Additional allowance for each additional year	0,75%	2,25%

Note:

1. In the case of interest-rate contracts, investment intermediaries may, subject to the consent of their competent authorities, choose either original or residual maturity.

Annex N 4
to Chapter 12, Section I

Standardized Approach

(Am. and suppl. – SG, iss. 68 in 2008)

1. Risk Weights

1.1 Exposures to central governments or central banks

1.1.1 Without prejudice to points 1.1.2 to 1.1.7 exposures to central governments and central banks shall be assigned a 100% risk weight.

1.1.2. Exposures to points 1.1.3, for which a credit assessment by a nominated ECAI is available shall be assigned a risk weight according to the assignment of the credit assessments in accordance with one of the six steps in a credit quality assessment scale in Table 1.

Table 1

Credit quality step	1	2	3	4	5	6
Risk weight	0%	20%	50%	100%	100%	150%

1.1.3. Exposures to the European Central Bank shall be assigned a 0% risk weight.

1.1.4. Exposures to Member States' central governments and central banks denominated in the domestic currency of that central government and central bank shall be assigned a risk weight of 0%.

1.1.5. When the competent authorities of a third country which apply supervisory and regulatory arrangements at least equivalent to those required under this Ordinance, assign a risk weight which is lower than that indicated in point 1.1.1 and 1.1.2 for exposures to their central government and central bank denominated and funded in the domestic currency, the deputy chairman may allow their investment intermediary to risk weight such exposures in the same manner.

1.1.6. Export Credit Agency credit assessments shall be recognized by the competent authorities if either of the following conditions is met:

(a) it is a consensus risk score from Export Credit Agencies participating in the OECD "Arrangement on Guidelines for Officially Supported Export Credits"; or

(b) the Export Credit Agency publishes its credit assessments, and the Export Credit Agency subscribes to the OECD agreed methodology, and the credit assessment is associated with one of the eight minimum export insurance premiums (MEIP) that the OECD agreed methodology establishes.

1.1.7. Exposures for which a credit assessment by an Export Credit Agency is recognized for risk weighting purposes shall be assigned a risk weight according to Table 2.

Table 2

MEIP	0	1	2	3	4	5	6	7
Risk weight	0%	0%	20%	50%	100%	100%	100%	150%

1.2. Exposures to regional governments or local authorities

1.2.1. Without prejudice to points 1.2.2. to 1.2.4. exposures to regional governments and local authorities shall be risk weighted as exposures to institutions. The preferential treatment for short-term exposures specified in points 1.6.9., 1.6.10. and 1.6.12. shall not be applied.

1.2.2. (Suppl. – SG, iss. 68 in 2008) Exposures to regional governments and local authorities shall be treated as exposures to the central government only if the assessment of credit quality of the local authorities is equivalent to the assessment for the central government and provided that there exist simultaneously revenue-raising powers of the local authorities, and institutional arrangements the effect of which is to reduce their risk of default. The Commission shall draw up and make public a list of the regional governments and local authorities in the state to be risk-weighted like central governments on the proposal of the deputy chairperson.

1.2.3. Exposures to churches and other religious communities constituted in the form of a legal person under their national law, forming revenues from the activities allowed to them by law, shall be treated as exposures to public sector entities.

1.2.4. When competent authorities of a third country jurisdiction which apply supervisory and regulatory arrangements at least equivalent to those under this Ordinance, treat exposures to regional governments and local authorities as exposures to their central government, the deputy chairman may allow an investment intermediary to risk weight exposures to such regional governments and local authorities in the same manner.

1.3. Exposures to administrative bodies and non-commercial undertakings

1.3.1. Without prejudice to points 1.3.2. to 1.3.6. exposures to administrative bodies and non-commercial undertakings shall be assigned a 100% risk weight.

1.3.2. Without prejudice to points 1.3.3. to 1.3.6. exposures to public sector entities shall be assigned a 100% risk weight.

1.3.3. Subject to the discretion of deputy chairman, exposures to public sector entities may be treated as exposures to institutions. The preferential treatment for short-term exposures specified in points 1.6.9., 1.6.10. and 1.6.12. shall not be applied.

1.3.4. In exceptional circumstances, exposures to public-sector entities may be treated as exposures to the central government in whose jurisdiction they are established where in the opinion of the deputy chairman there is no difference in risk between such exposures because of the existence of an appropriate guarantee by the central government.

1.3.5. When the discretion to treat exposures to public-sector entities as exposures to institutions or as exposures to the central government in whose jurisdiction they are established is exercised by the competent authorities of one Member State, the deputy chairman may allow the investment intermediary to risk-weight exposures to such public-sector entities in the same manner.

1.3.6. When competent authorities of a third country jurisdiction, which apply supervisory and regulatory arrangements at least equivalent or more stringent to those applied under this Ordinance, treat exposures to public sector entities as exposures to institutions, the deputy chairman may allow the investment intermediary to risk weight exposures to such public sector entities in the same manner.

1.4. Exposures to multilateral development banks

1.4.1. For the purposes of Chapter Twelve, Section I, the Inter-American Investment Corporation, the Black Sea Trade and Development Bank and the Central American Bank for Economic Integration are considered to be Multilateral Development Banks (MDB).

1.4.2. Without prejudice to points 1.4.3. and 1.4.4., exposures to multilateral development banks shall be treated in the same manner as exposures to institutions in accordance with points 1.6.7. to 1.6.10. The preferential treatment for short-term exposures as specified in points 1.6.9., 1.6.10. and 1.6.12. shall not apply.

1.4.3. Exposures to the following multilateral development banks shall be assigned a 0% risk weight:

(a) the International Bank for Reconstruction and Development;

(b) the International Finance Corporation;

(c) the Inter-American Development Bank;

(d) the Asian Development Bank;

(e) the African Development Bank;

(f) the Council of Europe Development Bank

(g) the Nordic Investment Bank;

(h) the Caribbean Development Bank;

(i) the European Bank for Reconstruction and Development;

(j) the European Investment Bank;

(k) the European Investment Fund; and

(l) the Multilateral Investment Guarantee Agency.

1.4.4. A risk weight of 20% shall be assigned to the portion of unpaid capital subscribed to the European Investment Fund.

1.5. Exposures to international organizations

Exposures to the following international organizations shall be assigned a 0% risk weight:

(a) the European Community;

(b) the International Monetary Fund;

(c) the Bank for International Settlements.

1.6. Exposures to institutions

1.6.1. An investment intermediary in determining the risk weights for exposures to institutions shall apply one of the two methods described in points 1.6.4. to 1.6.5. and 1.6.7. to1.6.10.

1.6.2. Without prejudice to the other provisions of points 1.6.1. to 1.6.14. exposures to financial institutions supervised by the Commission and subject to prudential requirements equivalent to those applied to an investment intermediary shall be risk-weighted as exposures to institutions.

1.6.3. Exposures to an unrated institution shall not be assigned a risk weight lower than that applied to exposures to its central government.

1.6.4. Exposures to institutions shall be assigned a risk weight according to the credit quality step to which exposures to the central government of the jurisdiction in which the institution is incorporated are assigned in accordance with Table 3.

Table 3

Credit quality step to which central government is assigned	1	2	3	4	5	6
Risk weight of exposure	20%	50%	100%	100%	100%	150%

1.6.5. For exposures to institutions incorporated in countries where the central government is unrated, risk weight shall be assigned not more than 100%.
1.6.6. For exposures to institutions with an original effective maturity of three months or less, the risk weight shall be 20%.

1.6.7. Exposures to institutions with an original effective maturity of more than three months for which a credit assessment by a nominated ECAI is available shall be assigned a risk weight according to Table 4.

Table 4

Credit quality step	1	2	3	4	5	6
Risk weight	20%	50%	50%	100%	100%	150%

1.6.8. Exposures to unrated institutions shall be assigned a risk weight of 50%.

1.6.9. Exposures to an institution with an original effective maturity of three months or less for which a credit assessment by a nominated ECAI is available shall be assigned a risk weight according to Table 5.

Table 5

Credit quality step	1	2	3	4	5	6
Risk weight	20%	20%	20%	50%	50%	150%

1.6.10. Exposures to unrated institutions having an original effective maturity of three months or less shall be assigned a 20% risk weight.

1.6.11. If the method specified in points 1.6.7. to 1.6.10. is applied to exposures to institutions, then the interaction with specific short-term assessments shall be as follows.

a) If there is no short-term exposure assessment, the general preferential treatment for short-term exposures as specified in point 1.6.9. shall apply to all exposures to institutions of up to three months residual maturity.

b) If there is a short-term assessment and such an assessment determines the application of a more favourable risk weight than the use of the general preferential treatment for short-term exposures, as specified in point 1.6.9, then the short-term assessment shall be used for that specific exposure only. Other short-term exposures shall follow the general preferential treatment for short-term exposures, as specified in point 1.6.9.

c) If the exposure has a short-term assessment and such an assessment determines a less favourable risk weight than the use of the general preferential treatment for short-term exposures, as specified in point 1.6.9, then all unrated short-term claims shall be assigned the same risk weight as that applied by the specific short-term assessment.

1.6.12. Exposures to institutions of a residual maturity of 3 months or less denominated and funded in the national currency may be assigned a risk weight determined according the methods described in points 1.6.4 to 1.6.5 and 1.6.7 to 1.6.10, but with one category less favourable than the preferential risk weight to exposures to its central government, determined according to points 1.1.4 and 1.1.5.

1.6.13. No exposures of a residual maturity of 3 months or less denominated and funded in the national currency of the borrower shall be assigned a risk weight less than 20%.

1.6.14. Investments in equity or regulatory capital instruments issued by institutions shall be risk weighted at 100%, unless deducted from the own funds.

1.7. Exposures to corporates

1.7.1. Exposures to corporates for which a credit assessment by a nominated ECAI is available shall be assigned a risk weight according to Table 6.

Table 6

Credit quality step	1	2	3	4	5	6
Risk weight	20%	50%	100%	100%	150%	150%

1.7.2. Exposures to corporates for which such a credit assessment is not available shall be assigned a 100% risk weight or the risk weight of its central government, whichever is the higher.

1.8. Retail exposures

1.8.1. Exposures that comply with the criteria listed in Article 107 para 2 shall be assigned a risk weight of 75%.

1.9. Exposures secured by real estate property

1.9.1. Without prejudice to points 1.9.2. to 1.9.15, exposures fully secured by real estate property shall be assigned a risk weight of 100%.

1.9.2. Exposures or any part of an exposure fully and completely secured, to the satisfaction of the competent authorities, by mortgages on residential property which is or shall be occupied or let by the owner, or the beneficial owner, shall be assigned a risk weight of 35%.

1.9.3. Exposures to a tenant under a property leasing transaction concerning residential property under which the investment intermediary is the lessor and the tenant has an option to purchase, shall be assigned a risk weight of 35% provided that the competent authorities are satisfied that the exposures are fully and completely secured by its ownership of the property.

1.9.4. To apply the risk weights under item 1.9.2 and 1.9.3, the following conditions shall be met:

a) the value of the property does not materially depend upon the credit quality of the obligor, including where purely macro-economic factors affect both the value of the property and the performance of the borrower;

b) the risk of the borrower does not materially depend upon the performance of the underlying property or project, but rather on the underlying capacity of the borrower to repay the debt from other sources. As such, repayment of the facility does not materially depend on any cash flow generated by the underlying property serving as collateral;

c) the minimum requirements and the valuation rules for use of real property as collateral set out in Annex 6,

d) the value of the property exceeds the exposures by a substantial margin.

1.9.5. For exposures fully and completely secured by mortgages on residential property which is situated within the Republic of Bulgaria, the requirements of item 1.9.4 letter b shall not apply.

1.9.6 When the discretion contained in point 1.9.5 is exercised by the competent authorities of a Member State in relation to exposures secured by mortgages on residential property situated in the relevant state, the deputy chairman may allow an investment intermediary to assign a risk weight of 35% to such exposures.

1.9.7. Exposures or any part of an exposure fully and completely secured, by mortgages on offices or other commercial premises situated in the Republic of Bulgaria, may be assigned a risk weight of 50%.

1.9.8. Exposures related to property leasing transactions concerning offices or other commercial premises situated in the Republic of Bulgaria under which the investment intermediary is the lessor and the tenant has an option to purchase the propery may be assigned a risk weight of 50% provided that the exposure is fully and completely secured by the title over the property.

1.9.9. The application of points 1.9.7 to 1.9.8 is subject to the following conditions:

a) the value of the property must not materially depend upon the credit quality of the obligor including where purely macro-economic factors affect both the value of the property and the performance of the borrower;

b) the risk of the borrower must not materially depend upon the performance of the underlying property or project, but rather on the underlying capacity of the borrower to repay the debt from other sources. As such, repayment of the facility must not materially depend on any cash flow generated by the underlying property serving as collateral; and

c) the minimum requirements set out in Annex 6 concerning the use of real estate as collateral have been met.

1.9.10. (Am. – SG, iss. 68 in 2008) The 50% risk weight shall be assigned to the part of the loan that does not exceed the limits calculated according to either of the following conditions:

a) 50% of the market value of the mortgaged property in question;

b) 50% of the market value of the mortgaged property or 60% of the initial mortgage lending value, whichever is lower,

1.9.11. A 100% risk weigh shall be assigned to the part of the loan that exceeds the limits set out in point 1.9.10.

1.9.12. The deputy chairman may recognize the 50% risk weight according item 1.9.7 and 1.9.8, allowed by the competent authorities of another Member State for exposures fully and completely secured by mortgages on commercial property, situated on their territory.

1.9.13. For exposures fully and completely secured by mortgages on commercial property which is situated in the Republic of Bulgaria, the requirements under 1.9.9 letter “b” shall not apply if the loss-rates do not exceed the following limits:

a) (Am. – SG, iss. 68 in 2008) losses for the fiscal year, stemming from lending collateralized by commercial real estate property up to 50% of the market value do not exceed 0,3% of the outstanding loans collateralized by commercial real estate property.

b) (Am. – SG, iss. 68 in 2008) overall losses for the fiscal year, stemming from lending collateralized by commercial real estate property must not exceed 0,5% of the outstanding loans collateralized by commercial real estate property.

1.9.14. (Suppl. – SG, iss. 68 in 2008) If either of the two limits referred to in point 1.9.13 is not satisfied in a given fiscal year, the conditions contained in point 1.9.9.(b) shall apply until the conditions in point 1.9.13. are satisfied in a subsequent period.

1.9.15. The deputy chairman may recognize the treatment under item 1.9.13 allowed by the competent authorities in another Member States, for exposures fully and completely secured by mortgages on commercial property situated within their territory.

1.10. Past due items

1.10.1 Without prejudice to the provisions contained in points 1.10.2 to 1.10.5, the unsecured part of any item that is past due for more than 90 days and which reflects a reasonable level of risk shall be assigned a risk weight of:

a) 150%, if value adjustments are less than 20% of the unsecured part of the exposure gross of value adjustments; and

b) 100%, if value adjustments are no less than 20% of the unsecured part of the exposure gross of value adjustments.

1.10.2 For the purpose of defining the secured part of the past due items, eligible collateral and guarantees shall be those eligible for credit risk mitigation purposes.

1.10.3 Nonetheless, where a past due item is fully secured by forms of collateral other then those eligible for credit risk mitigation purposes, a 100% risk weight may be assigned to the same.

1.10.4. Exposures indicated in points 1.9.2. to 1.9.7 shall be assigned a risk weight of 100% net of value adjustments if they are past due for more than 90 days.

1.10.5. Exposures indicated in points 1.9.8 to 1.9.17 shall be assigned a risk weight of 100% if they are past due for more than 90 days.

1.11. Items belonging to regulatory high-risk categories

Exposures associated with particularly high risks such as investments in venture capital firms and private equity investments shall be assigned a risk weight of 150%.

1.12. Exposures in the form of covered bonds

1.12.1. "Covered bonds" shall mean mortgage bonds collateralized by any of the following eligible assets:

a) exposures to or guaranteed by central governments, central banks, public sector entities, regional governments and local authorities in the EU;

b) exposures to or guaranteed by non-EU central governments, non-EU central banks, multilateral development banks, international organizations that qualify for the credit quality step 1 as set out in this Annex, and exposures to or guaranteed by non-EU public sector entities, non-EU regional governments and non-EU local authorities that are risk weighted as exposures to institutions or central governments and central banks according to points 1.2.1., 1.2.2, 1.3.3. or 1.3.4 respectively and that qualify for the credit quality step 1 as set out in this Annex, and exposures that qualify as a minimum for the credit quality step 2 as set out in this Annex, provided that they do not exceed 20% of the nominal amount of outstanding covered bonds of issuing institutions;

c) exposures to institutions that qualify for the credit quality step 1 as set out in this Annex; the total exposure of this kind shall not exceed 15% of the nominal amount of outstanding covered bonds of the issuer; exposures caused by transmission and management of payments of the obligors of, or liquidation proceeds in respect of, loans secured by real estate to the holders of covered bonds shall not be comprised by the 15% limit. Exposures to institutions in the EU with a maturity not exceeding 100 days shall not be comprised by the credit quality step 1 requirement but those institutions must as a minimum qualify for credit quality step 2 as set out in this Annex;

d) loans secured by residential real estate or of equivalent securitisation entities governed by the laws of a Member State are composed of mortgages that are combined with any prior liens up to the lesser of the principal amounts due under the units, the principal amounts of the liens, and 80% of the value of the pledged properties and the units qualify for the credit quality step 1. Exposures caused by transmission and management of payments of the obligors of, or liquidation proceeds in respect of, loans secured by pledged properties, holders of covered bonds shall not be comprised in calculating the 80% limit;

e) loans secured by commercial real estate up to the lesser of the principal amount of the liens that are combined with any prior liens and 60% of the value of the pledged properties; it is admissible the Loan to the mortgage's Fair Value ratio is exceeded up to a maximum level of 70% if the fair value of the total assets pledged as collateral for the covered bonds exceed the nominal amount outstanding on the covered bond by at least 10%, and the bondholders' claim meets the legal certainty requirements set out in Annex 6. The bondholders' claim must take priority over all other claims on the collateral.

f) loans secured by ships where only liens that are combined with any prior liens within 60% of the value of the pledged ship.

For these purposes "collateralized" includes situations where the assets as described in subpoints (a) to (f) are exclusively dedicated in law to the protection of the bond-holders against losses.

1.12.2. In the cases of real estate collateralizing covered bonds, the minimum requirements and assessment rules set out in Annex 6 must be met.

1.12.3. Notwithstanding the treatment under points 1.12.1 and 1.12.2, covered bonds issued before 31 December 2007 are also eligible for the preferential treatment until their maturity.

1.12.4. Covered bonds shall be assigned a risk weight on the basis of the risk weight assigned to senior unsecured exposures to the same issuer in the following way:

a) if the exposures to the institution are assigned a risk weight of 20%, the covered bond shall be assigned a risk weight of 10%;

b) if the exposures to the institution are assigned a risk weight of 50%, the covered bond shall be assigned a risk weight of 20%;

c) if the exposures to the institution are assigned a risk weight of 100%, the covered bond shall be assigned a risk weight of 50%; and

d) if the exposures to the institution are assigned a risk weight of 150%, the covered bond shall be assigned a risk weight of 100%.

1.13. Items representing securitisation positions

Risk weight exposure amounts for such positions shall be determined in accordance with Chapter Twelve, Section IV.

1.14. Short-term exposures to institutions and corporates

1.14.1 Short-term exposures to an institution or corporate for which a credit assessment by a nominated ECAI is available shall be assigned a risk weight in accordance with their assignment to one of the steps in a credit quality assessment scale according to Table 7:

Table 7

Credit Quality Step	1	2	3	4	5	6
Risk weight	20%	50%	100%	150%	150%	150%

1.15. Exposures in the form of collective investment undertakings (CIUs)

1.15.1. Without prejudice to points 1.15.2 to 1.15.8, exposures in collective investment undertakings (CIUs) shall be assigned a risk weight of 100%.

1.15.2. Exposures in the form of CIUs for which a credit assessment by a nominated ECAI is available shall be assigned a risk weight according to Table 8, in accordance with their assigning to one of the steps in a credit quality assessment scale according to Table 8.

Table 8

Credit quality step	1	2	3	4	5	6
Risk weight	20%	50%	100%	100%	150%	150%

1.15.3. Where the deputy chairman considers that a position in a CIU is associated with particularly high risks, that position shall be assigned a risk weight of 150%.

1.15.4. Investment intermediaries may determine the risk weight for a CIU as set out in points 1.15.6 to 1.15.8, if the following eligibility criteria are met:

a) the CIU's management company is subject to supervision in the Republic of Bulgaria or another Member State, or its activity is licensed by the Commission, if:

- the CIU is managed by a company which is subject to supervision that is considered equivalent to that laid down in Community law; and
- the Commission has signed a contract for cooperation with the relevant competent authority;

b) the prospectus or equivalent document includes:

- the categories of assets in which the CIU is authorized to invest; and
- the methodologies to calculate investment limits in case that such are established; and

c) the business of the CIU is reported on at least an annual basis to enable an assessment to be made of the assets and liabilities, income and operations over the reporting period.

1.15.5. If a competent authority of a Member State approves a third country CIU as eligible according item 1.15.4 letter “a”, then the deputy chairman may make use of this recognition without conducting its own assessment.

1.15.6 Where the investment intermediary is aware of the underlying exposures of a CIU, it may look through to those underlying exposures in order to calculate an average risk weight for the CIU in accordance with the methods set out in Chapter Twelve, Section I.

1.15.7. Where the investment intermediary is not aware of the underlying exposures of a CIU, it may calculate an average risk weight for the CIU in accordance with the methods set out in Chapter Twelve, Section I, but it will be assumed that the CIU first invests, to the maximum extent allowed under its mandate, in the exposure classes attracting the highest capital requirement, and then continues making investments in descending order until the maximum total investment limit is reached.

1.15.8. An investment intermediary, subject to approval by the Commission, may rely on a third party to calculate and report, in accordance with the methods set out in points 1.15.6 and 1.15.7. a risk weight for the CIU provided that the correctness of the calculation shall be adequately ensured.

1.16. Other items

1.16.1.Non-current tangible assets shall be assigned a risk weight of 100%.

1.16.2. Prepayments and accrued income for which an investment intermediary cannot specify the relevant counterparty, shall be assigned a risk weight of 100%.

1.16.3. Cash in hand and equivalent cash items shall be assigned a 0% risk weight. Cash items in the process of collection shall be assigned a 20% risk weight.

1.16.4. The deputy chairman may allow a risk weight of 10% for exposures to institutions, subject to supervision and specializing in the inter-bank and public-debt markets and whose asset items are secured by items assigned a 0% or a 20% risk weight constituting adequate collateral.

1.16.5 Holdings of equity and other participations, except where deducted from own funds, shall be assigned a risk weight of at least 100%.

1.16.6 Gold bullion held in own vaults or in depository shall be assigned a 0% risk weight.

1.16.7 In the case of asset sale and repurchase transactions and unconditional forward purchase contracts, the risk weight of the asset of the transaction shall apply.

1.16.8. Where an investment intermediary provides credit protection for a number of exposures under terms that the nth default among the exposures shall trigger payment and that this credit event shall terminate the contract, a risk weight for those exposures shall be calculated as follow:

a) where the product has an external credit assessment from an eligible ECAI, the risk weights prescribed in Chapter Twelve, Section IV shall be assigned.

b) If the product is not rated by an eligible ECAI, the risk weights of the exposures included in the basket will be aggregated, excluding n-1 exposures, up to a maximum of 1 250% and multiplied by the nominal amount of the protection provided by the credit derivative to obtain the risk weighted asset amount. The n-1 exposures to be excluded from the aggregation shall be determined on the basis that they shall include those exposures each of which produces a lower risk-weighted exposure amount than the risk-weighted exposure amount of any of the exposures included in the aggregation.

2. Recognition of ECAIs and mapping of their credit assessments

2.1. Methodology

2.1.1. The Commission shall verify that the methodology for assigning credit assessments is rigorous, systematic, continuous and subject to validation based on historical experience.

2.1.2. The methodology shall be free from external political influences or constraints, and from economic pressures that may influence the credit assessment.

2.1.3. Independence of the ECAI's methodology shall be assessed by Commission according to factors such as the following:

- ownership and organization structure of the ECAI;
- financial resources of the ECAI;
- staffing and expertise of the ECAI; and
- corporate governance of the ECAI.

2.1.4. The Commission shall verify that ECAI's credit assessments are subject to ongoing review and shall be responsive to changes in the financial conditions. Such review shall take place after all significant events and at least annually.

2.1.5. The assessment methodology for each market segment is established according to standards such as the following:

a) the back-testing must be established for at least one year;

b) the regularity of the review process by the ECAI;

c) the Commission must be able to receive from the ECAI the extent of its contacts with the senior management of the entities which it rates.

2.1.6. The Commission shall be informed by ECAIs of any material changes in the methodology they use.

2.1.7 The principles of the methodology employed by the ECAI are publicly available as to allow all potential users to decide whether they are derived in a reasonable way.

2.2. Individual credit assessment

2.2.1. The ECAIs' individual credit assessments shall be recognized in the market as credible and reliable by the users of such credit assessments.

2.2.2. Credibility shall be assessed by Commission according to factors such as the following:

a) market share of the ECAI;

b) revenues and financial resources of the ECAI;

c) whether there is any pricing on the basis of the rating; and

d) at least two investment intermediaries use the ECAI's individual credit assessment for bond issuing and/or assessing credit risks.

2.2.3 The ECAI shall offer accessible and equivalent terms to all investment intermediaries having a legitimate interest in these individual credit assessments.

2.2.4. The ECAI shall offer individual credit assessments to non-domestic parties on equivalent terms as to domestic credit institutions.

2.3. Mapping

2.3.1. (Am. – SG, iss. 68 in 2008) In order to differentiate between the relative degrees of risk expressed by each credit assessment, the Commission shall consider quantitative factors such as the long-term default rate associated with all items assigned the same credit assessment. For recently established ECAIs and for those that have compiled only a short record of default data, the ECAI shall define what it understands to be the long-term default rate associated with all items assigned the same credit assessment.

2.3.2. (Am. – SG, iss. 68 in 2008) In order to differentiate between the relative degrees of risk expressed by each credit assessment, Commission shall consider qualitative factors such as the group of entities to which the ECAI assigns credit assessment, the range of credit assessments that the ECAI assigns, each credit assessment meaning and the ECAI's definition of default.

2.3.3. The Commission shall compare default rates experienced for each credit assessment of a particular ECAI and compare them with a benchmark built on the basis of default rates experienced by other ECAIs, to present an equivalent level of credit risk.

2.3.4. When the Commission believes that the default rates experienced for the credit assessment of a particular ECAI are materially and systematically higher then the benchmark, the Commission shall assign a higher credit quality step in the credit quality assessment scale to the ECAI credit assessment.

2.3.5. When the Commission has increased the associated risk weight or a specific credit assessment of a particular ECAI, if the ECAI demonstrates that the default rates experienced are no longer materially and systematically higher than the benchmark, the Commission may decide to restore the original credit quality step in the credit quality assessment scale for the ECAI credit assessment.

2.4. Use of ECAIs' credit assessments for the determination of risk weights

2.4.1. An investment intermediary may nominate one or more eligible ECAIs to be used for the determination of risk weights to be assigned to asset and off-balance sheet items.

2.4.2. An investment intermediary which decides to use the credit assessments produced by an eligible ECAI for a certain class of items must use those credit assessments consistently for all exposures belonging to that class.

2.4.3. An investment intermediary which decides to use the credit assessments produced by an eligible ECAI must use them in a continuous and consistent way over time.

2.4.4. Only ECAIs credit assessments can be used that take into account all amounts both in principal and in interest owed to it.

2.4.5. If only one credit assessment is available from a nominated ECAI for a rated item, that credit assessment shall be used to determine the risk weight for that item.

2.4.6. If two credit assessments are available from nominated ECAIs and the two correspond to different risk weights for a rated item, the higher risk weight shall be assigned.

2.4.7. If three or more credit assessments are available from nominated ECAIs for a rated item, the two assessments generating the two lowest risk weights shall be referred to. If the two lowest risk weights are different, the higher risk weight shall be assigned and if the two lowest risk weights are the same, that risk weight shall be assigned.

2.4.8. Where a credit assessment exists for a specific issuing program or facility to which the item constituting the exposure belongs, this credit assessment shall be used to determine the risk weight to be assigned to that item.

2.4.9.Where no directly applicable credit assessment exists for a certain item, but a credit assessment exists for a specific issuing program or facility to which the item constituting the exposure does not belong or a general credit assessment exists for the issuer, then that credit assessment shall be used if it produces a higher risk weight than would other wise be the case or if it produces a lower risk weight and the exposure in question ranks pari passu or senior in all respects to the specific issuing program or facility or to senior unsecured exposures of that issuer, as relevant.

2.4.10. Points 2.4.8 and 2.4.9 are not to prevent the application of points 1.12.1 to 1.12.4.

2.4.11.Credit assessments for issuers within a corporate group cannot be used as credit assessment of another issuer within the same corporate group.

2.4.12. Short-term credit assessments may only be used for short-term asset and off-balance sheet items constituting exposures to institutions and corporates.

2.4.13. Any short-term credit assessment shall only apply to the item the short-term credit assessment refers to, and it shall not be used to derive risk weights for any other item.

2.4.14. Notwithstanding the treatment under item 2.4.13, if a short-term rated facility is assigned a 150% risk weight, then all unrated unsecured exposures on that obligor whether short-term or long-term shall also be assigned a 150% risk weight.

2.4.15. Notwithstanding the treatment under item 2.14.13, if a short-term rated facility is assigned a 50% risk-weight, then unrated short-term exposures shall be assigned a risk weight of 100%.

2.4.16. A credit assessment that refers to an item denominated in the obligor's domestic currency cannot be used to derive a risk weight for another exposure on that same obligor that is denominated in a foreign currency.

2.4.17. Notwithstanding point 2.4.16, when an exposure arises through an investment intermediary's participation in a loan that has been extended by a Multilateral Development Bank whose preferred creditor status is recognized in the market, the Commission may allow the credit assessment on the obligors' domestic currency item to be used for risk weighting purposes.

Annex 5

To Chapter 12, Section II

(Am. – SG, iss. 68 in 2008)

Internal Ratings Based Approach

Section 1 – Risk weighted exposure amounts and expected loss amounts

1. Calculation of risk weighted exposure amounts for credit risk

1.1. Risk weighted exposure amounts for exposures to corporates, institutions and central governments and central banks.

1.1.1. The risk weighted exposure amounts for exposures to corporates, institutions and central governments and central banks shall be calculated according to the following formulae:

Correlation (R) = $0.12 \times (1 - EXP(-50 * PD))/(1 - EXP(-50)) + 0.24 * [1 - (1 - EXP(-50 * PD))/(1 - EXP(-50))]$

Maturity factor (b) = $(0.11852 - 0.05478 * \ln(PD))^2$

Risk weight (RW) = $(LGD*N[(1-R)^{-0.5}*G(PD)+(R/(1-R))^{0.5}*G(0.999)]-PD*LGD)*(1-1.5*b)^{1}*(1+(M2.5)*b)*12.5*1.06$

For PD = 0, RW shall be 0.

For PD = 1:

- for defaulted exposures where an investment intermediary applies the LGD values set out in item 2.1.7 of Section II, RW shall be 0;

- for defaulted exposures where credit institutions use own estimates of LGDs, RW shall be Max{0, 12.5 *(LGD-EL_{BE})};

where

EL_{BE} shall be the investment intermediary's best estimate of expected loss for the defaulted exposure according to point 2.4.10 of Section IV.

Risk-weighted exposure amount = RW * exposure value.

1.1.2 The risk weighted exposure amount for each exposure which meets the requirements set out in item 18 and 27 of Annex 6 may be adjusted according to the following formula:

Risk-weighted exposure amount = RW * exposure value * (0,15 + 160*PDpp)]

where:

PDpp = PD of the protection provider.

The risk weight (RW) shall be calculated using the relevant risk weight formula set out in point 1.1.1. for the exposure, the PD of the obligor and the LGD of a comparable direct exposure to the protection provider. The maturity factor (b) shall be calculated using the lower of the PD of the protection provider and the PD of the obligor.

1.1.3 For exposures to corporates where the total annual sales for the consolidated group of which the firm is a part is less than the BGN equivalence of EUR 50 million, an investment intermediary may use the following correlation formula:

$$\text{Correlation (R)} = \begin{array}{l} 0.12 \times \left(1 - EXP\left(-50 * PD\right)\right)/\left(1 - EXP\left(-50\right)\right) + 0.24 * \\ \left[1 - \left(1 - EXP\left(-50 * PD\right)\right)/\left(1 - EXP\left(-50\right)\right)\right] \\ -0.04 * \left(1 - \left(S - 5\right)/45\right) \end{array}$$

where:

S is expressed as total annual sales in millions of Euros (the value of S being between the BGN equivalences of EUR 5 million <= S <= EUR 50 million). Reported sales of less than the BGN equivalence of EUR 5 million shall be treated as if they were equivalent to the BGN equivalence of EUR 5 million. For purchased receivables the total annual sales shall be the weighted average by individual exposures of the pool.

An investment intermediary shall substitute total assets of the consolidated group for total annual sales when total assets are a more meaningful indicator than total annual sales.

1.1.4. For specialized lending exposures in respect of which the PD estimates of an investment intermediary do not meet the minimum requirements set out in Section IV, it shall assign risk weights to these exposures according to Table 1, as follows:

Table 1

Remaining maturity	Category 1	Category 2	Category 3	Category 4	Category 5
Less than 2,5 years	50%	70%	115%	250%	0%
Equal or more than 2,5 years	70%	90%	115%	250%	0%

The deputy chairman may authorize an investment intermediary generally to assign preferential risk weights of 50% to exposures in category 1, and a 70% risk weight to exposures in category 2, provided the investment intermediary's underwriting characteristics and other risk characteristics are substantially strong for the relevant category.

In assigning risk weights to specialized lending exposures, the investment intermediary shall take into account the following factors: financial strength, political and legal environment, transaction and/or asset characteristics, stability of the incomes of the sponsor and developer, including from any public private partnership.

1.1.5 The purchased corporate receivables shall comply with the minimum requirements set out in points 2.7.1 to 2.7.5. of Section IV. For purchased corporate receivables that comply in addition with the conditions set out in point 1.2.5, and where it would be unduly burdensome for an investment intermediary to use the risk quantification standards for corporate exposures as set out in Section IV for these receivables, the risk quantification standards for retail exposures as set out in Section 4 may be used.

1.1.6 Purchased corporate receivables, refundable purchase discounts, collateral or partial guarantees that provide first-loss protection for default losses and/or dilution losses, or both, may be treated as first-loss positions under the IRB securitisation framework.

1.1.7 Where an investment intermediary provides credit protection for a number of exposures under terms that the nth default among the exposures shall trigger payment and that this credit event shall terminate the contract, if the product has an external credit assessment from an eligible ECAI the risk weights set out in Chapter 12, Section IV will be applied. If the product is not rated by an eligible ECAI, the risk weights of the exposures included in the basket will be aggregated, excluding n-1 exposures where the sum of the expected loss amount multiplied by 12,5 and the risk weighted exposure amount shall not exceed the nominal amount of the protection provided by the credit derivative multiplied by 12,5. The n-1 exposures to be excluded from the aggregation shall be determined on the basis that they shall include those exposures each of which produces a lower risk-weighted exposure amount than the risk-weighted exposure amount of any of the exposures included in the aggregation.

1.2. Risk weighted exposure amounts for retail exposures

1.2.1. The risk weighted exposure amounts for retail exposures shall be calculated according the following formulae:

$$\text{Correlation (R)} = \begin{array}{l} 0.03 \times (1 - EXP(-35 * PD))/(1 - EXP(-35)) + 0.16 * \\ [1 - (1 - EXP(-35 * PD))/(1 - EXP(-35))] \end{array}$$

Risk weight (RW) = (LGD*N[(1-R)$^{-0.5}$*G(PD)+(R/(1-R))$^{0.5}$*G(0.999)]-PD*12.5*1.06)

$$\textit{(LGD*}\ \mathrm{N}\left[(1-\mathrm{R})^{-0.5} * \mathrm{G}(\mathrm{PD}) + (\mathrm{R}/(1-\mathrm{R}))^{0.5} * \mathrm{G}(0.999)\right] - \mathrm{PD} * \mathrm{LGD}) * 12.5 * 1.06$$

For PD = 1 (defaulted exposure), RW shall be Max {0, 12.5 *(LGD-EL_{BE})},

where

EL_{BE} shall be the investment intermediary's best estimate of expected loss for the defaulted exposure according to point 2.4.8. of Section IV.

Risk-weighted exposure amount for retail exposures = RW * exposure value.

1.2.2 The risk weighted exposure amount for each exposure to small and medium sized entities as defined in Article 113, para1, item 4 which meets the requirements set out in item 18 and 27 of Annex 6, may be calculated according to point 1.1.2.

1.2.3. For retail exposures secured by real estate collateral a correlation (R) of 0,15 shall replace the figure produced by the correlation formula in point 1.2.1.

1.2.4. For qualifying revolving retail exposures a correlation (R) of 0,04 shall replace the figure produced by the correlation formula in point 1.2.1.

Exposures shall qualify as qualifying revolving retail exposures if they meet the following conditions:

(a) The exposures are to individuals;

(b) The exposures are revolving, unsecured, and to the extent they are not drawn immediately and unconditionally, cancellable by the investment intermediary. In this context revolving exposures are defined as those where customers' outstanding balances are permitted to fluctuate based on their decisions to borrow and repay, up to a limit established by the investment intermediary. Undrawn commitments may be considered as unconditionally cancellable if the terms permit the investment intermediary to cancel them to the full extent allowable;

(c) The maximum exposure to a single individual in the sub-portfolio is the BGN equivalence of EUR 100 000;

(d) The investment intermediary can demonstrate that the use of the correlation of this point is limited to portfolios that have exhibited low volatility of loss rates, relative to their average level of loss rates, especially within the low PD bands. The deputy chairman shall review the relative volatility of loss rates across the qualifying revolving retail sub-portfolios, as well the aggregate qualifying revolving retail portfolio, and may share information on the typical characteristics of qualifying revolving retail loss rates with other competent authorities;

(e) The deputy chairman concurs that treatment as a qualifying revolving retail exposure is consistent with the underlying risk characteristics of the sub-portfolio.

1.2.5. To be eligible for the retail treatment, purchased receivables shall comply with the minimum requirements set out in Section IV, points 2.7.1. to 2.7.5 and the following conditions:

(a) The receivables have been purchased from unrelated to the investment intermediary third party sellers, and do not include any exposures that are directly or indirectly originated by the investment intermediary itself;

(b) The purchased receivables shall be generated on an arm's-length basis between the seller and the obligor. As such, inter-company accounts receivables and receivables subject to contra-accounts between firms that buy and sell to each other are ineligible;

(c) The purchasing investment intermediary has a claim on all proceeds from the purchased receivables or a pro-rata interest in the proceeds; and

(d) The portfolio of purchased receivables is sufficiently diversified.

1.2.6. For purchased receivables, refundable purchase discounts, collateral or partial guarantees that provide first-loss protection for default losses and/or dilution losses, or both, may be treated as first-loss positions under the IRB securitisation framework.

1.2.7. For hybrid pools of purchased retail receivables where purchasing investment intermediary cannot separate exposures secured by real estate collateral and qualifying revolving retail exposures from other retail exposures, the retail risk weight function producing the highest capital requirements for those exposures shall apply.

1.3. Risk weighted exposure amounts for equity exposures

a) An investment intermediary may employ different approaches to different portfolios where the investment intermediary itself uses different approaches internally. Where an investment intermediary uses different approaches, the investment intermediary shall demonstrate to the competent authorities that the choice is made consistently and is not determined by regulatory arbitrage considerations.

b) Notwithstanding point a), the deputy chairman of the Commission may allow the attribution of risk weighted exposure amounts for equity exposures to ancillary services undertakings according to the treatment of other non credit-obligation assets.

1.3.1. Simple risk weight approach

a). The risk weighted exposure amount under the simple risk weight approach shall be calculated by multiplying the exposure value by the following risk weights:

Risk weight (RW) = 190% for private equity exposures in sufficiently diversified portfolios.

Risk weight (RW) = 290% for exchange traded equity exposures.

Risk weight (RW) = 370% for all other equity exposures.

Risk-weighted exposure amount = RW * exposure value.

b) Short cash positions and derivative instruments held in the non-trading book are permitted to offset long positions in the same individual securities provided that these instruments have been explicitly designated as hedges for a period of at least one year. Other short positions are to be treated as if they are long positions with the relevant risk weight assigned to the absolute value of each position. In the context of maturity mismatched positions, the method is that for corporate exposures as set out in point 1.16 of Section II.

c) The investment intermediary may recognize unfunded credit protection obtained on an equity exposure in accordance with the methods set out in Chapter Twelve, Section III.

1.3.2. PD/LGD approach for the risk weight calculation

a) The risk weighted exposure amounts under the PD/LGD approach shall be calculated according to the formulas in point 1.1.1. If the investment intermediary does not have sufficient information to use the definition of default set out in points 2.1.1 to 2.1.5 of Section IV, a scaling factor of 1,5 shall be assigned to the risk weights.

b) At the individual exposure level the sum of the expected loss amount multiplied by 12,5 and the risk weighted exposure amount shall not exceed the exposure value multiplied by 12,5.

c) The investment intermediary may recognize unfunded credit protection obtained on an equity exposure in accordance with the methods set out in Chapter Twelve Section III. This shall be subject to an LGD of 90% on the exposure to the provider of the hedge. For private equity exposures in sufficiently diversified portfolios an LGD of 65% may be used. For these purposes M shall be 5 years.

1.3.3. Internal models approach

a) The risk weighted exposure amount shall be the potential loss on the investment intermediary's equity exposures as derived using internal value-at-risk models subject to the 99th percentile, one-tailed confidence interval of the difference between quarterly returns and an appropriate risk-free rate computed over a long-term sample period, multiplied by 12,5. The risk weighted exposure amounts at the individual exposure level shall not be less than the sum of minimum risk weighted exposure amounts required under the PD/LGD Approach and the corresponding expected loss amounts multiplied by 12,5 and calculated on the basis of the PD values set out in point 3.1 letter "a" of Section II and the corresponding LGD values set out in item 3.2 of Section II.

b) The investment intermediary may recognize unfunded credit protection obtained on an equity position.

1.4. Risk weighted exposure amounts for other non credit-obligation assets

The risk weighted exposure amounts for other non credit-obligation assets shall be calculated by assigning to the exposure value 100% risk weight, except for when the exposure is a residual value in which case the risk weighted exposure amount shall be calculated by assigning to the exposure value 100% risk weight and dividing it by the term of the contract provisioned in years.

2. Calculation of risk weighted exposure amounts for dilution risk of purchased receivables

Risk weights for dilution risk of purchased corporate and retail receivables shall be calculated according to the formula in point 1.1.1. The input parameters PD and LGD shall be determined as set out in Section II, the exposure value shall be determined as set out in Section III and M shall be 1 year. If the investment intermediary can demonstrate to the deputy chairman that dilution risk is immaterial, no capital charge shall be calculated for that type of risk.

3. Calculation of expected loss amounts

3.1.. Unless noted otherwise, the input parameters PD and LGD shall be determined as set out in Section II and the exposure value shall be determined as set out in Section III.

3.2. The expected loss amounts for exposures to corporates, institutions, central governments and central banks and retail exposures shall be calculated according to the following formulae:

Expected loss (EL) = PD × LGD, and

Expected loss amount = EL × exposure value.

For defaulted exposures (PD =1) where the investment intermediary uses own estimates of LGD, EL shall be EL_{BE}, the investment intermediary's best estimate of expected loss for the defaulted exposure according to point 2.4.8 Section IV.

For exposures subject to the treatment set out in point 1.1.2, EL shall be 0.

3.3. The EL values for specialized lending exposures where the investment intermediary uses the methods set out in point 1.1.4 , shall be determined according to Table 2.

Table 2

Remaining maturity	Category 1	Category 2	Category 3	Category 4	Category 5
Less than 2.5 years	0%	0,4%	2,8%	8%	50%
Equal to or more than 2.5 years	0,4%	0,8%	2,8%	8%	50%

Where the deputy chairman of the Commission has authorized an investment intermediary generally to assign preferential risk weights of 50% to exposures in category 1, and 70% to exposures in category 2, the EL value for exposures in category 1 shall be 0%, and for exposures in category 2 shall be 0,4%.

3.4. The expected loss amounts for equity exposures where the risk weighted exposure amounts are calculated according to the methods set out in points 1.3.1 letter "a" – "b', shall be calculated by multiplying the expected loss amount (EL) by the exposure value:

Expected loss amount = EL × exposure value

The EL values shall be the following:

3.4.1. Expected loss (EL) = 0,8% for private equity exposures in sufficiently diversified portfolios

3.4.2. Expected loss (EL) = 0,8% for exchange traded equity exposures

3.4.3.Expected loss (EL) = 2,4% for all other equity exposures.

3.5. The expected loss amounts for equity exposures where the risk weighted exposure amounts are calculated by the investment intermediary according to the methods set out in points 1.3.2. (a) to 1.3.2 (c) shall be calculated according to the following formulae:

Expected loss (EL) = PD × LGD; and

Expected loss amount = EL × exposure value

3.6 The expected loss amounts for equity exposures where the risk weighted exposure amounts are calculated according to the methods set out in item 1.3.3 letter "a" – "b" shall be 0%.

3.7. The expected loss amounts for dilution risk of purchased receivables shall be calculated according to the following formula:

Expected loss (EL) = PD × LGD and

Expected loss amount = EL × exposure value

4. Treatment of expected loss amounts

The expected loss amounts calculated in accordance with points 3.2., 3.3. and 3.7. shall be subtracted from the sum of value adjustments and provisions related to these exposures. Discounts on balance sheet exposures purchased when in default according to Section III, point 1.1 shall be treated in the same manner as value adjustments. Expected loss amounts for securitised exposures and value adjustments and provisions related to these exposures shall not be included in this calculation.

Section 2 – PD, LGD and Maturity

1. Exposures to corporates, institutions and central governments and central banks

1.1. The PD of an exposure to a corporate or an institution shall be at least 0,03%.

1.2. For purchased corporate receivables in respect of which an investment intermediary cannot demonstrate that its PD estimates meet the minimum requirements set out in Section IV, the PDs for these exposures shall be determined according to the following methods:

1.2.1 for senior claims on purchased corporate receivables PD shall be the investment intermediary estimate of EL divided by LGD for these receivables.

1.2.2. For subordinated claims on purchased corporate receivables PD shall be the investment intermediary's estimate of EL.

1.2.3. If an investment intermediary uses own LGD estimates for corporate exposures and it can decompose its EL estimates for purchased corporate receivables into PDs and LGDs in a reliable manner, the PD estimate may be used

1.3. The PD of obligors in default shall be 100%.

1.4. The investment intermediary may recognize unfunded credit protection in the PD in accordance with the provisions of Chapter Twelve, Section III. For dilution risk, however, the deputy chairman of the Commission may recognize as eligible unfunded credit protection providers other than those indicated in Annex 6.

1.5. An investment intermediary using own LGD estimates may recognize unfunded credit protection by adjusting PDs subject to point 1.10.

1.6. For dilution risk of purchased corporate receivables, PD shall be set equal to EL estimate for dilution risk. If an investment intermediary uses own LGD estimates for corporate exposures and it can decompose its EL estimates for dilution risk of purchased corporate receivables into PDs and LGDs in a reliable manner, the PD estimate may be used. The investment intermediary may recognize unfunded credit protection in the PD in accordance with the provisions of Chapter Twelve, Section III. The deputy Chairman of the Commission may recognize as eligible unfunded credit protection providers other than those indicated in Annex 6. An investment intermediary using own LGD estimates may recognize unfunded credit protection by adjusting PDs subject of point 1.10.

1.7. The investment intermediary shall use the following LGD values:

1.7.1. Senior exposures without eligible collateral: 45%;

1.7.2. Subordinated exposures without eligible collateral: 75%;

1.7.3. The investment intermediary may recognize funded and unfunded credit protection in calculating the LGD in accordance with Chapter Twelve, Section III;

1.7.4. Covered bonds may be assigned an LGD under Annex 4 – 12,5%;

1.7.5. For senior purchased corporate receivables exposures where an investment intermediary cannot demonstrate that its PD estimates meet the minimum requirements set out in Section IV - 45%;

1.7.6. For subordinated purchased corporate receivables exposures where an investment intermediary cannot demonstrate that its PD estimates meet the minimum requirements set out in Section IV: 100%;

1.7.7. For dilution risk of purchased corporate receivables: 75%.

1.8. Until 31 December 2010, covered bonds as defined in points 1.12.1 to 1.12.3 of Annex No. 4, shall be assigned an LGD value of 11,25% if:

1.8.1 assets as set out in Annex 4, point 1.12.1(a) to (c) collateralizing the bonds all qualify for credit quality step 1 as set out in that Annex;

1.8.2. assets set out in Annex 4, point 1.12.1(d) and (e) are used as collateral, and with which the LGD shall be with a limit up to 10% of the nominal value of the bond issue;

1.8.3. assets as set out in item 1.12.1 letter “f” of Annex 4 are not used as collateral; or

1.8.4. the covered bonds are the subject of a credit assessment by a recognized ECAI, and the ECAI places them in the most favourable category of credit assessment.

1.9. Notwithstanding the treatment under point 1.7 and 1.8, for dilution and default risk if an investment intermediary uses own LGD estimates for corporate exposures and it can decompose its EL estimates for purchased corporate receivables into PDs and LGDs, the LGD estimate for purchased corporate receivables may be used.

1.10. Notwithstanding the treatment under point 1.7 and 1.8, if an investment intermediary uses own LGD estimates for exposures to corporates, institutions, central governments and central banks, unfunded credit protection may be recognized by adjusting PD and/or LGD subject to minimum requirements as specified in Section IV and approval of the deputy chairman of the Commission. An investment intermediary shall not assign guaranteed exposures an adjusted PD or LGD such that the adjusted risk weight would be lower than that of a comparable, direct exposure to the guarantor.

1.11. Notwithstanding the treatment under points 1.7., 1.8 and 1.10, for the purposes of Section 1, point 1.1.4, the LGD of a comparable direct exposure to the protection provider shall either be the LGD associated with an unhedged facility to the guarantor or the unhedged facility of the obligor, depending upon whether in the event both the guarantor and obligor default during the life of the hedged transaction, available evidence and the structure of the guarantee indicate that the amount recovered would depend on the financial condition of the guarantor or obligor, respectively.

1.12. Subject to point 1.13, an investment intermediary shall assign to exposures arising from repurchase transactions or securities or commodities lending or borrowing transactions a maturity value (M) of 0,5 years and to all other exposures - 2,5 years. The deputy chairman of the Commission may require all investment intermediaries in their jurisdiction to use M for each exposure as set out under point 1.13.

1.13. The investment intermediary which uses own LGDs and/or own conversion factors for exposures to corporates, institutions or central governments and central banks shall calculate M for each of these exposures as set out in 1.14 to 1.16, M being no greater than 5 years and complying with the following conditions:

(a) For an instrument subject to a cash flow schedule, M shall be calculated according to the following formula:

$$M = MAX\{1; MIN\{\sum_t t * CF_t / \sum_t CF_t \quad ; 5\}\}$$

where CF_t denotes the cash flows (principal, interest payments and fees) contractually payable by the obligor in period t;

(b) For derivatives subject to a master netting agreement, M shall be the weighted average remaining maturity of the exposure, where M shall be at least 1 year. The notional amount of each exposure shall be used for weighting the maturity;

(c) For exposures arising from fully or nearly-fully collateralized derivative instruments transactions according Annex No. 10, and fully or nearly-fully collateralized margin lending transactions which are subject to a master netting agreement, M shall be the weighted average remaining maturity of the transactions where M shall be at least 10 days

(d) If an investment intermediary uses own PD estimates for purchased corporate receivables, for drawn amounts M shall equal the purchased receivables exposure weighted average maturity, where M shall be at least 90 days. This same value of M shall also be used for undrawn amounts under a committed purchase facility provided the facility contains effective covenants, early amortisation triggers, or other features that protect the investment intermediary against a significant deterioration in the quality of the future receivables it is required to purchase over a set term. Absent such effective protections, M for undrawn amounts shall be calculated as the sum of the longest-dated potential receivable under the purchase agreement and the remaining maturity of the purchase facility, where M shall be at least 90 days;

(e) For any other instrument than those mentioned in this point or when an investment intermediary is not in a position to calculate M as set out in (a), M shall be the maximum remaining time (in years) that the obligor is permitted to take to fully discharge its contractual obligations, where M shall be at least 1 year ;

(f) An investment intermediary using the Internal Model Method set out in Annex 3 for exposures to which it apply this method and for which the maturity of the longest-dated contract contained in the netting set is greater than one year, shall calculate M according to the following formula:

$$M = MIN\left(\frac{\sum_{k=1}^{tk \le 1 year} EffectiveEE_k * \Delta t_k * df_k + \sum_{tk > 1 year}^{maturity} EE_k * \Delta t_k * df_k}{\sum_{k=1}^{tk \le 1 year} EffectiveEE_k * \Delta t_k * df_k} ;5 \right)$$

where: dfk = the risk-free discount factor for future time period t_k and the remaining symbols are defined according the internal models method in Annex 3.

An investment intermediary that uses an internal model to calculate a one-sided credit valuation adjustment (CVA) may use, subject to the approval of the deputy chairman, the effective credit duration estimated by the internal model.

For all contracts that have an original maturity of less than one year the formula in point (a) shall apply;

(g) for the purposes of Section 1, point 1.1.2, M shall be the effective maturity of the credit protection but at least 1 year.

1.14. Notwithstanding the treatment under point 1.13 letters (a), (b), (d) and (e), M shall be at least one-day for:

1.14.1 fully or nearly-fully collateralized derivative instruments listed in Annex No. 10;

1.14.2. fully or nearly-fully collateralized margin lending transactions;

1.14.3. repurchase transactions, securities or commodities lending or borrowing transactions

provided the documentation requires daily re-margining and daily revaluation and includes provisions that allow for the prompt liquidation or setoff of collateral in the event of default or failure to re-margin.

For other short-term exposures which are not part of the credit institution's ongoing financing of the obligor, M shall be at least one-day.

1.15. The deputy chairman of the Commission may allow for exposures to corporates with registered office in the Republic of Bulgaria or other Member States and having consolidated sales and consolidated assets of less than the BGN equivalence of EUR 500 million, to calculate M as set out in point 1.12. The deputy chairman of the Commission at his/her discretion, may increase the amount of the total assets to the BGN equivalence of EUR 1000 million total assets for corporates which primarily invest in real estate.

1.16. Maturity mismatches shall be treated as specified in Chapter Twelve, Section III.

2. Retail exposures

2.1. The PD of a retail exposure shall be at least 0,03%.

2.2. The PD of obligors in case of an exposure in default shall be 100%.

2.3. For dilution risk of purchased receivables PD shall be set equal to EL estimates for dilution risk. If an investment intermediary can decompose its EL estimates for dilution risk of purchased receivables into PDs and LGDs in a reliable manner, the PD estimate may be used.

2.4. Unfunded credit protection may be recognized as eligible by adjusting PDs subject to point 2.6. For dilution risk, where an investment intermediary does not use own estimates of LGDs, this shall be subject to compliance with Chapter Twelve, Section III; the deputy chairman of the Commission may recognize as eligible unfunded protection providers other than those indicated in Annex 6.

2.5. An investment intermediary shall provide own estimates of LGDs subject to minimum requirements as specified in Section IV and approval of the deputy chairman. For dilution risk of purchased receivables, an LGD value of 75% shall be used. If an investment intermediary can decompose its EL estimates for dilution risk of purchased receivables into PDs and LGDs it shall use the LGD estimate.

2.6. Unfunded credit protection may be recognized as eligible by adjusting PD or LGD estimates subject to minimum requirements as specified in points 2.6.4 to 2.6.9 Section IV and approval of the deputy chairman of the Commission. An investment intermediary shall not assign guaranteed exposures an adjusted PD or LGD such that the adjusted risk weight would be lower than that of a comparable, direct exposure to the guarantor.

2.7. Notwithstanding the treatment under point 2.6., for the purposes of Section 1, point 1.2.2 the LGD of a comparable direct exposure to the protection provider shall either be the LGD associated with an unhedged facility to the guarantor or the unhedged facility of the obligor, depending upon whether, in the event both the guarantor and obligor default during the life of the hedged transaction, available evidence and the structure of the guarantee indicate that the amount recovered would depend on the financial condition of the guarantor or obligor, respectively.

3. Equity exposures subject to PD/LGD method

3.1. PDs shall be determined according to the methods for corporate exposures. For equity exposures shall apply the following minimum PDs:

3.1.1. 0,09% for exchange traded equity exposures where the investment is part of a long-term customer relationship;

3.1.2. 0,09% for non-exchange traded equity exposures where the returns on the investment are based on regular and periodic cash flows not derived from capital gains;

3.1.3. 0,40% for exchange traded equity exposures including other short positions as set out in Section I, point 1.3.1 (b); and

3.1.4 1,25% for all other equity exposures including other short positions as set out in Section I, point 1.3.1. (b).

3.2. Private equity exposures in sufficiently diversified portfolios may be assigned an LGD of 65%.

3.3. All other exposures shall be assigned an LGD of 90%.

3.4. M assigned to all exposures shall be 5 years.

Section 3 – Exposure value

1. Exposures to corporates, institutions, central governments and central banks and retail exposures.

1.1. Unless provided otherwise, the exposure value of on-balance sheet exposures shall be measured gross of value adjustments. Sentence one shall also apply to assets purchased at a price different than the amount owed. For purchased assets, the difference between the amount owed and the net value recorded on the balance-sheet of the investment intermediary is denoted discount if the amount owed is larger, and premium if it is smaller.

1.2. Where an investment intermediary use Master netting agreements in relation to repurchase transactions or securities or commodities lending or borrowing transactions, the exposure value shall be calculated in accordance with Chapter Twelve, Section III.

1.3. For on-balance sheet netting of loans and deposits, an investment intermediary shall apply for the calculation of the exposure value the methods set out Chapter Twelve, Section III.

1.4. The exposure value for leases shall be the discounted minimum lease payments.

"Minimum lease payments" are the payments over the lease term that the lessee is or can be required to make and any bargain option (i.e. option the exercise of which is reasonably certain). Any guaranteed residual value fulfilling the set of conditions in item 19 of Annex 6, regarding the eligibility of protection providers as well as the minimum requirements for recognizing other types of guarantees provided in item 22-24 in Annex 6 should also be included in the minimum lease payments.

1.5. In the case of the instruments under Annex No. 10, the exposure value shall be determined by the methods set out in Annex 3.

1.6. The exposure value for the calculation of risk weighted exposure amounts of purchased receivables shall be the outstanding amount minus the capital requirements for dilution risk prior to credit risk mitigation.

1.7. Where an exposure takes the form of securities or commodities sold, posted or lent under repurchase transactions or securities or commodities lending or borrowing transactions, long settlement transactions and margin lending transactions, the exposure value shall be calculated in accordance of the requirements for valuation of the assets and the off-balance positions in accordance with the applicable accounting standards. Where the Financial Collateral Comprehensive Method as set out under Annex 6 is used, the exposure value shall be increased by the volatility adjustment appropriate to such securities or commodities, as set out therein. The exposure value of repurchase transactions, securities or commodities lending or borrowing transactions, long settlement transactions and margin lending transactions may be determined either in accordance with Annex 3 or the Internal Model under Annex 6.

1.8. (Am. – SG, iss. 68 in 2008) Notwithstanding the treatment under point 1.7., the risk-weighted exposure value of credit risk exposures outstanding, with a central counterparty shall be determined in accordance with item 8 of Annex 3 provided that the central counterparty's credit risk exposures with all participants in its arrangements are fully collateralized on a daily basis.

1.9. The exposure value for the following items shall be calculated as the committed but undrawn amount multiplied by a conversion factor, as follows:

1.9.1 for credit lines which are uncommitted, that are unconditionally cancellable at any time by the investment intermediary without prior notice, or that effectively provide for automatic cancellation due to deterioration in a borrower's credit worthiness, a conversion factor of 0% shall apply. To apply a conversion factor of 0%, investment intermediary shall actively monitor the financial condition of the obligor, and their internal control systems shall enable them to immediately detect deterioration in the credit quality of the obligor. Undrawn retail credit lines may be considered as unconditionally cancellable if the contractual terms permit the investment intermediary to cancel them to the full extent allowable under consumer protection and related legislation;

1.9.2. for short-term letters of credit arising from the movement of goods, a conversion factor of 20% shall apply for both the issuing or confirming investment intermediary;

1.9.3. for undrawn purchase commitments for revolving purchased receivables that are unconditionally cancellable or that effectively provide for automatic cancellation at any time by the investment intermediary without prior notice, a conversion factor of 0% shall apply. The investment intermediary shall actively monitor the financial condition of the obligor, and their internal control systems shall enable them to immediately detect deterioration in the credit quality of the obligor;

1.9.4. for other credit lines, of the type of revolving underwriting facilities (RUFs) to one or several investment intermediaries, a conversion factor of 75% shall apply; and

1.9.5. the investment intermediary which meets the minimum requirements for the use of own estimates of conversion factors may use their own estimates of conversion factors across different product types as mentioned in points 1.9.1 to 1.9.4, subject to approval of the deputy chairperson of the Commission.

1.10. Where a commitment refers to the extension of another commitment, the investment intermediary must use the lower of the two conversion factors associated with the individual commitments.

1.11. For all off-balance sheet items other than those mentioned in points 1.1. to 1.9, the exposure value shall be the following percentage of its value:

1.11.1 100% if it is a full risk item,

1.11.2 50% if it is a medium-risk item,

1.11.3 20% if it is a medium/low-risk item, and

1.11.4 0% if it is a low-risk item.

The off-balance sheet items shall be assigned to risk categories as indicated in Annex 2.

2. Equity exposures

The exposure value shall be the value presented in the financial statements. Admissible equity exposure measures are the following:

2.1 (Am. – SG, iss. 68 in 2008) For investments held at fair value, with changes in value being accounted for directly through income and into own funds on the balance sheet, the exposure value is the fair value presented in the balance sheet;

2.2 For investments held at fair value with changes in value not flowing through income but into a tax-adjusted separate component of equity, the exposure value is the fair value presented in the balance sheet; and

2.3. For investments held at cost or at the lower of cost or market, the exposure value is the cost or market value presented in the balance sheet.

3. Other non credit-obligation assets

The exposure value of other non credit-obligation assets shall be the value presented in the financial statements.

Section 4 – Minimum Requirements for IRB Approach

1. Rating systems

General provisions

(a) A "rating system" shall comprise all of the methods, processes, controls, data collection and IT systems that support the assessment of credit risk, the assignment of exposures to grades or pools (rating), and the quantification of default and loss estimates for a certain type of exposure.

(b) If an investment intermediary uses multiple rating systems, the rationale for assigning an obligor or a transaction to a rating system shall be documented and applied in a manner that appropriately reflects the level of risk.

(c) Assignment criteria and processes for assigning an obligor or a transaction to a rating system shall be periodically reviewed to determine whether they remain appropriate for the current portfolio and external conditions.

1.1. Structure of rating systems

Where an investment intermediary uses direct estimates of risk parameters these may be seen as the outputs of grades on a continuous rating scale.

1.1.1. Exposures to corporates, institutions and central governments and central banks

(a) A rating system shall take into account obligor and transaction risk characteristics.

(b) A rating system shall have an obligor rating scale which reflects exclusively quantification of the risk of obligor default. The obligor rating scale shall have a minimum of 7 grades for non-defaulted obligors and one for defaulted obligors.

(c) An "obligor grade" shall mean a risk category within a rating system's obligor rating scale, to which obligors are assigned on the basis of a specified and distinct set of rating criteria, from which estimates of PD are derived. An investment intermediary shall document the relationship between obligor grades in terms of the level of default risk each grade implies and the criteria used to distinguish that level of default risk.

(d) An investment intermediary with portfolios concentrated in a particular market segment and range of default risk shall have enough obligor grades within that range to avoid undue concentrations of obligors in a particular grade. Significant concentrations within a single grade shall be supported by convincing empirical evidence that the obligor grade covers a reasonably narrow PD band and that the default risk posed by all obligors in the grade falls within that band.

(e) To qualify for recognition by the deputy chairman of the use for capital requirement calculation of own estimates of LGDs, a rating system shall incorporate a distinct facility rating scale which exclusively reflects LGD related transaction characteristics.

(f) A "facility grade" shall mean a risk category within a rating system's facility scale, to which exposures are assigned on the basis of a specified and distinct set of rating criteria from which own estimates of LGDs are derived. The grade definition shall include both a description of how exposures are assigned to the grade and of the criteria used to distinguish the level of risk across grades.

(g) Significant concentrations within a single facility grade shall be supported by convincing empirical evidence that the facility grade covers a reasonably narrow LGD band, respectively, and that the risk posed by all exposures in the grade falls within that band.

(h) An investment intermediary using the methods set out in Section 1, point 1.1.4 for assigning risk weights for specialized lending exposures are exempt from the requirement to have an obligor rating scale which reflects exclusively quantification of the risk of obligor default for these exposures. For these exposures the investment intermediary must have at least 4 grades for non-defaulted obligors and at least one grade for defaulted obligors.

1.1.2. Retail exposures

(a) Rating systems for retail exposures shall reflect both obligor and transaction risk, and shall capture all relevant obligor and transaction characteristics.

(b) The level of risk differentiation shall ensure that the number of exposures in a given grade or pool is sufficient to allow for meaningful quantification and validation of the loss characteristics at the grade or pool level. The distribution of exposures and obligors across grades or pools shall be such as to avoid excessive concentrations.

(c) The process of assigning exposures to grades or pools provides for a meaningful differentiation of risk, provides for a grouping of sufficiently homogenous exposures, and allows for accurate and consistent estimation of loss characteristics at grade or pool level. For purchased receivables the grouping shall reflect the seller's underwriting practices and the heterogeneity of its customers.

(d) An investment intermediary shall consider the following risk drivers when assigning exposures to grades or pools.

- Obligor risk characteristics;
- Transaction risk characteristics, including product and/or collateral types and cases shall be explicitly addressed where several exposures benefit from the same collateral;
- Delinquency, unless the investment intermediary demonstrates to the deputy chairman that delinquency is not a material risk drivers for the exposure;

1.2. Assignment to grades or pools.

1.2.1. An investment intermediary shall have specific definitions, processes and criteria for assigning exposures to grades or pools within a rating system as follow:

(a) The grade or pool definitions and criteria shall be sufficiently detailed to allow those charged with assigning ratings to consistently assign obligors or facilities posing similar risk to the same grade or pool. This consistency shall exist across lines of business, departments and geographic locations;

(b) The documentation of the rating process shall allow third parties to understand the assignments of exposures to grades or pools, as well as to evaluate the appropriateness of the assignments to a grade or a pool;

(c) The criteria shall also be consistent with the investment intermediary’s internal lending standards and its policies for handling troubled obligors or transactions of the investment intermediary.

1.2.2. An investment intermediary shall take all relevant information into account in assigning obligors and transactions to risk grades or pools. Information shall be current and shall enable the investment intermediary to forecast the future performance of the exposure. The less information an investment intermediary has, the more conservative shall be its assignments of exposures to obligor and transaction grades or pools. If an investment intermediary uses an external rating as a primary factor determining an internal rating assignment, the credit institution shall ensure that it considers other relevant information.

1.3. Assignment of exposures

1.3.1. Exposures to corporates, institutions and central governments and central banks

(a) Each obligor shall be assigned to an obligor grade as part of the credit approval process.

(b) For those investment intermediaries permitted to use own estimates of LGDs and/or conversion factors, each exposure shall also be assigned to a transaction grade as part of the credit approval process.

(c) An investment intermediary using the methods set out in Section I, point 1.1.4 for assigning risk weights for specialized lending exposures shall assign each of these exposures to a grade in accordance with point 1.1.1. (h).

(d) (Am. – SG, iss. 28 in 2009) Each separate legal entity to which the investment intermediary is exposed shall be separately rated. An investment intermediary shall demonstrate to the deputy chairman that it applies adequate policy regarding the treatment of individual persons and groups of connected persons.

(e) Separate exposures to the same obligor shall be assigned to the same obligor grade, irrespective of any differences in the nature of each specific transaction. Exceptions, where separate exposures are allowed to result in multiple grades for the same obligor are:

- country transfer risk, this being dependent on whether the exposures are denominated in local or foreign currency;
- where the treatment of associated guarantees to an exposure may be reflected in an adjusted assignment to an obligor grade;
- where consumer protection, bank secrecy or other legislation prohibit the exchange of client data.

1.3.2. Retail exposures

Each exposure shall be assigned to a grade or a pool as part of the credit approval process.

1.3.3. For grade and pool assignments an investment intermediary shall document the exceptions where expert judgment may override the inputs or outputs of the assignment process and the personnel responsible for approving these overrides. An investment intermediary shall analyze the performance of the exposures whose assignments have been overridden and shall document the actions of the relevant responsible person.

1.4. Integrity of assignment process

1.4.1. Exposures to corporates, institutions and central governments and central banks

a) Assignments and periodic reviews of assignments shall be completed or approved by an independent party that does not directly benefit from decisions to extend the credit.

b) An investment intermediary shall update at least annually the risk category or the rating group of obligors or the facility. The high-risk obligors and problem exposures shall be subject to more frequent review. An investment intermediary shall undertake a new assignment if material information on the obligor or exposure becomes available.

c) An investment intermediary shall have an effective process to obtain and update relevant information on obligor characteristics that affect PDs, and on transaction characteristics that affect LGDs and/or conversion factors.

d) An investment intermediary shall at least annually update obligor and facility assignments or review the loss characteristics and delinquency status of each identified risk pool, whichever applicable. An investment intermediary shall also at least annually review in a representative sample of the status of individual exposures within each pool as a means of ensuring that exposures continue to be assigned to the correct pool.

1.5. Use of models

1.5.1. If an investment intermediary uses statistical models and other mechanical methods to assign exposures to obligors or facilities grades or pools, then:

(a) the investment intermediary shall demonstrate to the deputy chairman that the model has good predictive power and that capital requirements are not distorted as a result of its use. The input variables shall form a reasonable and effective basis for the resulting predictions;

(b) the investment intermediary shall have in place a process for vetting data inputs into the model, which includes an assessment of the accuracy, completeness and appropriateness of the data;

(c) the investment intermediary shall demonstrate that the data used to build the model is representative of the population of the investment intermediary's actual obligors or exposures;

(d) the investment intermediary shall have a regular cycle of model validation that includes monitoring of model performance and stability; review of model specification; and testing of model outputs against outcomes;

(e) the investment intermediary shall complement the statistical model by expert judgment and human oversight to review model-based assignments and to ensure that the models are used appropriately. Review procedures shall aim at finding and limiting errors associated with model weaknesses. Expert judgments shall take into account all relevant information not considered by the model. The investment intermediary shall document how human judgment and model results are to be combined.

1.6. Documentation of rating systems

1.6.1 An investment intermediary shall document the design and operational details of its rating systems. The documentation shall evidence compliance with the minimum requirements in this part, and address topics including portfolio differentiation, rating criteria, responsibilities of parties that rate obligors and exposures, frequency of assignment reviews, and management oversight of the rating process.

1.6.2. The investment intermediary shall document the rationale for and analysis supporting its choice of rating criteria as well as all major changes in the risk rating process, indicating the changes made to the risk rating process. The organization of rating assignment including the rating assignment process and the internal control structure shall also be documented.

1.6.3. The investment intermediary shall document the specific definitions of default and loss used internally and demonstrate consistency with the definitions set out in this Ordinance.

1.6.4. If the investment intermediary employs statistical models in the rating process, it shall document their methodologies. The documentation shall:

(a) provide a detailed outline of the theory, assumptions and/or mathematical and empirical basis of the assignment of estimates to grades, individual obligors, exposures, or pools, and the data source(s) used to estimate the model;

(b) establish a rigorous statistical process (including out-of-time and out-of-sample performance tests) for validating the model; and

(c) indicate any circumstances under which the model does not work effectively.

1.6.5. Use of a model obtained from a third-party vendor that claims proprietary technology, the investment intermediary shall guarantee that it satisfies all conditions.

1.7. Data maintenance

An investment intermediary shall collect and store data on the internal ratings as required under Art. 147 and 148, Art. 152, para 1 and Art. 153 para 1-3.

1.7.1. Exposures to corporates, institutions and central governments and central banks

(a) An investment intermediary shall collect and store the following information:

- complete rating histories on obligors and recognized guarantors;
- the dates the ratings were assigned;
- the key data and methodology used to derive the rating;
- the person responsible for the rating assignment;
- the identity of obligors and exposures that defaulted;
- the date and circumstances of such defaults;
- data on the PDs and realized default rates associated with rating grades and ratings migration;

An investment intermediary not using own estimates of LGDs and/or conversion factors shall collect and store data on comparisons of realized LGDs to the values as set out in Section II, point 2.1.7 and realized conversion factors to the values as set out in Section III, point 1.9.

(b) An investment intermediary using own estimates of LGDs and/or conversion factors shall collect and store the following information:

- complete histories of data on the facility ratings and LGD and conversion factor estimates associated with each rating scale;
- the dates the ratings were assigned and the estimates were done;
- the key data and methodology used to derive the facility ratings and LGD and conversion factor estimates;
- the person who assigned the facility rating and the person who provided LGD and conversion factor estimates;
- data on the estimated and realized LGDs and conversion factors associated with each defaulted exposure;
- data on the LGD of the exposure before and after evaluation of the effects of a guarantee/ or credit derivative, for those credit investment intermediaries that reflect the credit risk mitigating effects of guarantees or credit derivatives through LGD; and
- data on the components of loss for each defaulted exposure.

1.7.2. In case of retail exposures, an investment intermediary shall collect and store the following information:

- data used in the process of allocating exposures to grades or pools;

- data on the estimated PDs, LGDs and conversion factors associated with grades or pools of exposures;
- the identity of obligors and exposures that defaulted;
- for defaulted exposures, data on the grades or pools to which the exposure was assigned over the year prior to default and the realized outcomes on LGD and conversion factor; and
- data on loss rates for qualifying revolving retail exposures.

1.8. Stress tests used in assessment of capital adequacy

1.8.1. An investment intermediary shall have in place sound stress testing processes for use in the assessment of its capital adequacy. Stress testing shall involve identifying possible events or future changes in economic conditions that could have unfavourable effects on an investment intermediary's credit exposures and assessment of the investment intermediary's ability to withstand such changes.

1.8.2. An investment intermediary shall regularly perform a credit risk stress test to assess the effect of certain specific conditions on its total capital requirements for credit risk. The test shall be one chosen by the investment intermediary, subject to supervisory review by the deputy chairman. The tests to be employed shall be meaningful and reasonably conservative, considering at least the effect of mild recession scenarios. An investment intermediary shall account for and assess potential migration of the exposures in its ratings under the stress test scenarios. Stressed portfolios shall contain the vast majority of an investment intermediary's total exposure.

1.8.3. An investment intermediary using the treatment set out in Section I, point 1.1.4 shall consider as part of their stress testing framework the impact of a deterioration in the credit quality of protection providers, in particular the impact of protection providers falling outside the eligibility criteria.

2. Risk quantification

2.1. Definition of default

2.1.1. A "default" shall be considered to have occurred with regard to a particular obligor when either or both of the two following events have taken place:

(a) the investment intermediary considers that the obligor is unlikely to pay its credit obligations to the investment intermediary, the parent undertaking or any of its subsidiaries in full, without recourse by the investment intermediary to actions such as realizing security (if held);

(b) the obligor is past due more than 90 days on any material credit obligation to the investment intermediary, the parent undertaking or any of its subsidiaries.

For overdrafts, days past due commence once an obligor has breached an advised limit, has been advised a limit smaller than current outstandings, or has drawn credit without authorization by the investment intermediary and the underlying amount is material.

An "advised limit" shall mean a limit which has been brought to the knowledge of the obligor.

- In the case of retail exposures and exposures to public sector entities (PSE) the deputy chairman shall set a number of days past due as specified in point 2.1.5;
- In the case of corporate exposures the deputy chairman may set a number of days past due;
- In the case of retail exposures investment intermediaries may apply the definition of default at a facility level;
- In all cases, the exposure past due shall be above a threshold defined by the deputy chairman and which reflects a reasonable level of risk.

2.1.2. Elements to be taken as indications of unlikeliness to pay shall include the following events:

a) The investment intermediary has stopped the current calculation of interest and makes a value adjustment resulting from a significant perceived decline in credit quality subsequent to the investment intermediary taking on the exposure,

b) The investment intermediary sells the credit obligation at a material credit-related economic loss,

c) The investment intermediary consents to a distressed restructuring of the credit obligation where this is likely to result in a diminished financial obligation caused by the material concessions (forgiveness, or postponement, of principal, interest or fees). This includes, in the case of equity exposures assessed under a PD/LGD Approach, distressed restructuring of the equity itself,

d) The investment intermediary has filed for the obligor's bankruptcy or a similar order in respect of an obligor's credit obligation to the investment intermediary, the parent undertaking or any of its subsidiaries, and

e) The obligor has sought or has been placed in bankruptcy or similar protection where this would avoid or delay repayment of a credit obligation to the investment intermediary, the parent undertaking or any of its subsidiaries.

2.1.3. The investment intermediaries that use external data that is not itself consistent with the definition of default, shall demonstrate to the deputy chairman that appropriate adjustments have been made to achieve broad equivalence with the definition of default.

2.1.4. If the investment intermediary considers that a previously defaulted exposure is such that no trigger of default continues to apply, the investment intermediary shall rate the obligor or facility as they would for a non-defaulted exposure. Should the definition of default subsequently be triggered, another default would be deemed to have occurred.

2.1.5. For retail and PSE exposures, the deputy chairman shall set the exact number of days past due that all investment intermediaries in its jurisdiction shall abide by under the definition of default set out in point 2.1.1., for exposures to such counterparts situated within this Member State. The specific number shall fall within 90-180 days and may differ across product lines. For exposures to such counterparts situated in the territories of other Member States, the competent authorities shall set a number of days past due which is not higher than the number set by the competent authority of the respective Member State.

2.2. Overall requirements for estimation

2.2.1. A investment intermediary's own estimates of the risk parameters PD, LGD, conversion factor and EL shall incorporate all relevant data, information and methods. The estimates shall be derived using both historical experience and empirical evidence, and not based purely on judgmental considerations. The estimates shall be plausible and shall be based on the material drivers of the respective risk parameters. The less data an investment intermediary has, the more conservative it shall be in its estimation.

2.2.2. The investment intermediary shall be able to provide a breakdown of its loss experience in terms of default frequency, LGD, conversion factor, or loss where EL estimates are used, by the factors it sees as the drivers of the respective risk parameters. The investment intermediary shall demonstrate that its estimates are representative of long run experience.

2.2.3. Any changes in lending practice or the process for pursuing recoveries over the observation periods referred to in points 2.3.8, 2.3.13, 2.4.10, 2.4.14, 2.5.7 and 2.5.9 shall be taken into account by the investment intermediary. An investment intermediary's estimates shall reflect the implications of technical advances and new data. The investment intermediaries shall review their estimates when new information comes to light but at least on an annual basis.

2.2.4. The population of exposures represented in the data used for estimation, the lending standards used when the data was generated and other relevant characteristics shall be comparable with those of the investment intermediary's exposures and standards. The investment intermediary shall also demonstrate that the economic or market conditions that underlie the data are relevant to current and foreseeable market conditions. The number of exposures in the sample and the data period used for quantification shall be sufficient to provide confidence in the accuracy and robustness of its estimates.

2.2.5. For purchased receivables the estimates shall reflect all relevant information available to the purchasing investment intermediary regarding the quality of the underlying receivables, including data for similar pools provided by the seller, by the purchasing investment intermediary, or by external sources. The purchasing investment intermediary shall evaluate any data relied upon which is provided by the seller.

2.2.6. An investment intermediary shall add to its estimates a margin of conservatism that is related to the expected range of estimation errors. Where methods and data are less satisfactory and the expected range of errors is larger, the margin of conservatism shall be larger.

2.2.7. If an investment intermediary uses different estimates for the calculation of risk weights and for internal purposes, it shall be documented and their reasonableness shall be demonstrated to the deputy chairman.

2.2.8. If an investment intermediary uses data that is pooled across investment intermediaries it shall demonstrate that:

- the rating systems and criteria of other investment intermediaries in the pool are similar with its own;

- the pool is representative of the portfolio for which the pooled data is used;

- the pooled data is used consistently over time by the investment intermediary for its estimates of the risk parameters.

2.2.9. If an investment intermediary uses data that is pooled across investment intermediaries, it shall remain responsible for the integrity of its rating systems. The investment intermediary shall demonstrate to the deputy chairman that it has sufficient in-house understanding of its rating systems, including effective ability to monitor and audit the rating process.

2.3. Requirements specific to PD estimation

Exposures to corporates, institutions and central governments and central banks

2.3.1. The investment intermediaries shall estimate PDs by obligor grade from long run averages of one-year default rates.

2.3.2.. For purchased corporate receivables investment intermediary may estimate ELs by obligor grade from long run averages of one-year realized default rates.

2.3.3. If an investment intermediary derives long run average estimates of PDs and LGDs for purchased corporate receivables from an estimate of EL, and an appropriate estimate of PD or LGD, the process for estimating total losses shall meet the overall standards for estimation of PD and LGD set out in this part, and the outcome shall be consistent with the concept of LGD as set out in point 2.4.1.

2.3.4. The investment intermediary shall use PD estimation techniques only with supporting analysis. The investment intermediary shall recognize the importance of judgmental considerations in combining results of techniques and in making adjustments for limitations of techniques and information.

2.3.5. To the extent that an investment intermediary uses data on internal default experience for the estimation of PDs, it shall demonstrate in its analysis that the estimates are reflective of underwriting standards and of any differences in the rating system that generated the data and the current rating system. Where underwriting standards or rating systems have changed, the investment intermediary shall add a greater margin of conservatism in its estimate of PD.

2.3.6. To the extent that an investment intermediary associates or maps its internal grades to the scale used by an ECAI, it shall attribute the default rate observed for the external organization's grades to its own grades while complying with the following conditions:

a) mappings shall be based on a comparison of internal rating criteria to the criteria used by ECAI and on a comparison of the internal and external ratings of any common obligors;

b) biases or inconsistencies in the mapping approach or underlying data shall be avoided;

c) the external organization's criteria underlying the data used for quantification shall be oriented to default risk only and not reflect transaction characteristics;

d) the investment intermediary's analysis shall include a comparison and documentation of the default definitions used by external agencies with the requirements in points 2.1.1 to 2.1.5.

2.3.7. To the extent that an investment intermediary uses statistical default prediction models it is allowed to estimate PDs as the simple average of default-probability estimates for individual obligors in a given grade, the models for this purpose shall meet the standards specified in point 1.5.1.

2.3.8. Irrespective of whether an investment intermediary is using external, internal, or pooled data sources, or a combination of the three, for its PD estimation, the length of the underlying historical observation period used shall be at least five years for at least one source. If the available observation period spans a longer period for any source, and this data is relevant, this longer period shall be used by the investment intermediary. This point also applies to the PD/LGD Approach to equity.

Retail exposures

2.3.9. The investment intermediary shall estimate PDs by obligor grade or pool from long run averages of one-year default rates.

2.3.10. Notwithstanding the treatment under point 2.3.9, PD estimates may also be derived by the investment intermediary from realized losses and appropriate estimates of LGDs.

2.3.11. The investment intermediary shall regard internal data for assigning exposures to grades or pools as the primary source of information for estimating loss characteristics. The investment intermediaries are permitted to use external data (including pooled data) or statistical models for quantification provided a strong link can be demonstrated between:

- the investment intermediary's process of assigning exposures to grades or pools and the process used by the external data source; and
- the investment intermediary's internal risk profile and the composition of the external data.

For purchased retail receivables, investment intermediaries may use external and internal reference data. The investment intermediary shall use all relevant data sources as points of comparison.

2.3.12. If an investment intermediary derives long run average estimates of PD and LGD for retail from an estimate of total losses and an appropriate estimate of PD or LGD, the process for estimating total losses shall meet the overall standards for estimation of PD and LGD set out in this part, and the outcome shall be consistent with the concept of LGD as set out in point 2.4.1.

2.3.13. Irrespective of whether an investment intermediary is using external, internal or pooled data sources or a combination of the three, for their estimation of loss characteristics, the length of the underlying historical observation period used shall be at least five years for at least one source. If the available observation spans a longer period for any source, the investment intermediary shall use this longer period. An investment intermediary needs not give equal importance to historic data if it can convince the deputy chairman that more recent data is a better predictor of loss rates.

2.3.14 The investment intermediary shall identify and analyze expected changes of risk parameters over the life of credit exposures (seasoning effects).

2.4. Requirements specific to own-LGD estimates

2.4.1. The investment intermediary shall estimate LGDs on the basis of the average realized LGDs by facility grade or pool using all observed defaults within the data sources (default weighted average).

2.4.2 The investment intermediary shall use LGD estimates that are appropriate for an economic downturn if those are more conservative than the long-run average. To the extent a rating system is expected to deliver realized LGDs at a constant level by grade or pool over time, adjustments shall be made to the estimates of risk parameters by grade or pool to limit the capital impact of an economic downturn.

2.4.3. An investment intermediary shall consider the extent of any dependence between the risk of the obligor with that of the collateral or collateral provider. Cases where there is a significant degree of dependence shall be addressed in a conservative manner.

2.4.4.. Currency mismatches between the underlying obligation and the collateral shall be treated conservatively in the investment intermediary's assessment of LGD.

2.4.5. To the extent that LGD estimates take into account the existence of collateral, these estimates shall not solely be based on the collateral's estimated market value. LGD estimates shall take into account the effect of the potential inability of the investment intermediary to expeditiously gain control of their collateral and liquidate it.

2.4.6. To the extent that LGD estimates take into account the existence of collateral, an investment intermediary must establish internal requirements for collateral management, legal certainty and risk management that are generally consistent with those set out in Annex 6.

2.4.7. To the extent that an investment intermediary recognizes collateral for determining the exposure value for counterparty credit risk according to Sections V and VI of Annex 3, any amount expected to be recovered from the collateral shall not be taken into account in the LGD estimates.

2.4.8. For the specific case of exposures already in default, the investment intermediary shall use the sum of its best estimate of expected loss for each exposure given current economic circumstances and exposure status and the possibility of additional unexpected losses during the recovery period.

2.4.9. To the extent that unpaid late fees have been capitalised in the investment intermediary's income statement, they shall be added to the investment intermediary’s measure of exposure and loss.

Exposures to corporates, institutions and central governments and central banks

2.4.10 Estimates of LGD shall be based on data over a minimum of five years, increasing by one year each year after implementation until a minimum of seven years is reached, for at least one data source. If the available observation period spans a longer period for any source, this longer period shall be used.

2.4.11. Notwithstanding point 2.4.1, LGD estimates may be derived from realized losses and appropriate estimates of PDs.

2.4.12. Notwithstanding point 2.5.3, investment intermediary may reflect future drawings either in their conversion factors or in their LGD estimates.

2.4.13. For purchased retail receivables the investment intermediary may use external and internal reference data to estimate LGDs.

2.4.14. Estimates of LGD shall be based on data over a minimum of five years. Notwithstanding point 2.4.1, an investment intermediary needs not give equal importance to historic data if it can demonstrate to the deputy chairman that more recent data is a better predictor of loss rates.

2.5. Requirements specific to own-conversion factor estimates

2.5.1. The investment intermediary shall estimate conversion factors by facility grade or pool on the basis of the average realized conversion factors by facility grade or pool using all observed defaults within the data sources (default weighted average).

2.5.2. The investment intermediary shall use conversion factor estimates that are appropriate for a period of an economic downturn if those are more conservative than the long-run average. To the extent a rating system is expected to deliver realized conversion factors at a constant level by grade or pool over time, adjustments shall be made to the estimates of risk parameters by grade or pool to limit the capital impact of an economic downturn.

2.5.3. The investment intermediary's estimates of conversion factors shall reflect the possibility of additional drawings by the obligor up to and after the time a default event is triggered.

The conversion factor estimate shall incorporate a larger margin of conservatism where a stronger positive correlation can reasonably be expected between the default frequency and the magnitude of conversion factor.

2.5.4. In arriving at estimates of conversion factors investment intermediary shall consider its specific policies and strategies adopted in respect of account monitoring and payment processing. The investment intermediary shall also consider their ability and willingness to prevent further drawings in circumstances short of payment default, such as covenant violations or other technical default events.

2.5.5. The investment intermediary shall have adequate systems and procedures in place to monitor facility amounts, current outstandings against committed lines and changes in outstandings per obligor and per grade.

2.5.6. If an investment intermediary uses different estimates of conversion factors for the calculation of risk weighted exposure amounts and internal purposes they shall be documented and their reasonableness shall be demonstrated to the deputy chairman.

Exposures to corporates, institutions and central governments and central banks

2.5.7 Estimates of conversion factors shall be based on data over a minimum of five years, increasing by one year each year after implementation until a minimum of seven years is reached, for at least one data source. If the available observation period spans a longer period for any source, the investment intermediary shall use this longer period.

Retail exposures

2.5.8. Notwithstanding the application of point 2.5.3, an investment intermediary may reflect future drawings either in their conversion factors or in their LGD estimates.

2.5.9. Estimates of conversion factors with retail exposures shall be based on historic data over a minimum of five years. Notwithstanding point 2.5.1, an investment intermediary needs not give equal importance to historic data if it can demonstrate to the deputy chairman that more recent data is a better predictor of draw downs.

2.6. Minimum requirements for assessing the effect of guarantees and credit derivatives

2.6.1. The requirements in points 2.6.2 to 2.6.9 shall not apply for guarantees provided by institutions and central governments and central banks if an investment intermediary has received approval to apply the rules under Chapter Twelve, Section I for exposures to such entities. In this case the requirements of Chapter Twelve, Section III shall apply.

2.6.2. For retail guarantees, these requirements under item 2.6.3 – 2.6.9 also apply to the assignment of exposures to grades or pools, and the estimation of PD.

2.6.3. The investment intermediary shall have clearly specified criteria for the types of guarantors they recognize for the calculation of risk weighted exposure amounts.

2.6.4. For recognized guarantors the same rules as for obligors as set out in points 1.2.1 to 1.4.1(d) shall be applied by the investment intermediary.

2.6.5 The guarantee shall be evidenced in writing, non-cancellable on the part of the guarantor, in force until the obligation is satisfied in full (to the extent of the amount and tenor of the guarantee) and legally enforceable against the guarantor in a jurisdiction where the guarantor has assets to attach and enforce a judgment. Guarantees prescribing conditions under which the guarantor may not be obliged to perform (conditional guarantees) may be recognized subject to approval of the deputy chairman. The investment intermediary shall demonstrate that the assignment criteria adequately address any potential change in the risk mitigation effect.

2.6.6 An investment intermediary shall have clearly specified criteria for adjusting grades, pools or LGD estimates, and, in the case of retail and eligible purchased receivables, the process of allocating exposures to grades or pools, to reflect the impact of guarantees for the calculation of risk weighted exposure amounts. These criteria shall comply with the minimum requirements set out in points 1.2.1 to 1.4.

2.6.7. The criteria shall be plausible, address the guarantor's ability and willingness to perform under the guarantee, the likely timing of any payments from the guarantor, the degree to which the guarantor's ability to perform under the guarantee is correlated with the obligor's ability to repay, and the extent to which residual risk to the obligor remains.

2.6.8. The minimum requirements for guarantees under this Section shall apply also for single-name credit derivatives. In relation to a mismatch between the underlying obligation and the reference obligation of the credit derivative or the obligation used for determining whether a credit event has occurred, the requirements set out under point 26 of Annex 6 shall apply. For retail exposures and eligible purchased receivables, these requirements apply to the process of allocating exposures to grades or pools.

2.6.9. The criteria shall address the payout structure of the credit derivative and assess the impact this has on the level and timing of recoveries and the residual risk.

2.7. Minimum requirements for purchased receivables

2.7.1 The conditions of the transaction shall ensure that under all foreseeable circumstances the investment intermediary has effective ownership and control of all cash remittances from the receivables. When the obligor makes payments directly to a seller or servicer, the investment intermediary shall verify regularly that payments are forwarded completely and within the contractually agreed terms. "Servicer" shall mean an entity that manages a pool of purchased receivables or the underlying credit exposures on a day-to-day basis. The investment intermediary shall have procedures to ensure that ownership over the receivables and cash receipts is protected against bankruptcy or legal challenges that could materially delay the lender's ability to liquidate or assign the receivables or retain control over cash receipts.

2.7.2. The investment intermediary shall monitor both the quality of the purchased receivables and the financial condition of the seller and servicer. In particular:

- the investment intermediary shall assess the correlation among the quality of the purchased receivables and the financial condition of both the seller and servicer, and have in place internal policies and procedures that provide adequate safeguards to protect against any contingencies, including the assignment of an internal risk rating for each seller and servicer;

- the investment intermediary shall have clear and effective policies and procedures for determining seller and servicer eligibility; the investment intermediary shall conduct periodic reviews of sellers and servicers in order to verify the accuracy of reports from the seller or servicer, detect fraud or operational weaknesses, and verify the quality of the seller's credit policies and servicer's collection policies and procedures. The findings of these reviews shall be documented;

- the investment intermediary shall assess the characteristics of the purchased receivables pools, including over-advances; history of the seller's arrears, bad debts, and bad debt allowances; payment terms, and potential contra accounts;

- the investment intermediary shall have effective policies and procedures for monitoring on an aggregate basis single-obligor concentrations both within and across purchased receivables pools; and

- the investment intermediary shall ensure that it receives from the servicer timely and sufficiently detailed reports of receivables ageings and dilutions to ensure compliance with the investment intermediary’s eligibility criteria and advancing policies governing purchased receivables, and provide an effective means with which to monitor and confirm the seller's terms of sale and dilution.

2.7.3 The investment intermediary shall have systems and procedures for detecting deteriorations in the seller's financial condition and purchased receivables quality at an early stage, and for addressing emerging problems pro-actively. In particular, the investment intermediary shall have clear and effective policies, procedures, and information systems to monitor covenant violations, and clear and effective policies and procedures for initiating legal actions and dealing with problem purchased receivables.

2.7.4. The investment intermediary shall have clear and effective policies and procedures governing the control of purchased receivables, credit, and cash. In particular, written internal policies shall specify all material elements of the receivables purchase programme, including the advancing rates, eligible collateral, necessary documentation, concentration limits, and the way cash receipts are to be handled. These elements shall take appropriate account of all relevant and material factors, including the seller and servicer's financial condition, risk concentrations, and trends in the quality of the purchased receivables and the seller's customer base. The internal systems shall ensure that funds are advanced only against specified supporting collateral and documentation.

2.7.5 The investment intermediary shall have an effective internal process for assessing compliance with all internal policies and procedures. The process shall include regular audits of all critical phases of the receivables purchase programme, verification of the separation of duties between firstly the assessment of the seller and servicer and the assessment of the obligor and secondly between the assessment of the seller and servicer and the field audit of the seller and servicer, as well as evaluations of the operations, qualifications and experience of the personnel and the supporting automation systems.

3. Validation of internal estimates

3.1. The investment intermediary shall have robust procedures in place to validate the accuracy and consistency of rating systems, processes, and the estimation of all relevant risk parameters. An investment intermediary shall demonstrate to the deputy chairman that the internal validation process enables it to assess the performance of internal rating and risk estimation systems consistently and meaningfully.

3.2. The investment intermediary shall regularly compare realized default rates with estimated PDs for each grade and, where realized default rates are outside the expected range for that grade, the investment intermediary shall specifically analyze the reasons for the deviation. The investment intermediary using own estimates of LGDs and/or conversion factors shall also perform analogous analysis for these estimates. Such comparisons shall make use of historical data that cover as long period as possible, the used methods and data shall be documented and updated at least annually.

3.3. The investment intermediary shall also use other quantitative validation tools and comparisons with relevant external data sources. The analysis shall be based on data that are appropriate to the portfolio, are updated regularly, and cover a relevant observation period. The investment intermediary's internal assessments of the performance of their rating systems shall be based on as long a period as possible.

3.4. The methods and data used for quantitative validation shall be consistent through time. Changes in estimation and validation methods and data (both data sources and periods covered) shall be documented.

3.5. The investment intermediary shall have sound internal standards for situations where deviations in realized risk parameters values, or conversion factors, where EL is used, from expectations, become significant enough to call the validity of the estimates into question. These standards shall take account of business cycles and similar systematic variability in default experience. Where realized values continue to be higher than expected values, the estimates shall be revised upward to reflect their default and loss experience.

4. Calculation of risk weighted exposure amounts for equity exposures under the internal models approach

4.1. Capital requirement and risk quantification

For the purpose of calculating capital requirements to equity exposures, an investment intermediary shall meet the following standards:

4.1.1. The estimate of potential loss shall be robust to adverse market movements relevant to the long-term risk profile of the investment intermediary's specific holdings. The data used to represent return distributions shall reflect the longest sample period for which data is available and meaningful in representing the risk profile of the investment intermediary's specific equity exposures. The data used shall be sufficient to provide conservative, statistically reliable and robust loss estimates that are not based purely on subjective or judgmental considerations. The investment intermediary shall demonstrate to the deputy chairman that the shock employed provides a conservative estimate of potential losses over a relevant long-term market or business cycle. The investment intermediary shall combine empirical analysis of available data with adjustments based on a variety of factors in order to attain model outputs that achieve appropriate realism and conservatism. In constructing Value at Risk (VaR) models estimating potential quarterly losses, the investment intermediary may use quarterly data or convert shorter horizon period data to a quarterly equivalent using an analytically appropriate method supported by empirical evidence and through a well-developed and documented analysis. Such an approach shall be applied consistently over time with conservatism higher when the available data are limited.

4.1.2. The models used shall be able to capture adequately all of the material risks embodied in equity returns including both the general market risk and specific risk exposure of the investment intermediary's equity holdings. The internal models shall adequately explain historical price variation, capture both the magnitude and changes in the composition of potential concentrations, and their results are robust to adverse market environments. The population of risk exposures represented in the data used for estimation shall be closely matched to or at least comparable with those of the investment intermediary's equity exposures.

4.1.3. The internal model shall be appropriate for the risk profile and complexity of an investment intermediary's equity holdings. Where an investment intermediary has material holdings with values that are highly non-linear in nature, the internal models shall be designed to capture appropriately the risks associated with such instruments.

4.1.4. Mapping of individual positions to proxies, market indices, and risk factors shall be plausible and conceptually sound.

4.1.5. The investment intermediary shall demonstrate through empirical analyses the appropriateness of risk factors, including their ability to cover both general and specific risk.

4.1.6. The estimates of the return volatility of equity exposures shall incorporate relevant and available data, information and methods. Independently reviewed internal data or data from external sources (including pooled data) shall be used;

4.1.7. A rigorous and comprehensive stress-testing programme shall be in place;

4.2. Risk management process and controls

With regard to the development and use of internal models for capital requirement purposes, an investment intermediary shall establish policies, procedures and controls to ensure the integrity of the model and modelling process. These policies, procedures and controls shall include the following:

4.2.1 Full integration of the internal model into the overall management information systems and in the management of the non-trading book equity portfolio. Internal models shall be fully integrated into the risk management infrastructure if they are particularly used in measuring and assessing equity portfolio performance, (including the risk-adjusted performance), allocating economic capital to equity exposures and evaluating overall capital adequacy and the investment management process.

4.2.2. Established management systems, procedures and control functions for ensuring the periodic and independent review of all elements of the internal modelling process, including approval of model revisions, vetting of model inputs, and review of model results (such as direct verification of risk computations). These reviews shall assess the accuracy, completeness, and appropriateness of model inputs and results and focus on both finding and limiting potential errors associated with known weaknesses and identifying unknown model weaknesses. Such reviews may be conducted by an internal independent unit, or by an independent external third party.

4.2.3. Adequate systems and procedures for monitoring investment limits and the risk exposures of equity exposures;

4.2.4. The units responsible for the design and application of the model shall be functionally independent from the units responsible for managing individual investments.

4.2.5. Parties responsible for any aspect of the modelling process shall be adequately competent and qualified.

4.3. Validation and documentation

4.3.1. The investment intermediary shall have a robust system in place to validate the accuracy and consistency of their internal models and modelling processes and all material elements shall be documented.

4.3.2. The investment intermediary shall use the internal validation process to assess the performance of its internal models and processes in a consistent and meaningful way.

4.3.3 The methods and data used for quantitative validation shall be consistent through time. Changes in estimation and validation methods and data (both data sources and periods covered) shall be documented.

4.3.4 The investment intermediary shall regularly compare and document actual equity returns, computed using realized and unrealized gains and losses, with modelled estimates. Such comparisons shall make use of historical data that cover as long a period as possible. The investment intermediary shall document the methods and data used in such comparisons. This analysis and documentation shall be updated at least annually.

4.3.5 The investment intermediary shall make use of other quantitative validation tools and comparisons with external data sources. The analysis shall be based on data that are appropriate to the portfolio, are updated regularly, and cover a relevant observation period. The internal assessments of the performance of the models shall be based on as long a period as possible.

4.3.6 The investment intermediary shall have sound internal standards for situations where comparison of actual equity returns with the models estimates calls the validity of the estimates or of the models as such into question. These standards shall take account of business cycles and similar systematic variability in equity returns. All adjustments made to internal models in response to model reviews shall be documented and consistent with the model review standards.

4.3.7 The internal model and the modelling process shall be documented, including the responsibilities of parties involved in the modelling, and the model approval and model review processes.

5. Corporate governance and oversight

5.1. Corporate Governance

5.1.1. (Am. – SG, iss. 68 in 2008) All material aspects of the rating and estimation processes shall be approved by the investment intermediary's management body or a designated committee thereof and senior management. They must be acquainted with the investment intermediary's rating systems and understand the associated with them management reports.

5.1.2. Senior management shall provide notice to the management body described in or authorized by them persons of material changes or exceptions from established policies that will materially impact the operations of the credit institution's rating systems.

5.1.3. Senior management shall have a good understanding of the rating systems designs and operations and shall ensure, on an ongoing basis that the rating systems are operating properly. Senior management shall be regularly informed by the credit risk control units about the performance of the rating process, areas needing improvement, and the status of efforts to improve previously identified deficiencies.

5.1.4. Internal ratings-based analysis of the investment intermediary's credit risk profile shall be an essential part of the management reporting to these parties. Reporting shall include at least risk profile by grade, migration across grades, estimation of the relevant risk parameters per grade, and comparison of realized default rates, and to the extent that own estimates are used of realized LGDs and realized conversion factors against expectations and stress-test results. Reporting frequencies shall depend on the significance and type of information and the level of the recipient.

5.2. Credit Risk Control

5.2.1. (Am. – SG, iss. 68 in 2008) The credit risk control unit shall be independent from the investment intermediary's management bodies and front office and shall report directly to senior management. The unit shall be responsible for the design or selection, implementation, oversight and performance of the rating systems. It shall regularly produce and analyze reports on the output of the rating systems.

5.2.2 The areas of responsibility for the credit risk control unit shall include:

(a) testing and monitoring grades and pools;

(b) production and analysis of summary reports containing data and results from and for the rating systems;

(c) implementing procedures to verify that grade and pool definitions are consistently applied across departments and geographic areas;

(d) reviewing and documenting any changes to the rating process, including the reasons for the changes;

(e) reviewing the rating criteria to evaluate if they remain predictive of risk. Changes to the rating process, criteria or individual rating parameters shall be documented and retained;

(f) control of the rating models, active participation in the design or selection, implementation and validation of models used in the rating process;

(g) oversight and supervision of models used in the rating process; and

(h) ongoing review and alterations to models used in the rating process.

5.2.3 The investment intermediary using pooled data according to points 2.2.9 and 2.2.10 may outsource the following tasks:

- production of information relevant to testing and monitoring grades and pools;

- production of summary reports from the investment intermediary's rating systems;

- production of information relevant to review of the rating criteria to evaluate if they remain predictive of risk;

- documentation of changes to the rating process, criteria or individual rating parameters; and

- production of information relevant to ongoing review and alterations to models used in the rating process.

5.2.4. An investment intermediary applying item 5.2.3 shall:

a) have available all the information from the third persons which is needed for establishment of compliance with the requirements;

b) ensure access for conducting on-site inspections to the same extent that such may be carried out with respect to the investment intermediary.

5.3. (Am. – SG, iss. 68 in 2008) Internal control

The specialized internal audit office or another relevant independent auditing unit shall conduct once annually a review of the investment intermediary's activity and rating systems, including the activity of crediting and valuation of the risk parameters and conversion factors.

Annex 6

to Chapter Twelve, Section III

Credit Risk Mitigation
(Am. – SG, iss. 68 in 2008)

General Provisions

1. For calculation of the risk-weighted exposures by the Standardized Approach according to Chapter Twelve, Section I or by the Internal Model Methods under Chapter Twelve, Section II, the investment intermediaries may take account of the credit risk mitigation, where the requirements of this Annex are complied with.

2. Rules for applying credit risk mitigation.

2.1 Investment intermediaries, which take account of credit risk mitigation or expected loss, must apply rules and procedures for efficient management and control of the risks, arising from the actions for the credit risk reduction.

2.2 When credit risk mitigation or expected loss are accounted for, investment intermediaries shall also make an overall assessment of the credit risk of the underlying exposure.

2.3 The investment intermediary shall monitor and control through appropriate written rules and procedures the residual risk, arising from lower efficiency than expected of the used techniques for credit risk mitigation.

2.4 With repurchase transactions the net amount of the exposure shall be considered to be underlying exposure.

Funded Credit Protection

3. On-balance sheet netting with a counterparty

3.1. The on-balance sheet items of the counterparty can be netted where there is a netting agreement with the investment intermediary.

3.2. The netting under item 3.1. shall be applied where the following conditions exist:

3.2.1. it has been envisaged that in case of default, insolvency or bankruptcy, the one party shall owe to the other the net amount of the liability;

3.2.2. the investment intermediary has verified that the netting agreement is legally valid and applicable in all cases under the relevant jurisdictions, including in case of the counterparty's insolvency or bankruptcy;

3.2.3. the investment intermediary is able to establish at any time the claims and liabilities subject of the netting agreement;

3.2.4. the investment intermediary shall monitor and control the risks associated with the termination of the credit collateral; and

3.2.5. the investment intermediary shall monitor and control exposures on net basis.

3.3. The netting under item 3.1 of on-balance sheet positions shall not be recognized when it is done on the basis of Master netting agreements covering repurchase transactions and/or securities lending or borrowing transactions and/or other capital market-driven transactions. In such cases the requirements under item 5 – 7 shall apply.

4. Debit and credit on-balance sheet positions of a customer may be netted where there is effective pledge contract, regardless whether it has been concluded independently, represents a part of the main liability, a part of the master agreement or a contract with general terms.

5. Master netting agreements covering repurchase transactions and/or securities or commodities lending or borrowing transactions and/or other capital market-driven transactions

5.1. An investment intermediary adopting the Financial Collateral Comprehensive Method under item 34, can effect netting between positions subject of Master netting agreements covering repurchase transactions and/or securities or commodities lending or borrowing transactions and/or other capital market-driven transactions, when the Master netting agreement meets the requirements of item 6.

5.2. Beside the requirements under Chapter Seven, the collateral taken and securities received by virtue of the Master netting agreement shall also satisfy the criteria of item set out at points 8 to 10.

6. The Master Netting Agreements under item 5 shall be recognized for the purposes of credit risk mitigation, when they simultaneously satisfy the following conditions:

6.1. the agreement is legally valid and applicable in the relevant legislations, including in cases of the counterparty's insolvency and bankruptcy;

6.2. the agreement ensures to the non-defaulting party the right to terminate and close in due time all transactions subject of the agreement in case of default, insolvency or bankruptcy of the other party to the agreement;

6.3. the agreement shall settle the netting between the incomes and losses under the transactions when one of the parties owes to the other only the net amount of the liability;

6.4. the investment intermediary meets the minimal requirements for recognition of financial collateral according item 11.

Financial Collateral

7. An investment intermediary may use standardized method or comprehensive method for credit risk mitigation and when using collateral.

8. The following financial items may be recognized as eligible collateral:

8.1. cash on deposit with, or cash assimilated instruments held by, the investment intermediary;

8.2. debt securities issued by central governments or central banks, which securities have a credit assessment by an ECAI associated with credit quality step 4 or above and include:

8.2.1. debt securities issued by regional governments or local authorities, exposures to which are treated according the standardized method as exposures to the central government in whose jurisdiction they are established;

8.2.2. debt securities issued by public sector entities which are treated as exposures to central governments under item 1.4.43 of Annex No. 4;

8.2.3 debt securities issued by multilateral development banks to which a 0% risk weight is assigned with the standardized method.

8.3. debt securities issued by institutions or other entities, which securities have a credit assessment by an eligible ECAI associated with credit quality step 3 or above and which include:

8.3.1. debt securities issued by regional governments or local authorities other than those exposures to which are treated as exposures to the central government in whose jurisdiction they are established;

8.3.2. debt securities issued by public sector entities, exposures to which are treated as exposures to institutions according the standardized approach;

8.3.3. debt securities issued by multilateral development banks other than those to which a 0% risk weight is assigned with the standardized approach.

8.4. Debt securities with a short-term credit assessment by an eligible ECAI which has been determined to be associated with credit quality step 3 or above;

8.5. Equities or convertible bonds that is included in a main index.

8.6. Gold.

8.7. Where a security has two credit assessments by eligible Éclairs, the less favorable assessment shall be deemed to apply. In cases where a security has more than two credit assessments by eligible Éclairs, the two most favorable assessments shall be deemed to apply. If the two most favorable credit assessments are different, the less favorable of the two shall be deemed to apply.

9. Collateral may also be:

9.1. Debt securities which do not have a credit assessment by an eligible ECAI if they fulfill the following criteria:

9.1.1. the debt securities are listed on a recognized exchange;

9.1.2. the debt securities qualify as senior debt;

9.1.3. all other rated issues by the issuing institution of the same seniority have a credit assessment by an eligible ECAI associated with credit quality step 3or above;

9.1.4. the investment intermediary declares that it has no information to suggest that the issue would justify a credit assessment below credit quality step 3; and

9.1.5. the investment intermediary can demonstrate to the Commission that the market liquidity of the instrument is sufficient for the purposes of collateral.

9.2. Units in collective investment undertakings may be recognized as eligible collateral if the following conditions are satisfied:

(a) they have a daily public price quote of redemption; and

(b) the collective investment undertaking is limited to investing in instruments that are eligible for recognition under points 8.1 – 9.1.

9.3. The use by a collective investment undertaking of derivative instruments to hedge risk shall not prevent units in that undertaking from being eligible according point 9.2.

10. Additional eligible collateral that are recognized by the Financial Collateral Comprehensive Method are:

10.1. equities or convertible bonds not included in a main index but traded on a recognized exchange; and

10.2. units in collective investment undertakings if they have a daily public redemption price quote and can be invested beside the instruments under point 9.2.2. also in the instruments under point 10.1.

11. Minimum requirements for the recognition of financial collateral

The collateral under item 8 shall be recognized for the purposes of credit risk mitigation, where the following conditions have been met:

11.1. Conditions for low correlation

11.1.1. The credit quality of the obligor and the value of the collateral must not have a material positive correlation.

11.1.2. Securities not to be issued by the obligor, or any related group entity, except for the cases of the obligor's own issues of covered bonds, according the requirements of the standardized method, where they are posted as collateral for repurchase transactions, provided that the requirements of point “a" are complied with.

11.2. Requirements for legal certainty – the investment intermediaries shall fulfil any contractual and statutory requirements in respect of, and take all steps necessary to ensure, the enforceability of the collateral arrangements under the relevant legislations.

11.3. Operational requirements

11.3.1. The collateral arrangements shall be properly documented;

11.3.2. The investment intermediary shall have documented policies and practices concerning the types and amounts of collateral accepted.

11.3.3. There are clear and robust procedures for timely use of collaterals and control of risks arising from that process – including risks of failed or reduced credit protection, valuation risks, risks associated with the termination of the credit protection, concentration risk arising from the use of collateral and the interaction with the credit institution's overall risk profile.

11.3.4. Investment intermediaries shall calculate the market value of the collateral, and revalue it accordingly, with a minimum frequency of once every six months or more frequently whenever there has occurred or is expected a decrease in its market value.

11.3.5. Where the collateral is held by a third party – pledge holder, investment intermediaries must take reasonable steps to ensure that the third party segregates the collateral from its own assets.

11.3.6. In the cases of use of Financial Collateral Simple Method, the residual maturity of the protection must be at least as long as the residual maturity of the exposure.

Other collaterals

12. Cash on deposit with, or cash assimilated instruments.

12.1 Cash on deposit with, or cash assimilated instruments held by, a third party credit institution in a non-custodial arrangement and pledged to the investment intermediary may be recognized as eligible credit protection when the following conditions have been met:

12.1.1. the receivable of the obligor from such institution is actual, unconditional and irrevocable, pledged or assigned in favour of the investment intermediary and is legally effective and applicable in the relevant legislations;

12.1.2. the credit institution – pledge holder has been notified for the setting up of the pledge or its assigning, and as a result of the notification, the pledge holder is able to make the payments only to the investment intermediary or other, indicated by it party.

12.2. For the purposes of establishment the effect from the credit collateral, cash deposit with a credit institution, shall be equalized to security from that credit institution, while complying with the requirements of item 56 and 57.

13. Life insurance policies

13.1. Life insurance policies pledged to the lending investment intermediary may be recognized as eligible credit protection, and as a value shall be accepted the buying value of the policy.

13.2. The credit protection in the form of life insurance policy has to satisfy the following conditions:

13.2.1. the insurer has been recognized as an eligible guarantor for the providing of credit protection in compliance with item 19;

13.2.2. the insurance policy has been provided as pledged or assigned in favour of the investment intermediary and the agreement is effective and applicable in all relative legislations;

13.2.3. the insurer has been notified of the pledge or the assignment of the policy, as a result of which it may not cancel the policy or the payment of amounts under it without the investor intermediary's consent;

13.2.4. the purchase value of the policy is non-reducable in amount;

13.2.5. the investment intermediary shall be entitled to demand the policy and to receive in due time the purchase value in case of default on the borrower's side;

13.2.6. The investment intermediary has been notified by the insured of all cases which envisage non-payment against the policy;

13.2.7. the credit protection shall be provided at least for the term of the credit amortisation; in case that the policy expires before the expiration of the credit term, the investment intermediary shall ensure the amount received under the policy to continue to be used as security until the expiration of the credit term.

13.3. Life-insurance policies shall be considered as security of the insurance policy in accordance with item 54.2, the requirements under item 56 and 57 being applied.

14. Institution instruments repurchased on request

14.1. Instruments issued by third party institutions which will be repurchased by that institution on request may be recognized as eligible credit protection when they satisfy the following requirements:

14.1.1. the institution issuer has a credit rating associated with credit quality step first for exposures to credit institutions under the standardized approach;

14.1.2. the institution may verify to the deputy chairman that the market liquidity of the instrument is sufficiently high.

14.2. The instruments under item 14.1 shall be considered as security of the issuer institution in accordance with item 54.2. The requirements under item 56 and 57 shall apply for this security accordingly.

14.3. The amount of the credit protection shall be determined as follows:

14.3.1. When the instrument is purchased at nominal value – at nominal value;

14.3.2. When the instrument is purchased at market prices – at the value calculated as for debt securities according item 8.3.3.

Additional eligibility for calculations

15. In addition to the collateral under points 11 to 14 and the guarantees issued by the entities under item 19, also the collateral in item 16 shall apply where an investment intermediary calculates risk-weighted exposure amounts and expected loss amounts by the Internal Ratings Method:

16. Real estate collateral

16.1. Residential real estate property meeting the requirements of item 16.2 – 16.4, item 17.2 – 17.4, which is or will be occupied or let by the owner, and offices and other commercial premises, may be recognized as eligible collateral where the following conditions are met:

16.1.1. the fair value of the property does not materially depend upon the credit quality of the obligor. This requirement does not preclude situations where purely macro-economic factors affect both the value of the property and the performance of the borrower;

16.1.2. the risk of the borrower's insolvency does not materially depend upon the performance of the underlying property or project, but rather on the underlying capacity of the borrower to repay the debt from other sources. Repayment of the facility does not materially depend on any cash flow generated by the underlying property serving as collateral.

16.2. The investment intermediary shall reappraise the real estate at least once yearly if it is commercial premises, and once in three years, if it is a residential real estate. The reappraisal shall also be made in case of significant changes in the market conditions.

16.3. Where there is information indicating likely substantial decrease in the real estate's value, the subsequent appraisal of the real estate shall be subject to review by an independent appraiser.

16.4. (Am. – SG, iss. 68 in 2008) When the loan exceeds the BGN equivalence of Euro 3 million or 5% of the investment intermediary's own funds, the appraisal of the property shall be subject to review by an independent appraiser in every two years.

17. To be recognized as collateral given real estate under item 16, the following conditions shall be met:

17.1. The investment intermediary has expressly specified in its rules of crediting the types of real estates, accepted as collateral;

17.2. The investment intermediary has in place procedures for monitoring the adequacy of the insurance cover of the real estate;

17.3. The mortgage is valid and applicable in the relevant legislations, in time and duly entered, and realizable within reasonable terms;

17.4. The investment intermediary shall conduct regular review for compliance by the customer with the conditions of the contracts for credit and collateral, as well as other legal requirements;

17.5. The amount of the collateral shall be the market value of the property, while complying with the following requirements;

17.5.1. the establishment of the market value has to be clearly documented;

17.5.2. the market value accounts for the availability of speculative elements;

17.5.3. the market value accounts for the availability of other encumbrances on the property.

18. Institutions, insurance, reinsurance companies and agencies for export crediting shall be recognized as sellers of credit protection when they have met the following conditions:

18.1. the seller has enough professional experience in ensuring protection;

18.2. the seller is subject to supervisory requirements, equivalent to the requirements of this Ordinance, or at the time of the protection provision had awarded rating by a recognized ECAI associated with third or higher credit quality step according the standardized method;

18.3. at the time of the credit protection provision or subsequently the seller is assigned an internal rating corresponding to probability of default (PD), equal or lower than that corresponding to second credit quality step according the standardized method;

18.4. the seller has an ongoing internal rating corresponding to probability of default (PD), equal or lower than that corresponding to third degree of credit capacity according the standardized method;

18.5. where the seller of credit protection is an ECAI, the issued by the government counter guarantees shall not be recognized.

Unfunded credit protection

19. Eligible providers of unfunded credit protection may be:

19.1. central governments and central banks;

19.2. regional governments or local authorities;

19.3. multilateral development banks;

19.4. international organizations to which a 0% risk weight is assigned under the standardized method;

19.5. public sector entities, claims on which are treated by the competent authorities as claims on institutions or central governments according the standardized method;

19.6. institutions;

19.7. other corporate entities, including parent, subsidiary and affiliate corporate entities of the investment intermediary, that have a credit assessment by a recognized ECAI associated with credit quality step 2 or above.

Credit derivatives

20.1. The following types of credit derivatives, and instruments that may be composed of such credit derivatives or that are economically effectively similar, may be recognized as eligible:

20.1.1. credit default swaps;

20.1.2. total return swaps; and

20.1.3. credit linked notes to the extent of their cash funding.

20.2. Where an investment intermediary buys credit protection through a total return swap and records the net payments received on the swap as net income, but does not record offsetting deterioration in the value of the asset that is protected, the credit protection shall not be recognized as eligible.

21. Internal hedges

21.1. When an investment intermediary conducts an internal hedge using a credit derivative, the used credit derivatives shall be recognized as eligible protection when the credit risk shall be transferred out to a third party or parties (recognized seller of credit protection).

21.2. When the condition under item 21.1. has been complied with, the rules for the calculation of risk-weighted exposure amounts and expected loss amounts where unfunded credit protection is acquired shall be applied.

22. credit protection deriving from a guarantee or credit derivative shall be recognized when the following conditions are met:

22.1. the credit protection shall be direct;

22.2. the extent of the credit protection shall be clearly defined and incontrovertible;

22.3. it must be legally effective and enforceable in all jurisdictions which are relevant;

22.4. the credit protection contract shall not contain any clause, the fulfillment of which is outside the direct control of the investment intermediary, that:

22.4.1. would allow the protection provider unilaterally to cancel the protection;

22.4.2. would increase the effective cost of protection as a result of deteriorating credit quality of the protected exposure;

22.4.3. could prevent the protection provider from being obliged to pay out in a timely manner in the event that the original obligor fails to make any payments due; or

22.4.4. could allow the maturity of the credit protection to be reduced by the protection provider; and

22.5. The investment intermediary shall verify that:

22.5.1. it has systems in place to manage potential concentration of risk arising from the use of guarantees and credit derivatives;

22.5.2. the strategy in respect of use of credit derivatives and guarantees interacts with the investment intermediary’s overall risk profile.

23. Counter guarantees

23.1. Where an exposure is protected by a guarantee which is counter-guaranteed, the same may be treated as exposure to the issuer of the counter-guarantee, if it is:

23.1.1. a central government or central bank;

23.1.2. a regional government or local authority which is treated as central government under the standardized method;

23.1.3. a multi-lateral development bank to which a 0% risk weight is assigned under the standardized method;

23.1.4. a public sector entity, claims on which are treated as claims on central government or credit institutions under the standardized method.

23.2. The guarantees shall be recognized when the following requirements have been satisfied:

23.2.1. the counter-guarantee covers all credit risk elements of the claim;

23.2.2. both the original guarantee and the counter-guarantee meet the requirements for guarantees set out in points 22 and 24, except for the requirement under item 22.1; and

23.2.3. the cover is robust and that nothing in the historical evidence suggests that the coverage of the counter-guarantee is less than effectively equivalent to that of a direct guarantee by the same guarantor.

24. Additional requirements for recognition of guarantees

24.1. The guarantees under item 22.1 – 22.4 and item 23.1 shall meet the following conditions:

24.1.1. on the qualifying default of and/or non-payment by the customer, the investment intermediary shall have the right to pursue, in a timely manner, the guarantor for any monies due under the claim in respect of which the protection is provided, not being subject to the investment intermediary first having to pursue the obligor.

24.1.2. the guarantee shall be an explicitly documented obligation assumed by the guarantor;

24.1.3. the guarantee shall cover all types of payments the obligor is expected to make in respect of the claim. Where certain types of payment are excluded from the guarantee, the recognized value of the guarantee shall be adjusted to reflect the limited coverage.

24.2. In the case of guarantees provided in the context of recognized mutual guarantee schemes or counter-guaranteed by the entities referred to in point 23.1, the requirements in point 24.1 shall be considered to be satisfied where either of the following conditions are met:

24.2.1. the investment intermediary has the right to obtain in a timely manner a provisional payment by the guarantor calculated to represent an estimate of the amount of the economic loss, likely to be incurred by the investment intermediary proportional to the coverage of the guarantee; or

24.2.2. the investment intermediary can demonstrate to the deputy chairman that the economic loss has been covered by the guarantee.

24.3. The economic loss for the purposes of item 24.2.2. are the losses as a result of non-effected payments on the obligor's side, including interest and other types of payments.

25. Additional requirements for recognition of credit derivatives

25.1. The credit derivatives under item 20.1. shall be recognized when the additional requirements under item 25.1 – 25.6 have been satisfied:

25.2. The credit events specified under the credit derivative shall include:

25.2.1. the failure to pay the amounts due under the terms of the underlying obligation when the grace period that is closely in line with or shorter than the grace period in the underlying obligation;

25.2.2. bankruptcy or insolvency of the obligor;

25.2.3. the restructuring of the underlying obligation involving forgiveness or postponement of principal, interest or fees that results in a credit loss event;

25.3. Where the condition under item 25.2.3. has not been complied with, the credit protection may nonetheless be recognized subject to reduction according point 54.

25.4. The identity of the parties responsible for determining whether a credit event has occurred shall be clearly defined in the contract for credit protection, at least one of them not being a provider of protection. The protection buyer shall have the right/ability to inform the protection provider of the occurrence of a credit event.

25.5. In the case of credit derivatives allowing for cash settlement, a robust valuation process shall be in place in order to estimate loss reliably. There shall be a clearly specified period for obtaining post-credit-event valuations of the underlying obligation;

25.6. If the protection purchaser's right and ability to transfer the underlying obligation to the protection provider is required for settlement, the terms of the underlying obligation shall provide that any required consent to such transfer may not be unreasonably withheld.

26. A mismatch between the underlying obligation and the reference obligation under the credit derivative (i.e. the obligation used for the purposes of determining cash settlement value or the deliverable obligation) or between the underlying obligation and the obligation used for purposes of determining whether a credit event has occurred is permissible only if the following conditions are met:

26.1. the reference obligation or the obligation used for purposes of determining whether a credit event has occurred, as the case may be, ranks pari passu with or is junior to the underlying obligation; and

26.2. the underlying obligation and the reference obligation or the obligation used for purposes of determining whether a credit event has occurred, as the case may be, share the same obligor and there are in place legally enforceable cross-default or cross-acceleration clauses.

27. Requirements to providers of protection for the treatment set out in item 1.1.2 Section I of Annex No. 5.

27.1. To be eligible credit protection deriving from a guarantee or credit derivative shall meet the following conditions:

27.1.1. the underlying obligation shall be:

(a) a corporate exposure as defined in Art. 113, excluding insurance and reinsurance undertakings;

(b) an exposure to a regional government, local authority or public sector entity which is not treated as an exposure to a central government or a central bank under Art. 113; or

(c) an exposure to a small or medium sized entity, classified as a retail exposure under Art. 113 para 4;

27.1.2. the underlying obligors shall not be members of the same group as the protection provider;

27.1.3. the exposure shall be hedged by one of the following instruments:

(a) single-name unfunded credit derivatives or single-name guarantees,

(b) first-to-default basket products – the treatment shall be applied to the asset within the basket with the lowest risk-weighted exposure amount, or

(c) n^{th}-to-default basket products – the protection obtained is only eligible for consideration under this framework if eligible (n-1)th default protection has also be obtained or where (n-1) of the assets within the basket has/have already defaulted. Where this is the case the treatment shall be applied to the asset within the basket with the lowest risk-weighted exposure amount;

27.1.4 The credit protection meets the requirements set out in points 22 and 21 – 26.

27.1.5. The risk weight that is associated with the exposure prior to the application of the treatment does not already factor in any aspect of the credit protection;

27.1.6. An investment intermediary shall have the right to require payment from the protection provider without having to take legal action in order to pursue the counterparty for payment. To the extent possible, an investment intermediary shall take steps to satisfy itself that the protection provider is willing to pay promptly should a credit event occur;

27.1.7. The credit protection shall absorb all credit losses incurred on the hedged portion of an exposure that arise due to the occurrence of credit events outlined in the contract;

27.1.8. If the payout structure provides for physical settlement, then there shall be legal certainty with respect to the deliverability of a loan, security, or contingent liability. If an investment intermediary intends to deliver an obligation other than the underlying exposure, it shall ensure that the deliverable obligation is sufficiently liquid so that the investment intermediary would have the ability to purchase it;

27.1.9. The terms and conditions of credit protection arrangements shall be legally confirmed in writing by both the protection provider and the credit institution;

27.1.10 The investment intermediary shall have a process in place to detect excessive correlation between the creditworthiness of a protection provider and the obligor of the underlying exposure due to their performance being dependent on common factors beyond the systematic risk factor; and

27.1.11. In the case of protection against dilution risk, the seller of purchased receivables shall not be a member of the same group as the protection provider.

Calculating exposure adjusted value

28. For calculation of the effect of credit protection applying the investment intermediary uses one of the following methods:

28.1. Financial Collateral Simple Method – may be used only by an investment intermediary, applying Standardized Method for credit risk;

28.2. Financial Collateral Comprehensive Method – may be used only by investment intermediaries applying Standardized Method or the Internal Ratings Based (IRB) Method without calculation of own conversion factors.

28.3. Internal model

29. Cash, securities or commodities purchased, borrowed or received under a repurchase transaction or securities or commodities lending or borrowing transaction shall be treated as collateral.

30. Credit linked notes which meet the requirements of credit derivatives under item 22 - 26 bound with issued by the investment intermediary loans may be recognized as cash pledge under item 8.

31. Loans and deposits with the lending credit institution subject to on-balance sheet netting are to be treated as cash collateral.

Financial Collateral Simple Method

32. Under the simple method the investment intermediaries use the risk weights indicated in item 33, and the recognized financial collateral is assigned a value equal to its market value.

33. The risk weight that would be assigned if the lender had a direct exposure shall be the risk weight that would be assigned to an unsecured exposure to the counterparty. To the collateralized portion of the exposure a risk weight shall be assigned corresponding to the collaterization according the standardized method, the risk weight being a minimum of 20%., except for the cases under item 33.1 – 33.4.

33.1. A risk weight of 0% shall be assigned to the collateralized portion of the exposure, arising from repurchase transactions and securities lending or borrowing transactions, meeting the criteria of item 43 para 2. If the counterparty to the transaction is not a core market participant a risk weight of 10% shall be assigned.

33.2. A risk weight of 0% shall, to the extent of the collateralization, be assigned to derivative instruments for which the following requirements have been satisfies:

33.2.1. they are subject to daily marking-to-market;

33.2.2. the collateralization is by cash deposit or cash-assimilated instruments where there is no currency mismatch.

33.3. A risk weight of 10% shall be assigned to the extent of the collateralization to the values of derivatives instruments collateralized by debt securities issued by:

33.3.1. central governments or central banks which are assigned a 0% risk weight under the Standardized Method.

33.3.2. by regional governments or local authorities exposures to which are treated as exposures to central governments or central banks;

33.3.3. by multilateral development banks and by international organizations to which a 0% risk weight is assigned under the Standardized Method;

33.4. A 0% risk weight is assigned for instruments where the exposure and the collateral are denominated in the same currency, and either:

33.4.1. the collateral is cash on deposit or cash assimilated instrument;

33.4.2. the collateral is in the form of debt securities under item 33.2, and its market value has been discounted by 20%.

Financial Collateral Comprehensive Method

34. When using the Financial Collateral Comprehensive Method, the investment intermediary takes account of the market value volatility of the collaterals by the employment of "Supervisory" volatility adjustments or the "Own Estimates" volatility adjustments approaches.

35. An investment intermediary which uses "Own Estimates" volatility adjustments approach must do so for all credit risk exposures, excluding those exposures which form immaterial portfolios.

35.1. Where the collateral consists of a number of recognized items, the volatility adjustment shall be $H = \sum_i a_i H_i$,

Where

a_i is the proportion of an item to the collateral as a whole and H_i is the volatility adjustment applicable to that item.

35.2. Where the collateral is denominated in currency other than that of the main exposure, to the volatility adjustment in the collateral value under item 34 shall be added volatility adjustment of the exchange rate.

35.3. In the cases under item 35.2., when the exposure is in OTC derivative instruments, subject of approved by the deputy chairman netting agreements, only one volatility adjustment of the exchange rate shall be applied. This treatment is applied irrespective of the number of currencies under the transactions covered by the netting agreement.

36. Supervisory volatility adjustments

36.1. With the Supervisory volatility adjustments approach, where the investment intermediary makes daily revaluation of the collaterals, the volatility adjustments to be applied shall be those set out in Tables 1 to 4.

Table 1 Supervisory volatility adjustments

Credit quality step with which the credit assessment of the debt security is associated	Residual Maturity	Volatility adjustments for debt securities issued by entities described under item 8.2.	Volatility adjustments for debt securities issued by entities described in item 8.3 and 8.4

		20-day liquidation period (%)	10-day liquidation period (%)	5-day liquidation period (%)	20-day liquidation period (%)	10-day liquidation period (%)	5-day liquidation period (%)
1	≤ 1 year	0,707	0,5	0,354	1,414	1	0,707
	>1 ≤ 5 years	2,828	2	1,414	5,657	4	2,828
	> 5 years	5,657	4	2,828	11,314	8	5,657
2-3	≤ 1 year	1,414	1	0,707	2,828	2	1,414
	>1 ≤ 5 years	4,243	3	2,121	8,485	6	4,243
	> 5 years	8,485	6	4,243	16,971	12	8,485
4	≤ 1 year	21,213	15	10,607	N/A	N/A	N/A
	>1 ≤ 5 years	21,213	15	10,607	N/A	N/A	N/A
	> 5 years	21,213	15	10,607	N/A	N/A	N/A

Table 2

Credit quality step with which the credit assessment of a short term debt security is associated	Volatility adjustments (%) for debt securities issued by entities described in item 8.2.with short-term credit assessments			Volatility adjustments (%) for debt securities issued by entities described in item 8.3 and 8.4 with short-term credit assessments		
	20-day liquidation period (%)	10-day liquidation period (%)	5-day liquidation period (%)	20-day liquidation period (%)	10-day liquidation period (%)	5-day liquidation period (%)
1	0,707	0,5	0,354	1,414	1	0,707
2-3	1,414	1	0,707	2,828	2	1,414

Table 3 Other types of collateral

Other collateral or exposure types			
	20-day liquidation period (%)	10-day liquidation period (%)	5-day liquidation period (%)
Main Index Equities, Main Index Convertible Bonds	21,213	15	10,607
Other Equities or Convertible Bonds listed on a recognized exchange	35,355	25	17,678
Cash	0	0	0
Gold	21,213	15	10,607

Table 4 Volatility adjustment (%) for currency mismatch

Period of realization		
20-day liquidation period (%)	10-day liquidation period (%)	5-day liquidation period)
11,314	8	5,657

36.2. Where the investment intermediary does not make daily revaluation, the requirements of item 42 shall be complied with.

36.3. In determining the volatility adjustments under item 36.1, the liquidation period shall be as follows:

36.3.1. for secured lending transactions: twenty business days;

36.3.2. for repurchase transactions with the subject of securities and securities lending or borrowing transactions: five business days;

36.3.3 for other capital market driven transactions: 10 business days.

36.4. For exposures in securities or commodities lent or sold under repurchase transactions or securities or commodities lending or borrowing transactions, which do not meet the requirements of item 8 and 9, the volatility adjustment is the same as for non-main index equities listed on a recognized exchange.

36.5. For eligible units in collective investment undertakings the volatility adjustment is the weighted average volatility adjustments that would apply, having regard to the liquidation period of every asset according item 36.3, 36.4, 36.6. If the assets in which the fund has invested are not known to the investment intermediary, the volatility adjustment is the highest volatility adjustment that would apply to any of the assets in which the collective investment undertaking has the right to invest.

36.6. For unrated debt securities satisfying the eligibility criteria in point 9.1 the volatility adjustments shall be the same as for securities issued by institutions or corporates with an external credit assessment associated with credit quality steps 2 or 3.

Own estimates of volatility adjustments

37. Subject to the permission of the deputy chairman, an investment intermediary complying with the qualititative requirements set out in points 38 to 40 and the quantitative requirements of point 41, may use their own volatility estimates for calculating the volatility adjustments to be applied to collateral.

37.1. When debt securities have a credit assessment from a recognized ECAI equivalent to investment grade or better, the investment intermediary may calculate a volatility estimate for each category of debt security.

37.2. In determining relevant categories under point 37.1, the investment intermediary shall take into account the type of issuer of the security, the external credit assessment of the securities, their residual maturity, and their modified duration. Volatility estimates must be representative of the securities included in the relevant category.

37.3. For debt securities having a credit assessment from a recognized ECAI below investment grade, and for other eligible collateral, the volatility adjustments must be calculated by the investment intermediary for each individual item.

37.4 In the estimate volatility of the collateral or foreign exchange mismatch, any correlations between the unsecured exposure, collateral and/or exchange rates shall not be taken into account.

38. Quantitative Criteria

38.1 In calculating the own estimates of volatility adjustments, the investment intermediary shall use a 99th percentile one-tailed confidence interval.

38.2. Where no daily revaluation of the collateral is made, the requirements under item 42 shall be complied with.

38.3. The investment intermediary shall update its estimates of volatility adjustments at least once in a quarter or more frequently, when the market conditions necessitate it.

39. Liquidation period

39.1. In calculating its own estimates of volatility adjustments, the investment intermediary shall comply with the following requirements for liquidation period: 20 business days for secured lending transactions; 5 business days for repurchase transactions; 10 business days for other capital market driven transactions.

39.2. Investment intermediaries may use volatility adjustment numbers calculated according to shorter or longer liquidation periods, scaled up or down to the liquidation period set out in point 39.1 , using the square root of time formula:

$$H_M = H_N \sqrt{T_M / T_N}$$

where T_M is the relevant liquidation period;

H_M is the volatility adjustment under T_M and

H_N is the volatility adjustment based on the liquidation period T_N.

39.3. An investment intermediary has to adjust upwards the liquidation period, in cases where there are circumstances presuming worsening the liquidity of the collateral.

39.4. The investment intermediary shall conduct stress tests to identify where used historical data may understate potential volatility.

40. The historical observation period (sample period) for calculating volatility adjustments shall be a minimum length of one year.

40.1. For an investment intermediary that uses a weighting scheme or other methods for the historical observation period, the effective observation period shall be at least one year, that is, the weighted average time lag of the individual observations shall not be less than 6 months.

40.2. The deputy chairman may also require volatility adjustments to be calculated for shorter observation period in case of significant upsurge in price volatility.

40.3. The volatility adjustments shall be reassessed at least once every three months when the investment intermediary renovates its observations and more frequently whenever market prices are subject to material changes.

Qualitative Criteria

41. The volatility estimates shall be used in the day-to-day risk management process of the investment intermediary including in relation to its internal exposure limits.

41.1. The investment intermediary shall have established procedures for monitoring and ensuring compliance with the internal set of policies and controls for the operation of its system for the estimation of volatility adjustments and for the integration of such estimations into its risk management process.

41.2. The estimation of volatility adjustments shall be a subject of a regular review in the investment intermediary's own internal auditing process, where at least once yearly a review and approval shall be made of:

41.2.1. the integration of estimated volatility adjustments into daily risk management;

41.2.2. the validation of any significant change in the process for the estimation of volatility adjustments;

41.2.3. the verification of the consistency, timeliness, reliability and independence of data sources used; and

41.2.4. the accuracy and appropriateness of the volatility assumptions.

42. Where the investment intermediary does not make daily revaluation of the collateral, the supervisory and own estimates of the volatility adjustments shall be calculated using the following "square root of time" formula:

$$H = H_M \sqrt{\frac{N_R + (T_M - 1)}{T_M}}$$

where:

H is the volatility adjustment to be applied

H_M is the volatility adjustment where there is daily revaluation

N_R is the actual number of business days between revaluations

T_M is the liquidation period for the type of transaction in question.

Conditions for applying a 0% volatility adjustment

43. In relation to repurchase transactions and securities lending or borrowing transactions, the investment intermediary may apply 0% volatility adjustment where the conditions set out in point 43.3. have been satisfied.

43.1. Where in another Member State the applying of 0% volatility adjustment is allowed in relation to repurchase transactions and lending or borrowing transactions with government securities issued by that Member State, the investment intermediary may apply a zero percent adjustment for those transactions.

43.2. The applying of 0% volatility adjustment is not allowed when the investment intermediary uses the internal models approach.

43.3. For the applying of 0% volatility adjustment, the following conditions must be simultaneously satisfied:

43.3.1. Both the exposure and the collateral are cash or debt securities issued by central governments or central banks, satisfying the requirements according item 8.2 and eligible for a 0% risk weight according the standardized method;

43.3.2. Both the exposure and the collateral are denominated in the same currency;

43.3.3. Either the maturity of the transaction is no more than one day or both the exposure and the collateral are subject to daily marking-to-market or daily remargining,

43.3.4. It is considered that the time between the last marking-to-market before a failure to remargin by the counterparty and the liquidation of the collateral shall be no more than four business days,

43.4.5 The transaction is settled across a settlement system proven for that type of transaction;

43.3.6. The counterparty to the transaction is an institutional investor;

43.3.7. The documentation covering the agreement is standard for such types of transactions,

43.3.8. The conditions of the transaction envisage immediate payment if the counterparty fails to satisfy an obligation to deliver cash or securities or to deliver margin or otherwise defaults.

44. Investment intermediaries using the Financial Collateral Comprehensive Method shall calculate the net adjusted exposure value according the following formula:

$E^* = \max \{0, [E_{VA} - C_{VAM}]\}$

Where:

E_{VA} is the volatility-adjusted exposure amount.

C_{VA} is the volatility-adjusted value of the collateral.

C_{VAM} is C_{VA} further adjusted for any maturity mismatch.

H_E is the volatility adjustment appropriate to the exposure (E).

H_C is the volatility adjustment appropriate to the collateral.

H_{FX} is the volatility adjustment appropriate to currency mismatch.

E* is the fully adjusted exposure value taking into account volatility and the risk-mitigating effects of the collateral.

Regardless of the used method for credit risk, for the purposes of item 44 investment intermediaries shall use the off-balance sheet items before applying conversion factors.

Calculating risk-weighted exposure amounts and expected loss amounts

45. As exposure value under the Standardized Approach for credit risk is taken the net adjusted exposure value, calculated in accordance with item 44.

45.1. An investment intermediary using the Internal Ratings Based Approach for credit risk, without calculation of own conversion factors, shall calculate the net adjusted exposure value according formula under item 35.1, while complying with the following requirements:

45.1.1. it uses supervisory volatility adjustments, accounting for the currency and maturity mismatches, as well as the requirements under item 42;

45.1.2. a 10-day liquidation period is applied.

45.2. The adjusted assessment of the parameter “Loss Given Default” which is used in the applying of the IRB Approach is calculated according the following formula:

$$LGD^* = LGD \times (E^*/E)$$

where:

LGD* is the adjusted assessment of the parameter LCD for the purposes of IRB Approach

LGD is the LGD that would apply to the exposure if the exposure was not collateralized;

E is the uncolletarized exposure value;

E* is the adjusted exposure value as calculated under point 44.

Master netting agreements covering repurchase transactions and/or securities or commodities lending or borrowing transactions and/or other capital market driven transactions

46.The adjusted value of the position under a Master netting agreements covering repurchase transactions and/or securities or commodities lending or borrowing transactions and/or other capital market driven transactions is calculated according the following formula:

$$E^* = \max \{0, [(\sum(E) - \sum(C)) + \sum(|\text{net position in each security}| \times H_{sec)} + (\sum|E_{fx}| \times Hfx)]\}$$

Where

E* is the fully adjusted exposure value;

E is the exposure value for each separate exposure under the agreement that would apply in the absence of the credit protection;

C is the value of the securities or commodities borrowed, purchased or received or the cash borrowed or received in respect of each such exposure.

$\sum(E)$ is the sum of all Es under the agreement.

$\sum(C)$ is the sum of all Cs under the agreement.

E_{fx} is the net position (positive or negative) in a given currency other than the settlement currency of the agreement as calculated under point 8.

H_{sec} is the volatility adjustment appropriate to a particular type of security.

H_{fx} is the foreign exchange volatility adjustment.

46.1. The net position in each type of security or commodity shall be calculated by subtracting from the total value of the securities or commodities of that type lent, sold or provided under the master netting agreement, the total value of securities or commodities of that type borrowed, purchased or received under the agreement. Securities of the same type means securities which are issued by the same entity, have the same issue date, the same maturity and are subject to the same terms and conditions.

46.2. The net position in each currency, other than the settlement currency of the master netting agreement, shall be calculated as the difference between:

46.2.1 the total value of the provided securities and cash denominated in that currency, and

46.2.2. the total value of the borrowed securities and cash denominated in that currency.

46.3. The volatility adjustment appropriate to a given type of security or cash position shall be applied to the absolute value of the positive or negative net position in the securities of that type.

46.4. The currency volatility adjustment shall be applied to the positive or negative position for every type of currency other than the currency of settlement of the master agreement.

47. The used by the investment intermediary own or supervisory volatility adjustments shall satisfy the requirements under item 38 – 43.

48. The maturity mismatches shall be treated according item 58 – 60.

49. As exposure value under the standardized approach or under the IRB approach for credit risk shall be accepted the adjusted exposure value calculated under item 46.1.

Internal Models approach

50. In calculating the fully adjusted exposure value, the investment intermediary may apply Internal Model approach which takes into account correlation effects between security positions subject to the master netting agreement as well as the liquidity of the instruments concerned. The result of the use of the Internal Model approach is estimate of the potential change in value of the unsecured exposure amount

50.1. The internal models approach is used independently of the chosen by the investment intermediary risk-management model.

50.2. Subject to approval by the deputy chairman, the investment intermediary may use its internal model also for margin loan transaction when they are covered by a bilateral master netting agreement.

50.3. An investment intermediary must apply this approach for all counterparties and securities, excluding immaterial portfolios where it may use the Supervisory volatility adjustments approach or the Own estimates volatility adjustments approach and the derivative instruments for which Art. 66-70 apply.

50.4. The investment intermediaries shall have the right to apply an internal model, provided that it has obtained an approval to apply internal risk-measurement model according point 134.

51. Subject to approval by the deputy chairman, an investment intermediary that does not use internal risk-measurement model, may use internal model under point 50, when the following requirements are met:

51.1. The investment intermediary has in place sound and implemented with integrity risk-management system for managing the risks arising on the transactions covered by the master netting agreements:

51.2. The internal risk-measurement model used by the investment intermediary for calculation of potential price volatility for the transactions is closely integrated into the daily risk-management process and captures a sufficient number of risk factors in order to capture all material price risks.

51.3. (Am. – SG, iss. 68 in 2008) The investment intermediary has a risk management and control unit that:

51.3.1. (Am. – SG, iss. 68 in 2008) is independent from business trading unit;

51.3.2. has sufficient staff skilled in the use of sophisticated models in the field of risk management;

51.3.3. (Am. – SG, iss. 68 in 2008) is responsible for designing and implementing the risk-management system;

51.3.4. it shall produce and analyze daily reports on the output of the risk-measurement model and on the appropriate measures to be taken in terms of position limits;

51.3.5. the daily reports produced by the risk management and control unit are reviewed by a level of management with sufficient authority to enforce reductions of positions taken and of overall risk exposure;

51.4. the investment intermediary's models have a proven track record of reasonable accuracy in measuring risks demonstrated through the back-testing of its output using at least one year of data;

51.5. the investment intermediary frequently conducts a rigorous programme of stress testing and the results of these tests are reviewed by senior management and reflected in the policies and limits it sets;

51.6. the investment intermediary has established procedures for monitoring and ensuring compliance with a documented set of internal policies and controls concerning the overall operation of the risk-measurement system;

51.7. (Am. – SG, iss. 68 in 2008) the internal audit unit of the investment intermediary must conduct regular review of its risk-measurement system. This review must include both the activities of the business trading unit and of the risk management and control unit;

51.8. at least once a year, the investment intermediary must conduct a review of its risk-management system;

51.9. the internal model shall meet the requirements set out in Annex III.

52. The calculation of the potential change in the uncolletarized part of the value shall be subject to the following minimum standards:

52.1. at least daily calculation of the potential change in value;

52.2. a 99th percentile, one-tailed confidence interval is used;

52.3. The following liquidation periods shall apply:

52.3.1. in case of securities repurchase transactions or securities lending or borrowing transactions - a 5-day equivalent liquidation period;

52.3.2. other transactions executed on the capital market: ten working days.

52.4. An effective historical observation period of at least one year except where a shorter observation period is justified by a significant upsurge in price volatility;

52.5. The investment intermediary shall update its volatility adjustments assessments at least once quarterly or more frequently when the market conditions necessitate it.

52.6. Subject to the approval of the deputy chairman, the investment intermediary may use empirical correlations within risk categories and across risk categories if it demonstrates that the system for measuring correlations is sound and implemented with integrity.

53. The fully adjusted exposure value (E*) in case of using the Internal models approach shall be calculated according to the following formula:

$$E^* = \max \{0, [(\sum E - \sum C) + (VaR)]\}$$

E* is the adjusted exposure value

E is the exposure value for each separate exposure under the agreement that would apply in the absence of the credit protection.

C is the value of the securities borrowed, purchased or received or the cash borrowed or received in respect of each such exposure.

VaR – the value at risk obtained under the internal model

In calculating risk-weighted exposure amounts using internal models, investment intermediaries shall use the previous business day's model output.

Unfunded Credit Protection

Calculating risk-weighted exposure amounts and expected loss amounts

54. The value of unfunded credit protection shall be the amount that the protection provider has undertaken to pay in the event of the default or non-payment of the borrower or on the occurrence of other specified credit events.

54.1. In the case of credit derivatives which do not include as a credit event restructuring of forgiveness or postponement of principal, interest or fees that result in a credit loss event for the investment intermediary, the amount of the credit protection shall be reduced as follows:

54.1.1. where the amount that the protection provider has undertaken to pay in case of credit event is not higher than the exposure value, the value of the credit protection shall be reduced by 40%; or

54.1.2. where the amount that the protection provider has undertaken to pay in case of credit protection is higher than the exposure value, the value of the credit protection shall be no higher than 60% of the exposure value.

54.2. Where unfunded credit protection is denominated in a currency different from that in which the exposure is denominated, the value of the credit protection shall be calculated according the following formula:

$G^* = G \times (1-H_{FX})$

where:

G is the nominal amount of the credit protection,

G* is G adjusted for any foreign exchange risk, and

H_{fx} is the volatility adjustment for any currency mismatch between the credit protection and the underlying obligation.

55. Where an investment intermediary transfers a part of the risk of a loan in one or more tranches, the rules set out in Annex No. 7 shall apply. Materiality thresholds on payments below which no payment shall be made in the event of loss are considered to be equivalent to retained by the investment intermediary first loss positions and to give rise to a tranched transfer of risk.

56. An investment intermediary applying Standardised Approach shall weight the exposures as follows:

56.1. to an exposure which is fully protected by unfunded protection is assigned the risk weight of exposures to the protection provider after adjustment of the protection value for any maturity mismatch;

56.2. to the non-protected part of the partial protection shall be assigned the obligor's risk weight.

56.3. Where the protected amount is less than the exposure value and the protected and unprotected parts are of equal seniority, the investment intermediary shall calculate risk-weighted exposure amounts in accordance with the following formula:

$RWE = (E-G_A) \times r + G_A \times g$

where:

RWE is the risk-weighted exposure amount

E is the exposure value;

G_A is the value of G* as further adjusted for any maturity mismatch according the formula under item 60.2;

r is the risk weight of exposures to the obligor ;and

g is the risk weight of exposures to the protection provider.

57. An investment intermediary applying the IRB Approach shall determine the risk weights of the exposures as follows:

57.1. For the covered portion of the exposure shall apply the PD of the protection provider, or a PD between that of the borrower and that of the guarantor if a full substitution is deemed not to be warranted. In calculation of the amount of the covered portion are also taken into account the adjustments for currency and maturity mismatches.

57.2. In the case of subordinated exposures and non-subordinated unfunded protection, the LGD to be applied may be that associated with senior claims.

57.3 For any uncovered portion of the exposure the PD shall be that of the borrower and the LGD shall be that of the underlying exposure.

Maturity mismatch

58. A maturity mismatch occurs when the residual maturity of the credit protection is less than that of the protected exposure.

58.1. Where there is a maturity mismatch the credit protection shall not be recognized where:

58.1.1. the original maturity of the protection is less than 1 year; or

58.1.2. the residual period of the protection is less than 3 months.

59. 3. Subject to a maximum of 5 years, the effective maturity of the underlying shall be the longest possible remaining time before the obligor is scheduled to fulfil its obligations.

59.1. As the maturity of the credit protection shall be accepted:

59.1.1. Where there is an option to terminate the protection which is at the discretion of the protection seller, the maturity of the protection shall be taken to be the time to the earliest date at which that option may be exercised.

59.1.2. Where the investment intermediary is interested, it is entitled to terminate unilaterally the protection before the deadline set according the terms of the arrangement, the maturity of the protection shall be taken to be the time to the earliest date at which that option may be exercised;

59.1.3. in all other cases – the term until the earliest date on which the protection may be terminated or its period expires.

59.2. Where a credit derivative is not prevented from terminating prior to expiration of any grace period required for a default on the underlying obligation to occur as a result of a failure to pay the maturity of the protection shall be reduced by the amount of the grace period.

60. In applying of Financial Collateral Simple Method for transactions subject to funded credit protection, where there is a mismatch between the maturity of the exposure and the maturity of the protection, the collateral shall not be recognized.

60.1. In applying Financial Collateral Comprehensive Method for transactions subject to funded credit protection the maturity of the credit protection and that of the exposure must be reflected in the adjusted value of the collateral according to the following formula:

$C_{VAM} = C_{VA} \times M$,

where:

C_{VA} is the volatility adjusted value of the collateral or the amount of the exposure, whichever is the lowest;

C_{VAM} shall be taken as C_{VA} further adjusted for maturity mismatch to be included in the formula for the calculation of the fully adjusted value of the exposure (E*) set out in point 33.

$M = (t-t^*)/(T-t^*)$

where:

t is the number of years remaining to the maturity date of the credit protection, or the value of T, whichever is the lower;

T is the number of years remaining to the maturity date of the exposure, or 5 years, whichever is the lower; and

t* is 0,25. (3 months)

60.2. In case of transactions subject to unfunded credit protection, the maturity of the credit protection and that of the exposure must be reflected in the adjusted value of the credit protection according to the following formula:

$G_A = G^* xM$

where:

G* is the amount of the protection adjusted for any currency mismatch according the formula in point 54.2;

G_A is G* adjusted for any maturity mismatch

M is calculated according the formula in item 60.1.

Combinations of credit risk mitigation in the Standardized Approach

61. In the case where an investment intermediary applying the Standardized Approach for credit risk, has more than one form of credit risk mitigation covering a single exposure, it shall be required to subdivide the exposure into parts covered by each type of credit risk mitigation tool and the risk-weighted exposure amount for each portion must be calculated separately. Such approach shall be applied by the investment intermediary also when credit protection provided by a single protection provider has differing maturities.

Basket CRM techniques

62. Protection by first-to-default credit derivatives is recognized where in the calculation of the risk-weighted exposure amounts and expected losses, it is assumed that protected is only the exposure which would, in the absence of the credit protection, produce the lowest risk-weighted exposure amount. The credit protection shall be recognized only if its value is bigger or equal to the exposure value.

63. Protection by nth-to-default credit derivatives is recognized where prior to that protection has also been recognized for defaults 1 to n-1 or when n-1 defaults have already occurred. In the calculation of the of risk-weighted exposure amounts and, as relevant, expected loss amounts, for protected is recognized the exposure with the lowest risk weighted equivalent, which is not accepted to be protected by previous in sequence default.

64. Calculating risk-weighted exposure amounts and expected loss amounts

64.1. Where the ratio of the value of the collateral to the exposure value is below the first threshold level of the required minimum collateralization level for the exposure as laid down in Table 5, LGD shall be calculated according the rules for treatment of uncollateralized exposures to the counterparty laid down in Annex V.

64.2. Where the ratio of the value of the collateral to the exposure value is above the second threshold level of the required collateralization level for the exposure, LGD shall be calculated according Table 5.

Table 5

Minimum LGD for secured parts of exposures

	LGD* for senior claims or contingent claims	LGD* for subordinated claims or contingent claims	First required minimum collateralization level of the exposure (C*)	Second required minimum collateralization level of the exposure (C**)
Receivables	35%	65%	0%	125%
Residential real estate	35%	65%	30%	140%
Other collateral	40%	70%	30%	140%

64.3. Where the ratio of the value of the collateral to the exposure value has not reached the second required threshold in respect of the exposure as a whole, the exposure shall be considered to be two exposures:

64.3.1. exposure in respect of which the second required threshold is achieved;

64.3.2. the remainder exposure.

65. Where risk-weighted exposure amounts and expected loss amounts are calculated under the IRB Approach, and an exposure is collateralized by both financial collateral and other eligible collateral, the investment intermediary shall be required to subdivide the volatility-adjusted value of the exposure into parts each covered by only one type of collateral and the remainder shall be treated as unsecured .

66. LGD for each part of exposure shall be calculated separately.

Annex 7

To Chapter 12, Section IV

(Am. – SG, iss. 4 in 2007; iss. 68 in 2008)

Securitization

1. For the purposes of this Annex:

1.1. "Excess spread" means finance charge collections and other fee income received in respect of the securitised exposures net of costs and expenses;

1.2. "Clean-up call option" means a contractual option for the originator to repurchase or extinguish the securitisation positions before all of the underlying exposures have been repaid, when the amount of outstanding exposures falls below a specified level;

1.3. "Liquidity facility" means the securitisation position arising from a contractual agreement to provide funding to ensure timeliness of cash flows to investors;

1.4."Kirb" means 8% of the risk-weighted exposure amounts that would be calculated under Chapter Twelve, Section II in respect of the securitised exposures, had they not been securitised, plus the amount of expected losses associated with those exposures calculated according the same provisions;

1.5. "Ratings based method" means the method of calculating risk-weighted exposure amounts for securitisation positions in accordance with point 6.3.3;

1.6. "Supervisory formula method" means the method of calculating risk-weighted exposure amounts for securitisation positions in accordance with point 6.3.4;

1.7."Unrated position" means a securitisation position which does not have an eligible credit assessment by an eligible ECAI as defined in Article 123;

1.8."Rated position" means a securitisation position which has an eligible credit assessment by an eligible ECAI as defined in Article 123;

1.9. "Asset-backed commercial paper (ABCP) programme" means a programme of securitisations the securities issued by which predominantly take the form of commercial paper with an original maturity of one year or less.

2. Minimum requirements for recognition of significant credit risk transfer in a traditional securitisation

The originator investment intermediary of a traditional securitisation may exclude securitised exposures from the calculation of risk-weighted exposure amounts and expected loss amounts if significant credit risk associated with the securitised exposures has been transferred to third parties and the transfer complies with the following conditions:

2.1. The securitisation documentation reflects with sufficiently high accuracy the economic substance of the transaction;

2.2.The securitised exposures are put beyond the reach of the originator investment intermediary and its creditors;

2.3 The securities issued do not represent payment obligations of the originator investment intermediary;

2.4.The transferee is a securitisation special-purpose entity (SSPE);

2.5 The originator investment intermediary does not maintain effective or indirect control over the transferred exposures. An originator investment intermediary shall be considered to have maintained effective control over the transferred exposures if it has the right to repurchase from the transferee the previously transferred exposures in order to realize their benefits or if it is obligated to re-assume transferred risk. The retention of servicing rights or obligations in respect of the exposures shall not of itself constitute indirect control of the exposures;

2.6. Where there is a clean-up call option, the following conditions are satisfied:

2.6.1. The clean-up call option is exercisable at the discretion of the originator investment intermediary;

2.6.2 The clean-up call option may only be exercised when 10% or less of the original value of the exposures securitised remains unamortized; and

2.6.3.The clean-up call option is not structured to avoid allocating losses to credit enhancement positions or other positions held by investors and is not otherwise structured to provide credit enhancement; and

2.7. The securitisation documentation does not contain clauses that increasing the yield payable to the holders of positions in the securitisation in response to deterioration in the credit quality of the underlying exposures

2.8. Without prejudice to case of early amortisation provisions, the securitisation documentation may not contain clauses:

2.8.1. which require positions in the securitisation to be improved by the originator investment intermediary or require increase of the yield payable to investors in response to a deterioration in the credit quality of the positions in the securitisation; or

2.8.2. increase the yield payable to holders of positions in the securitisation in response to deterioration in the credit quality of the underlying asset.

3. Minimum requirements for recognition of significant credit risk transfer in a synthetic securitisation

An originator investment intermediary of a synthetic securitisation may calculate risk-weighted exposure amounts, and, as relevant, expected loss amounts, for the securitised exposures in accordance with points 4.1 and 4.2 below, if significant credit risk has been transferred to third parties either through funded or unfunded credit protection and the transfer complies with the following conditions:

3.1.The securitisation documentation reflects with sufficiently high accuracy the economic substance of the transaction;

3.2. The credit protection by which the credit risk is transferred complies with the eligibility and other requirements under Chapter Twelve, Section III for the recognition of such credit protection. For the purposes of this point, special purpose entities shall not be recognised as eligible unfunded protection providers.

3.3. The instruments used to transfer credit risk do not contain terms or conditions that:

3.3.1 impose significant materiality thresholds below which credit protection is deemed not to be triggered if a credit event occurs;

3.3.2. allow for the termination of the protection due to deterioration of the credit quality of the underlying exposures;

3.3.3. other than in the case of early amortisation provisions, require positions in the securitisation to be improved by the originator investment intermediary;

3.3.4. increase the investment intermediary's cost of credit protection or the yield payable to holders of positions in the securitisation in response to deterioration in the credit quality of the underlying pool.

4. Originator investment intermediaries' calculation of risk-weighted exposure amounts for exposures securitised in a synthetic securitisation

4.1. In calculating risk-weighted exposure amounts for the securitised exposures, where the conditions in point 3. are met, the originator investment intermediary of a synthetic securitisation shall, subject to points 4.3, use the relevant calculation methodologies set out in Point 6 and not those set out in Chapter Twelve, Section I. For investment intermediary calculating risk-weighted exposure amounts and expected loss amounts under Chapter Twelve, Section II, the expected loss amount in respect of such exposures shall be zero.

4.2. The provisions of point 4.1 refer to the entire pool of exposures included in the securitisation. Subject to points 4.3, the originator investment intermediary is required to calculate risk-weighted exposure amounts in respect of all tranches in the securitisation in accordance with the provisions of Point 6 including those relating to the recognition of credit risk mitigation.

4.3. Treatment of maturity mismatches in synthetic securitisations

4.3.1. For the purposes of calculating risk-weighted exposure amounts in accordance with point 4.1, any maturity mismatch between the credit protection by which the tranching is achieved and the securitised exposures shall be taken into consideration in accordance with points 4.3.2. to 4.3.3.

4.3.2.The maturity of the securitised exposures shall be taken to be the longest maturity of any of those exposures subject to a maximum of five years. The maturity of the credit protection shall be determined in accordance with Annex 6.

4.3.3. An originator investment intermediary shall ignore any maturity mismatch in calculating risk-weighted exposure amounts for tranches appearing pursuant to Point 6 with a risk weighting of 1 250%. For all other tranches, the maturity mismatch treatment set out in Annex 6 shall be applied in accordance with the following formula:

RW^* is $[RW(SP) \times (t-t^*)/(T-t^*)] + [RW(Ass) \times (T-t)/(T-t^*)]$

Where:

RW^* is Risk-weighted exposure amounts for the purposes of Article 21, para1;

RW(Ass) is Risk-weighted exposure amounts for exposures if they had not been securitised, calculated on a pro-rata basis;

RW(SP) is Risk-weighted exposure amounts calculated under point 4.1 if there was no maturity mismatch;

T is maturity of the underlying exposures expressed in years;

t is maturity of credit protection expressed in years; and

t^* is 0,25.

5. Credit assessments of ECAIS

5.1. To be used for the purposes of calculating risk-weighted exposure amounts under item 6, a credit assessment of an eligible ECAI shall comply with the following conditions.

5.1.1.There shall be no mismatch between the types of payments reflected in the credit assessment and the types of payment envisaged under the contract giving rise to the securitisation position in question; and

5.1.2.The credit assessments shall be available publicly to the market. Credit assessments are considered to be publicly available only if they have been published in the web page of the entity for which the assessment was made.

5.1.3. Credit assessments that are made available only to a limited number of entities shall not be considered to be publicly available.

5.2. Use of credit assessment

5.2.1. An investment intermediary may nominate one or more eligible ECAIs the credit assessments of which shall be used in the calculation of its risk-weighted exposure amounts under Chapter Twelve, Section IV.

5.2.2. An investment intermediary must use credit assessments from nominated ECAIs consistently in respect of its securitisation positions.

5.2.3. Subject to points 5.2.4 and 5.2.5, an investment intermediary may not use an ECAI's credit assessments for its positions in some tranches and another ECAI's credit assessments for its positions in other tranches within the same structure.

5.2.4. Where a position has two credit assessments by nominated ECAIs, the investment intermediary shall use the less favourable credit assessment.

5.2.5. Where a position has more than two credit assessments by nominated ECAIs, the two most favourable credit assessments shall be used. If the two most favourable assessments are different, the least favourable of the two shall be used.

5.2.6. Where credit protection eligible under Chapter Twelve, Section III is provided directly to the SSPE, and that protection is reflected in the credit assessment of a position by a nominated ECAI, the risk weight associated with that credit assessment may be used. If the protection is not eligible under Chapter Twelve, Section III, the credit assessment shall not be recognized. In the situation where the credit protection is not provided to the SSPE but rather directly to a securitisation position, the credit assessment shall not be recognized.

5.2.7. The deputy chairman of the Commission shall determine with which credit quality step according the criteria under Point 6, each credit assessment of an eligible ECAI shall be associated.

6. Calculation

6.1. Calculation of risk-weighted exposure amounts

6.1.1. For the purposes of Article 121, the risk-weighted exposure amount of a securitisation position shall be calculated by applying to the exposure value of the position the relevant risk weight.

6.1.2. Subject to point 6.1.3:

(a) where an investment intermediary calculates risk-weighted exposure amounts under point 6.2, the exposure value of an on-balance sheet securitisation position shall be its balance sheet value;

(b) where an investment intermediary calculates risk-weighted exposure amounts under points 6.3, the exposure value of an on-balance sheet securitisation position shall be measured gross of value adjustments;

(c) the exposure value of an off-balance sheet securitisation position shall be its nominal value multiplied by a conversion figure as prescribed in this Annex. This conversion figure shall be 100% unless otherwise specified in this Annex

6.1.3. The exposure value of a securitisation position arising from a derivative instrument listed in Annex 10, shall be determined in accordance with Annex 3.

6.1.4. Where a securitisation position is subject to funded credit protection, the exposure value of that position may be modified in accordance with and subject to the requirements in Annex 6.

6.1.5. Where an investment intermediary has two or more overlapping positions in a securitisation, it will be required to the extent that they overlap to include in its calculation of risk-weighted exposure amounts only the position or portion of a position producing the higher risk-weighted exposure amounts. For the purpose of this point "overlapping" means that the positions, wholly or partially, represent an exposure to the same risk such that to the extent of the overlap there is a single exposure.

6.2. Calculation of risk-weighted exposure amounts under the standardized approach

6.2.1. Subject to point 6.2.3., the risk-weighted exposure amount of a rated securitisation position shall be calculated by applying to the exposure value the risk weight associated with the credit quality step in accordance with Tables 1 and 2.

Table 1

Positions other than ones with short-term credit assessments

Credit quality step	1	2	3	4	5 and below
Risk weight	20%	50%	100%	350%	1 250%

Table 2

Positions with short-term credit assessments

Credit quality step	1	2	3	All other credit assessments
Risk weight	20%	50%	100%	1 250%

6.2.2. Subject to points 6.2.4. letter “b” and 6.2.6.3., the risk-weighted exposure amount of an unrated securitisation position shall be calculated by applying a risk weight of 1 250%.

6.2.3. For an originator investment intermediary or sponsor investment intermediary, the risk-weighted exposure amounts calculated in respect of its positions in a securitisation may be limited to the risk-weighted exposure amounts which would be calculated for the securitised exposures had they not been securitised subject to the presumed application of a 150% risk weight to all past due items and items belonging to "regulatory high risk categories" amongst the securitised exposures.

6.2.4. Treatment of unrated positions

a) Investment intermediaries having an unrated securitisation position may apply the treatment set out in point 6.2.4. letter “b” for calculating the risk-weighted exposure amount for that position provided the composition of the pool of exposures securitised is known at all times.

b) An investment intermediary may apply the weighted-average risk weight that would be applied to the securitised exposures under Chapter Twelve, Section I by an investment intermediary holding the exposures, multiplied by a concentration ratio. This concentration ratio is equal to the sum of the nominal amounts of all the tranches divided by the sum of the nominal amounts of the tranches junior to or pari passu with the tranche in which the position is held including that tranche itself. The resulting risk weight shall not be higher than 1 250% or lower than any risk weight applicable to a rated more senior tranche. Where the investment intermediary is unable to determine the risk weights that would be applied to the securitised exposures under Chapter Twelve, Section I, it shall apply a risk weight of 1 250% to the position.

6.2.5. Treatment of securitisation positions in a second loss tranche or better in an ABCP programme

a) Subject to the availability of a more favourable treatment by virtue of the provisions concerning liquidity facilities in point 6.2.6., an investment intermediary may apply to securitisation positions meeting the conditions set out in letter “b” a risk weight that is the greater of 100% or the highest of the risk weights that would be applied to any of the securitised exposures under Chapter Twelve, Section I by an investment intermediary holding the exposures.

b) For the treatment set out in letter “a” to be available, the securitisation position shall be:

(aa) in a tranche which is economically in a second loss position or better in the securitisation and the first loss tranche must provide meaningful credit enhancement to the second loss tranche;

(bb) of a quality the equivalent of investment grade or better; and

(cc) held by an investment intermediary which does not hold a position in the first loss tranche.

6.2.6. Treatment of unrated liquidity facilities

6.2.6.1. Eligible liquidity facilities

a) When the following conditions are met, to determine its exposure value a conversion figure of 20% may be applied to the nominal amount of a liquidity facility with an original maturity of one year or less and a conversion figure of 50% may be applied to the nominal amount of a liquidity facility with an original maturity of more than one year:

(aa) the liquidity facility documentation shall clearly identify and limit the circumstances under which the facility may be drawn;

(bb) it shall not be possible for the facility to be drawn so as to provide credit support by covering losses already incurred at the time of draw;

(cc) the facility shall not be used to provide permanent or regular funding for the securitisation;

(dd) repayment of draws on the facility shall not be subordinated to the claims of investors other than to claims arising in respect of interest rate or currency derivative contracts, fees or other such payments, nor be subject to waiver or deferral;

(ee) it shall not be possible for the facility to be drawn after all applicable credit enhancements from which the liquidity facility would benefit are exhausted; and

(ff) the facility must include a provision that results in an automatic reduction in the amount that can be drawn by the amount of exposures that are in default, where "default" has the meaning given to it under Chapter Twelve, Section II, or where the pool of securitised exposures consists of rated instruments, that terminates the facility if the average quality of the pool falls below investment grade.

b) the risk weight to be applied shall be the highest risk weight that would be applied to any of the securitised exposures under Chapter Twelve, Section I by an investment intermediary holding the exposures.

6.2.6.2. Liquidity facilities that may be drawn only in the event of a general market disruption - for an investment intermediary to determine its exposure value, a conversion figure of 0% may be applied to the nominal amount of a liquidity facility that may be drawn only in the event of a general market disruption provided that the conditions set out in point 6.2.6.1, letter “a” are satisfied. For the purpose of this item general market disruption means where more than one SPE across different transactions are unable to roll over maturing commercial paper and that inability is not the result of impairment of the SPE's credit quality or of the credit quality of the securitised exposures.

6.2.6.3. Cash advance facilities - to determine its exposure value, a conversion figure of 0% may be applied by an investment intermediary to the nominal amount of a liquidity facility that is unconditionally cancellable provided that the conditions set out at point 6.2.6.1 are satisfied and that repayment of draws on the facility are senior to any other claims on the cash flows arising from the securitised exposures.

6.2.7. Additional capital requirements for securitisations of revolving exposures with early amortisation provisions

6.2.7.1. In addition to the risk-weighted exposure amounts calculated in respect of its securitisation positions, an originator investment intermediary shall calculate a risk-weighted exposure amount according to the method set out in points 6.2.7.2. to 6.2.7.7. when it sells revolving exposures into a securitisation that contains an early amortisation provision.

6.2.7.2. The investment intermediary shall calculate a risk-weighted exposure amount in respect of the sum of the originator's interest and the investors' interest.

6.2.7.3. For securitisation structures where the securitised exposures comprise revolving and non-revolving exposures, an originator investment intermediary shall apply the treatment set out in point 6.2.7.4. to 6.2.7.8 letters “a” – “h” to that portion of the underlying pool containing revolving exposures.

6.2.7.4. For the purposes of point 6.2.7. to 6.2.7.8 letters “a” – “h” "originator's interest" means the exposure value of that notional part of a pool of drawn amounts sold into a securitisation, the proportion of which in relation to the amount of the total pool sold into the structure determines the proportion of the cash flows generated by principal and interest collections and other associated amounts which are not available to make payments to those having securitisation positions in the securitisation. "Investors' interest" means the exposure value of the remaining notional part of the pool of drawn amounts.

6.2.7.5.The exposure of the originator an investment intermediary, associated with its rights in respect of the originator's interest, shall not be considered a securitisation position but as a pro rata exposure to the securitised exposures as if they had not been securitised.

6.2.7.6. (Am. – SG, iss. 4 in 2007) Exemptions from early amortisation treatment. The originators investment intermediaries shall not apply the capital requirements under point 6.2.7 in the following cases:

a) securitisations of revolving exposures whereby investors remain fully exposed to all future draws by borrowers so that the risk on the underlying facilities does not return to the originator investment intermediary even after an early amortisation event has occurred under point 6.2.7, and

b) securitisations where any early amortisation provision is solely triggered by events not related to the performance of the securitised assets or the originator investment intermediary, such as material changes in tax laws or regulations are exempted of capital requirement under point 6.2.7.

6.2.7.7. Maximum capital requirement

a) For an originator investment intermediary subject to the capital requirement in point 6.2.7. the total of the risk-weighted exposure amounts in respect of its positions in the investors' interest and the risk-weighted exposure amounts calculated under point 6.2.7.1 shall be no greater than the greater of:

(aa) the risk-weighted exposure amounts calculated in respect of its positions in the investors' interest; and (bb) the risk-weighted exposure amounts that would be calculated in respect of the securitised exposures by an investment intermediary holding the exposures as if they had not been securitised in an amount equal to the investors' interest.

b) Deduction of net gains, if any, arising from the capitalization of future income required under Art. 6 and 7 shall be treated outside the maximum amount indicated in letter “a”.

6.2.7.8. Calculation of risk-weighted exposure amounts

a) The risk-weighted exposure amount to be calculated in accordance with point 6.2.7.1 shall be determined by multiplying the amount of the investors' interest by the product of the appropriate conversion figure as indicated in points “b” “j” and the weighted average risk weight that would apply to the securitised exposures.

b) An early amortisation provision shall be considered to be "controlled" where the following conditions are met:

(aa) the originator investment intermediary has an appropriate capital/liquidity plan in the event of an early amortisation;

(bb) throughout the duration of the transaction there is pro-rata sharing between the originator's interest and the investor's interest of payments of interest and principal, expenses, losses and recoveries;

(cc) the amortisation period is considered sufficient for 90% of the total debt (originator's and investors' interest) outstanding at the beginning of the early amortisation period to have been repaid or recognized as in default; and

(dd) the speed of repayment is no more rapid than would be achieved by straight-line amortisation over the period set out in point (c).

c) In the case of securitisations subject to an early amortisation provision of retail exposures which are uncommitted and unconditionally cancellable without prior notice, where the early amortisation is triggered by the excess spread level falling to a specified level, the investment intermediary shall compare the three-month average excess spread level with the excess spread levels at which excess spread is required to be trapped.

d) Where the securitisation does not require excess spread to be trapped, the trapping point is deemed to be 4,5 percentage points greater than the excess spread level at which an early amortisation is triggered.

e) The conversion figure to be applied shall be determined by the level of the actual three month average excess spread in accordance with Table 3.

Table 3

	Securitisations subject to a controlled early amortization provision	Securitisations subject to a non-controlled early amortization provision
3 months average excess spread	Conversion figure	Conversion figure
Above level A	0%	0%
Level A	1%	5%

Level B	2%	15%
Level C	10%	50%
Level D	20%	100%
Level E	40%	100%

e) In Table 3, "Level A" means levels of excess spread less than 133,33% of the trapping level of excess spread but not less than 100% of that trapping level, "Level B" means levels of excess spread less than 100% of the trapping level of excess spread but not less than 75% of that trapping level, "Level C" means levels of excess spread less than 75% of the trapping level of excess spread but not less than 50% of that trapping level, "Level D" means levels of excess spread less than 50% of the trapping level of excess spread but not less than 25% of that trapping level and "Level E" means levels of excess spread less than 25% of the trapping level of excess spread.

g) In the case of securitisations subject to an early amortisation provision of retail exposures which are uncommitted and unconditionally cancellable without prior notice and where the early amortisation is triggered by a quantitative value in respect of something other than the three months average excess spread, a treatment may be applied which approximates closely to that prescribed in points “c” – “f” for determining the conversion figure indicated.

h) Where a Commission intends to apply a treatment in accordance with point “g” in respect of a particular securitisation, it shall first inform the relevant competent authorities of all the other Member States. Before the application of such a treatment becomes part of the general policy approach of the competent authority to securitisations containing early amortisation clauses of the type in question, the Commission shall consult the relevant competent authorities of all the other Member States and take into consideration the views expressed. The views expressed in such consultation and the treatment applied shall be publicly disclosed by the competent authority in question.

i) All other securitisations subject to a controlled early amortisation provision of revolving exposures shall be subject to a conversion figure of 90%.

k) All other securitisations subject to a non-controlled early amortisation provision of revolving exposures shall be subject to a conversion figure of 100%.

6.2.8. Recognition of credit risk mitigation on securitisation positions -where credit protection is obtained on a securitisation position, the calculation of risk-weighted exposure amounts may be modified in accordance with Annex 6.

6.2.9. Reduction in risk-weighted exposure amounts

a) In respect of a securitisation position in respect of which a 1 250% risk weight is assigned, an investment intermediary may, as an alternative to including the position in their calculation of risk-weighted exposure amounts, deduct from own funds the exposure value of the position. For these purposes, the calculation of the exposure value may reflect eligible funded credit protection in a manner consistent with point 6.2.8.

b) Where an investment intermediary makes use of the alternative indicated in point ”a”, 12,5 times the amount deducted in accordance with that point shall, for the purposes of point 6.2.2, be subtracted from the amount specified in point 6.2.2. as the maximum risk-weighted exposure amount to be calculated.

6.3. Calculation of risk-weighted exposure amounts under the internal ratings based approach

6.3.1. Hierarchy of methods

6.3.1.1. For the purposes of Art. 121, the risk-weighted exposure amount of a securitisation positions shall be calculated in accordance with points 6.3.1.2. to 6.3.8.

6.3.1.2. For a rated position or a position in respect of which an inferred rating may be used, the Ratings Based Method set out in points 6.3.3. shall be used to calculate the risk-weighted exposure amount.

6.3.1.3. For an unrated position the Supervisory Formula Method set out in points 6.3.4.2. to 6.3.4.5. shall be used except where the Internal Assessment Approach is permitted to be used as set out in points 6.3.1.7, letters “a” and “b”.

6.3.1.4. An investment intermediary other than an originator an investment intermediary or a sponsor investment intermediary may only use the Supervisory Formula Method with the approval of the deputy chairperson.

6.3.1.5. In the case of an originator or sponsor investment intermediary unable to calculate K_{irb} and which has not obtained approval to use the Internal Assessment Approach for positions in ABCP programmes, and in the case of other investment intermediaries where they have not obtained approval to use the Supervisory Formula Method or, for positions in ABCP programmes, the Internal Assessment Approach, a risk weight of 1 250% shall be assigned to securitisation positions which are unrated and in respect of which an inferred rating may not be used.

6.3.1.6 Use of inferred ratings

When the following minimum operational requirements are satisfied, an institution shall attribute to an unrated position an inferred credit assessment equivalent to the credit assessment of those rated positions (the "reference positions") which are the most senior positions which are in all respects subordinate to the unrated securitisation position in question:

(a) the reference positions must be subordinate in all respects to the unrated securitisation position;

(b) the maturity of the reference positions must be equal to or longer than that of the unrated position in question; and

(c) on an ongoing basis, any inferred rating must be updated to reflect any changes in the credit assessment of the reference positions.

6.3.1.7.The "Internal Assessment Approach" for positions in ABCP programmes

a) Subject to the approval of the deputy chairperson, when the following conditions are satisfied an investment intermediary may attribute to an unrated position in an ABCP programme a derived rating as laid down in letter “b’:

(aa) positions in the commercial paper issued from the ABCP programme shall be rated positions;

(bb) the investment intermediary shall satisfy the Deputy Chairperson of the Commission that its internal assessment of the credit quality of the position reflects the publicly available assessment methodology of one or more eligible ECAIs, for the rating of securities backed by the exposures of the type securitised;

(cc) as required by the item “bb”, the investment intermediary shall include those ECAIs which have provided an external rating for the commercial paper issued from the ABCP programme. Quantitative elements, such as stress factors, used in assessing the position to a particular credit quality must be at least as conservative as those used in the relevant assessment methodology of the ECAIs in question;

(dd) in developing its internal assessment methodology the investment intermediary shall take into consideration relevant published ratings methodologies of the eligible ECAIs that rate the commercial paper of the ABCP programme. This consideration shall be documented by the investment intermediary and updated regularly, as outlined in letter (ee);

(ee) the investment intermediary has to prove that the investment intermediary’s internal assessment methodology shall include rating grades. There shall be a correspondence between such rating grades and the credit assessments of eligible ECAIs. This correspondence shall be explicitly documented;

(ff) the internal assessment methodology shall be used in the investment intermediary’s internal risk management processes, including its decision making, management information and capital allocation processes;

(gg) (Am. – SG, iss. 68 in 2008) internal or external auditors, an ECAI, or the internal risk management and control unit shall perform regular reviews of the internal assessment process and the quality of the the investment intermediary's exposures to an ABCP programme. If the investment intermediary's internal audit, or risk management and control unit perform the review, then these functions shall be independent of the ABCP programme business line, as well as the customer relationship;

(hh) the investment intermediary shall track the performance of its internal ratings to evaluate the performance of its internal assessment methodology and shall make adjustments, as necessary, to that methodology when the performance of the exposures routinely diverges from that indicated by the internal ratings;

(ii) the ABCP programme shall incorporate standards in the form of credit and investment guidelines. In deciding on an asset purchase, the ABCP programme administrator shall consider the type of asset being purchased, the type and monetary value of the exposures arising from the provision of liquidity facilities and credit enhancements, the loss distribution, and the legal and economic isolation of the transferred assets from the entity selling the assets. A credit analysis of the asset seller's risk profile shall be performed and shall include analysis of past and expected future financial performance, current market position, expected future competitiveness, leverage, cash flow, interest coverage and debt rating. In addition, a review of the seller's standards regarding servicing capabilities and collection processes shall be performed;

(jj) the ABCP programme's standards shall establish minimum asset eligibility criteria that, in particular:

- exclude the purchase of assets that are significantly past due or defaulted;

- limit excess concentration to individual obligor or geographic area; and

- limits the tenor of the assets to be purchased;

(kk) the ABCP programme shall have collections policies and processes that take into account the operational capability and credit quality of the servicer. The ABCP programme shall mitigate seller/servicer risk through various methods, such as triggers based on current credit quality that would preclude commingling of funds;

(ll) the aggregated estimate of loss on an asset pool that the ABCP programme is considering purchasing must take into account all sources of potential risk, such as credit and dilution risk. If the seller-provided credit enhancement is sized based only on credit-related losses, then a separate reserve shall be established for dilution risk, if dilution risk is material for the particular exposure pool. In addition, in sizing the required enhancement level, the program shall review several years of historical information, including losses, delinquencies, dilutions, and the turnover rate of the receivables; and

(mm) the ABCP programme shall incorporate structural features into the purchase of exposures in order to mitigate potential credit deterioration of the underlying portfolio.

(nn) the requirement for the assessment methodology of the ECAI to be publicly available may be waived by the Deputy Chairperson of the Commission due to the specific features of the securitisation.

b) The unrated positions shall be assigned by the investment intermediary to one of the rating grades described in point 6.3.1.7. The position shall be attributed a derived rating the same as the credit assessments corresponding to that rating grade as laid down in point 6.3.1.7. Where this derived rating is, at the inception of the securitisation, at the level of investment grade or better, it shall be considered the same as an eligible credit assessment by an eligible ECAI for the purposes of calculating risk-weighted exposure amounts.

6.3.2. (Am. – SG, iss. 68 in 2008) Maximum risk-weighted exposure amounts - for an originator investment intermediary, a sponsor investment intermediary, or for other investment intermediaries which can calculate K_{IRB}, the risk-weighted exposure amounts calculated in respect of their positions in a securitisation may be limited to that which would produce a capital requirement under Art. 21, equal to the sum of 8% of the risk-weighted exposure amounts which would be produced if the securitised assets had not been securitised and were on the balance sheet of the investment intermediary plus the expected loss amounts of those exposures.

6.3.3 Ratings Based Method

Under the Ratings Based Method, the risk-weighted exposure amount of a rated securitisation position shall be calculated by applying to the exposure value the risk weight associated with the credit quality step with which the credit assessment has been determined to be associated in accordance with Art. 124, as set out in the Tables 4 and 5, multiplied by 1,06.

Table 4

Positions other than ones with short-term credit assessments

Credit Quality Step (CQS)	Risk weight

	A	B	C
CQS 1	7%	12%	20%
CQS 2	8%	15%	25%
CQS 3	10%	18%	35%
CQS 4	12%	20%	35%
CQS 5	20%	35%	35%
CQS 6	35%	50%	50%
CQS 7	60%	75%	75%
CQS 8	100 %	100 %	100 %
CQS 9	250%	250%	250%
CQS 10	425%	425%	425%
CQS 11	650%	650%	650%
Below CQS 11	1 250%	1 250%	1 250%

Table 5

Positions with short term credit assessments

Credit Quality Step (CQS)	Risk weight		
	A	B	C
CQS 1	7%	12%	20%
CQS 2	12%	20%	35%
CQS 3	60%	75%	75%
All other credit assessments	1 250%	1 250%	1 250%

a) Subject to the requirements of letters “b” and “c”, the risk weights in column A of each table shall be applied where the position is in the most senior tranche of a securitisation. When determining whether a tranche is the most senior, it is not required to take into consideration amounts due under interest rate or currency derivative contracts, fees due, or other similar payments.

b) A risk weight of 6% may be applied to a position in the most senior tranche of a securitisation where that tranche is senior in all respects to another tranche of the securitisation positions which would receive a risk weight of 7% under point 46, provided that:

(aa) the investment intermediary evidence to the Deputy Chairperson of the Commission that this is justified due to the loss absorption qualities of subordinate tranches in the securitisation; and

(bb) either the position has an external credit assessment which has been determined to be associated with credit quality step 1 in Table 4 or 5 or, if it is unrated, requirements in point 6.3.1.6 are satisfied where "reference positions" are taken to mean positions in the subordinate tranche which would receive a risk weight of 7% under point 6.3.3.

c) The risk weights in column C of each table shall be applied where the position is in a securitisation where the effective number of exposures securitised is less than six. In calculating the effective number of exposures securitised multiple exposures to one obligor must be treated as one exposure. The effective number of exposures is calculated as:

$$N = \frac{(\sum_i EAD_i)^2}{\sum_i EAD_i^2}$$

where EAD_i represents the sum of the exposure values of all exposures to the i^{th} obligor. In the case of resecuritisation (securitisation of securitisation exposures), the investment intermediary must look at the number of securitisation exposures in the pool and not the number of underlying exposures in the original pools from which the underlying securitisation exposures stem. If the portfolio share associated with the largest exposure, C_1, is available, the investment intermediary may compute N as $1/C_1$.

d) The risk weights in Column B shall be applied to all other positions.

e) Credit risk mitigation on securitisation positions may be recognised in accordance with points 6.3.6.1 to 6.3.6.3, letter “a”.

6.3.4. Supervisory Formula Method

6.3.4.1. Subject to points 6.3.5.4, under the Supervisory Formula Method, the risk weight for a securitisation position shall be the greater of 7% or the risk weight to be applied in accordance with point 6.3.4.2.

6.3.4.2. (Am. – SG, iss. 4 in 2007) With the exposures that have been securitised under point 6.3.5.4, the risk weight to be applied to the exposure amount shall be:

12.5 x (S[L+T] – S[L]) / T

where:

$$S[x] = \begin{cases} x & when \quad x \le Kirbr \\ Kirbr + K[x] - K[Kirbr] + (d \cdot Kirbr/\omega)\left(1 - e^{\omega(Kirbr - x)/Kirbr}\right) & when \ Kirbr < x \end{cases}$$

where:

$$h = (1 - Kirbr / ELGD)^{N}$$

$$c = Kirbr / (1 - h)$$

$$v = \frac{(ELGD - Kirbr) Kirbr + 0.25 (1 - ELGD) Kirbr}{N}$$

$$f = \left(\frac{v + Kirbr^{2}}{1 - h} - c^{2} \right) + \frac{(1 - Kirbr) Kirbr - v}{(1 - h)\tau}$$

$$g = \frac{(1 - c)c}{f} - 1$$

$$a = g \cdot c$$

$$b = g \cdot (1 - c)$$

$$d = 1 - (1 - h) \cdot (1 - Beta[Kirbr; a, b])$$

$$K[x] = (1 - h) \cdot ((1 - Beta[x; a, b]) x + Beta[x; a + 1, b] c)$$

$\tau = 1000$, and

$\omega = 20$.

In these expressions, Beta [x; a, b] refers to the cumulative beta distribution with parameters a and b evaluated at x.

T (the thickness of the tranche in which the position is held) is measured as the ratio of (a) the nominal amount of the tranche to (b) the sum of the exposure values of the exposures that have been securitised. For the purposes of calculating T the exposure value of a derivative instrument listed in Annex 10 shall, where the current replacement cost is not a positive value, be the potential future credit exposure calculated in accordance with Annex 3.

Kirbr is the ratio of (a) Kirb to (b) the sum of the exposure values of the exposures that have been securitised. Kirbr is expressed in decimal form.

L (the credit enhancement level) is measured as the ratio of the nominal amount of all tranches subordinate to the tranche in which the position is held to the sum of the exposure values of the exposures that have been securitised. Capitalized future income shall not be included in the measured L. Amounts due by counterparties to derivative instruments listed in Annex 10 that represent tranches more junior than the tranche in question may be measured at their current replacement cost (without the potential future credit exposures) in calculating the enhancement level.

N is the effective number of exposures calculated in accordance with point 6.3.3 letter “c”.

ELGD, the exposure-weighted average loss-given-default, is calculated as follows:

$$ELGD = \frac{\sum_{i} LGD_i \cdot EAD_i}{\sum_{i} EAD_i}$$

where LGD_i represents the average LGD associated with all exposures to the i^{th} obligor, where LGD is determined in accordance with Chapter Twelve, Section II. In the case of resecuritisation, an LGD of 100% shall be applied to the securitised positions. When default and dilution risk for purchased receivables are treated in an aggregate manner within a securitisation (e.g. a single reserve or over-collateralization is available to cover losses from either source), the LGDi input shall be constructed as a weighted average of the LGD for credit risk and the 75% LGD for dilution risk. The weights shall be the stand-alone capital charges for credit risk and dilution risk respectively.

6.3.4.3. Simplified inputs

If the exposure value of the largest securitised exposure, C_1, is no more than 3% of the sum of the exposure values of the securitised exposures, then, for the purposes of the Supervisory Formula Method, the investment intermediary may set LGD = 50% and N equal to either:

$$N = \left(C_1 C_m + \left(\frac{C_m - C_1}{m - 1} \right) \max\{1 - m C_1, 0\} \right)^{-1}$$

or

$N = 1/C_1$.

C_m is the ratio of the sum of the exposure values of the largest "m" exposures to the sum of the exposure values of the exposures securitised. The level of "m" may be set by the investment intermediary.

6.3.4.4. For securitisations involving retail exposures, the Deputy Chairperson may permit the Supervisory Formula Method to be implemented using the simplifications: h = 0 and v = 0.

6.3.4.5. Credit risk mitigation on securitisation positions may be recognised in accordance with points 6.3.6.1, 6.3.6.2. and 6.3.6.3 letters “b” and “c”.

6.3.5. Liquidity Facilities

6.3.5.1. The provisions in points 6.3.5.2 to 6.3.5.4. apply for the purposes of determining the exposure value of an unrated securitisation position in the form of certain types of liquidity facility.

6.3.5.2. A conversion figure of 20% may be applied to the nominal amount of a liquidity facility that may only be drawn in the event of a general market disruption and that meets the conditions to be an "eligible liquidity facility" set out in point 6.2.6.1.

6.3.5.3 A conversion figure of 0% may be applied to the nominal amount of a liquidity facility that meets the conditions set out in point 6.2.6.3.

6.3.5.4. Exceptional treatment where K_{irb} cannot be calculated.

a) If the investment intermediary demonstrates to the deputy chairman that it is not practicable to calculate the risk-weighted exposure amounts for the securitised exposures as if they had not been securitised, an investment intermediary may, on an exceptional basis and subject to the consent of the deputy chairperson, temporarily be allowed to apply the method set out in point “b”for the calculation of risk-weighted exposure amounts for an unrated securitisation position in the form of a liquidity facility that meets the conditions to be an "eligible liquidity facility" set out in point 6.2.6.1, letter “e”or that falls within the terms of point 6.3.5.3.

b) The highest risk weight that would be applied under Chapter Twelve, Section I to any of the securitised exposures, may be applied to the securitisation position represented by the liquidity facility. To determine the exposure value of the position a conversion figure of 50% may be applied to the nominal amount of the liquidity facility if the facility has an original maturity of one year or less. If the liquidity facility complies with the conditions in point 6.3.5.3 a conversion figure of 20% may be applied. In other cases a conversion factor of 100% shall be applied.

6.3.6. Recognition of credit risk mitigation in respect of securitisation positions

6.3.6.1.Eligible funded credit protection is limited to that which is eligible for the calculation of risk-weighted exposure amounts under Chapter Twelve, Section I, as laid down under Chapter Twelve Section III and recognition is subject to compliance with the relevant minimum requirements as laid down under those Articles.

6.3.6.2. Eligible unfunded credit protection and unfunded protection providers are limited to those which are eligible under Chapter Twelve, Section III and recognition is subject to compliance with the relevant minimum requirements laid down under those Articles.

6.3.6.3. Calculation of capital requirements for securitisation positions with credit risk mitigation

a) Ratings Based Method - where risk-weighted exposure amounts are calculated using the Ratings Based Method, the exposure value and/or the risk-weighted exposure amount for a securitisation position in respect of which credit protection has been obtained may be modified in accordance with the provisions of Annex 6 as they apply for the calculation of risk-weighted exposure amounts under Chapter Twelve, Section I.

b) Supervisory Formula Method – full credit protection

aa) Where risk-weighted exposure amounts are calculated using the Supervisory Formula Method, the investment intermediary shall determine the "effective risk weight" of the position. It shall do this by dividing the risk-weighted exposure amount of the position by the exposure value of the position and multiplying the result by 100.

bb) In the case of funded credit protection, the risk-weighted exposure amount of the securitisation position shall be calculated by multiplying the funded protection-adjusted exposure amount of the position (E*, as calculated under Chapter Twelve, Section III for the calculation of risk-weighted exposure amounts under Chapter Twelve, Section I, taking the amount of the securitisation position to be E) by the effective risk weight.

cc) In the case of unfunded credit protection, the risk-weighted exposure amount of the securitisation position shall be calculated by multiplying G_A (the amount of the protection adjusted for any currency mismatch and maturity mismatch in accordance with the provisions of Annex 6) by the risk weight of the protection provider; and adding this to the amount arrived at by multiplying the amount of the securitisation position minus G_A by the effective risk weight.

c) Supervisory formula method – partial protection

aa) If the credit risk mitigation covers the "first loss" or losses on a proportional basis on the securitisation position, the investment intermediary may apply points 6.3.6.3, letter “a”;

bb) In other cases, the investment intermediary shall treat the securitisation position as two or more positions with the uncovered portion being considered the position with the lower credit quality. For the purposes of calculating the risk-weighted exposure amount for this position, the provisions in points 6.3.4.1. to 6.3.4.5. shall apply subject to the modifications that "T" shall be adjusted to e* in the case of funded credit protection; and to T-g in the case of unfunded credit protection, where e* denotes the ratio of E* to the total notional amount of the underlying pool, where E* is the adjusted exposure amount of the securitisation position calculated in accordance with the provisions of Annex 6 as they apply for the calculation of risk-weighted exposure amounts under Chapter Twelve, Section I, taking the amount of the securitisation position to be E; and g is the ratio of the nominal amount of credit protection (adjusted for any currency or maturity mismatch in accordance with the provisions of Annex 6) to the sum of the exposure amounts of the securitised exposures. In the case of unfunded credit protection the risk weight of the protection provider shall be applied to that portion of the position not falling within the adjusted value of "T".

6.3.7. Additional capital requirements for securitisations of revolving exposures with early amortisation provisions

6.3.7.1. In addition to the risk-weighted exposure amounts calculated in respect of its securitisation positions, an originator investment intermediary shall be required to calculate a risk-weighted exposure amount according to the methodology set out in points 6.2.7.1 to 6.2.7.8 when it sells revolving exposures into a securitisation that contains an early amortisation provision.

6.3.7.2. For the purposes of point 6.3.7.1., points 6.3.7.3 and 6.3.7.6. shall replace points 6.2.7.4 and 6.2.7.5.

6.3.7.3. For the purposes of these provisions, "originator investment intermediary's interest" shall be the sum of:

a) the exposure value of that notional part of a pool of drawn amounts sold into a securitisation, the proportion of which in relation to the amount of the total pool sold into the structure determines the proportion of the cash flows generated by principal and interest collections and other associated amounts which are not available to make payments to those having securitisation positions in the securitisation; plus

b) the exposure value of that part of the pool of undrawn amounts of the credit lines, the drawn amounts of which have been sold into the securitisation, the proportion of which to the total amount of such undrawn amounts is the same as the proportion of the exposure value described in letter "a" to the exposure value of the pool of drawn amounts sold into the securitisation.

6.3.7.4. To qualify as such, the investment intermediary's interest may not be subordinate to the investors' interest.

6.3.7.5."Investors' interest" means the exposure value of the notional part of the pool of drawn amounts not falling within point 6.3.7.3 letter "a" plus the exposure value of that part of the pool of undrawn amounts of credit lines, the drawn amounts of which have been sold into the securitisation, not falling within point 6.3.7.3 letter "b".

6.3.7.6. The exposure of the originator investment intermediary associated with its rights in respect of that part of the investment intermediary's interest described in point 6.3.7.3 letter "a" shall not be considered a securitisation position but as a pro rata exposure to the securitised drawn amounts exposures as if they had not been securitised in an amount equal to that described in point 6.3.7.3 letter "a". The originator investment intermediary shall also be considered to have a pro rata exposure to the undrawn amounts of the credit lines, the drawn amounts of which have been sold into the securitisation, in an amount equal to that described in point 6.3.7.3 letter "b".

6.3.8. Reduction in risk-weighted exposure amounts

6.3.8.1. The risk-weighted exposure amount of a securitisation position to which a 1 250% risk weight is assigned may be reduced by 12,5 times the amount of any value adjustments made by the investment intermediary in respect of the securitised exposures. To the extent that value adjustments are taken account of for this purpose they shall not be taken account of for the purposes of the calculation indicated in item 4, Section III of Annex 5.

6.3.8.2 The risk-weighted exposure amount of a securitisation position may be reduced by 12,5 times the amount of any value adjustments made by the investment intermediary in respect of the position.

6.3.8.3. In respect of a securitisation position in respect of which a 1 250% risk weight applies, investment intermediaries may, as an alternative to including the position in their calculation of risk-weighted exposure amounts, deduct from own funds the exposure value of the position.

6.3.8.4. For the purposes of assessment of the exposures under 6.3.8.3:

a) the exposure value of the position may be derived from the risk-weighted exposure amounts taking into account any reductions made in accordance with points 6.3.8.1 - 6.3.8.2.;

(b) the calculation of the exposure value may reflect eligible funded protection in a manner consistent with the methodology prescribed in points 6.3.6; and

(c) where the Supervisory Formula Method is used to calculate risk-weighted exposure amounts and $L \leq K_{IRBR}$ and $[L+T] > K_{IRBR}$ the position may be treated as two positions with L equal to K_{IRBR} for the more senior of the positions.

76. Where an investment intermediary makes use of the alternative indicated in point 6.3.8.3., 12,5 times the amount deducted in accordance with that point shall, for the purposes of point 6.3.2., be subtracted from the amount specified in point 6.3.2. as the maximum risk-weighted exposure amount to be calculated by the investment intermediaries there indicated.

Annex 8

To Chapter Thirteen, Section I
(Am. – SG, iss. 68 in 2008)

Capital requirements for operational risk

1. Basic Indicator Approach

1.1. Under the Basic Indicator Approach the investment intermediaries maintain capital to cover operational risk, which is equal to 15% of the relevant indicator, which is the average over three years of the sum of net interest income and net non-interest income.
1.2. If for a given year, the sum of net interest income and net non-interest income is negative or equal to zero, this figure shall not be taken into account in the calculation of the indicator. The basic indicator shall be calculated as the sum of positive figures of average year income divided by the number of positive figures.
1.3. (Am. – SG, iss. 68 in 2008) The following elements of the profit and loss account, constituting the basic indicator, shall be included in the calculations with their positive or negative sign:
1.3.1. Interest receivable and similar income;

1.3.2. Interest payable and similar charges;

1.3.3. Income from shares and other variable/fixed-yield securities;

1.3.4. Commissions/fees receivable;

1.3.5. Commissions/fees payable;

1.3.6. Net profit or net loss on financial operations

1.3.7. Other operating income

1.4. The basic indicator shall be calculated before the deduction of any provisions and operating expenses. Operating expenses shall include fees paid for outsourcing services rendered by third parties which are not a parent or subsidiary of the investment intermediary or a subsidiary of a parent which is also the parent of the investment intermediary. Expenditure on the outsourcing of services rendered by third parties may reduce the average year income if the expenditure is incurred from an undertaking subject to supervision under this Ordinance.
1.5. The following elements shall not be used in the calculation of the basic indicator:

1.5.1. Realized profits/losses from the sale of non-trading book items;

1.5.2. Income from extraordinary or irregular items;

1.5.3. Income derived from insurance.

2. Standardized Approach

2.1. Under the Standardized Approach, the capital requirement for operational risk shall be calculated as the sum of capital requirements, calculated across the business lines referred to in Table 1, in accordance with the following formulae:

$$K = \left\{\sum years_{1-3} \max\left[\sum\left(GI_{1-8} \times \beta_{1-8}\right), 0\right]\right\} / 3$$

where:

K denotes the standardized approach capital requirement

GI_{1-8} denotes the net annual income under business lines;

β_{1-8} = is a fixed percentage in accordance with Table 1 of this Annex.

Table 1: Business lines of the investment intermediaries

Business line	List of activities	Percentage
Corporate finance	Underwriting of financial instruments and/or placing of financial instruments on a firm commitment basis; Services related to underwriting; Investment advice; Advice to undertakings on capital structure, industrial strategy and related matters and advice and services relating to the mergers and the purchase of undertakings; Investment	18%

	research and financial analysis and other forms of general recommendation relating to transactions in financial instruments	
Trading and sale	Dealing on own account; Money broking; Reception and transmission of orders in relation to one or more financial instruments; Execution of orders on behalf of clients; Placing of financial instruments without a firm commitment basis; Operation of Multilateral Trading Facility.	18%
Retail brokerage (Activities with individual physical persons or with small and medium sized entities*)	Reception and transmission of orders in relation to one or more financial instruments; Execution of orders on behalf of clients; Placing of financial instruments without a firm commitment basis	12%
Commercial banking	Lending; Guarantees and commitments.	15%
Retail banking (Activities with individual physical persons or with small and medium sized entities*)	Lending; Guarantees and commitments.	12%
Agency services	Safekeeping and administration of financial instruments for the account of clients, including custodianship and related services such as cash/collateral management	15%
Asset management	Portfolio management; Managing of UCITS; Other forma of asset management	12%

*Note: concerning small and medium sized entities:

1. relationship with clients must be with small and medium sized entities;

2. relationship with clients must be of such nature, so that the operational risk related to this relationship must be proven to be reduced; and

3. the volume of orders of each client must be similar and relatively small.

2.2. Net year incomes of the risk-weighted relevant indicators calculated each year across the business lines referred to in Table 2. However, where the aggregate capital charge across all business lines within a given year is negative, then the input to the average for that year shall be zero.
2.3. Investment intermediaries must develop and document specific policies and criteria for mapping the relevant indicator for current business lines and activities into the standardized framework. The criteria must be reviewed and adjusted as appropriate for new or changing business activities and risks.
2.4. The criteria for business line mapping are:

2.4.1 All activities must be mapped into the business lines in a mutually exclusive and jointly exhaustive manner;

2.4.2. Any activity which cannot be readily mapped into the business line framework, but which represents an ancillary function to an activity included in the framework, must be allocated to the business line it supports. If more than one business line is supported through the ancillary activity, an objective-mapping criterion must be used;

2.4.3. If an activity cannot be mapped into a particular business line then the business line yielding the highest percentage must be used. The same business line equally applies to any associated ancillary activity;

2.4.4. Investment intermediaries may use internal methods to allocate the net years income (relevant indicator) between business lines. Costs generated in one business line which are imputable to a different business line may be reallocated to the business line to which they pertain, for instance by using a treatment based on internal transfer costs between the two business lines;

2.4.5. The mapping of activities into business lines for operational risk capital purposes must be consistent with the categories used for credit and market risks;

2.4.6. The management body is responsible for the mapping policy of activities into the separate business lines;

2.4.7. The process of mapping the activities of the investment intermediary into business lines must be subject to independent review and control.

2.5. To be eligible for the Standardized Approach investment intermediaries must satisfy the requirements under Art. 142 para 2 and Art. 95 para 8 concerning risk management;
2.6. An investment intermediary applying the Standardized Approach shall also meet the following qualifying criteria:

2.6.1. Investment intermediaries shall have a well-documented assessment and management system for operational risk with clear responsibilities for identification of their exposures to operational risk and track relevant operational risk data, including material loss data.

2.6.2. The system under 2.6.1 shall be subject to regular independent review and must be closely integrated into the risk management processes of the investment intermediary. Its output must be an integral part of the process of monitoring and controlling the operational risk profile.

2.6.3. Investment intermediaries shall implement a system of reporting the operational risk and relevant procedures for taking appropriate action.

3. Advanced Measurement Approaches

Common criteria

Subject to approval by the deputy chairman, the investment intermediaries may use Advanced Measurement Approaches for calculation of its capital requirements for operational risk after assessing the adequacy of the used approach, the level of complexity of their operations and procedures and the level of operational risk.
The deputy chairman shall give an approval under the preceding sentence, when:
(a) the minimum qualifying criteria under item 2.5 have been met;

(b) the quantitative and qualitative qualifying criteria under items 3.1. – 3.2.1 have been met.

3.1. Qualitative criteria

The investment intermediaries' operational risk measurement system shall meet the following qualitative criteria:

3.1.1. The internal operational risk measurement system shall be closely integrated into the investment intermediary's day-to-day risk management processes.

3.1.2. The investment intermediaries must have an independent risk management unit for operational risk.

3.1.3. There must be three months regular reporting of operational risk exposures and loss experience. The investment intermediary shall have procedures for taking appropriate corrective action.

3.1.4. The risk management system must be well documented; the investment intermediary shall have routines in place for ensuring compliance with the legal regulations and policies for the treatment of non-compliance with them.

3.1.5. The operational risk management processes and measurement systems shall be subject to regular reviews performed by internal and/or external auditors.

3.1.6. The validation of the operational risk measurement system by the deputy chairman shall include the following elements:

- verifying that the internal validation processes are operating in a satisfactory manner;

- making sure that data flows and processes associated with the risk measurement system are transparent and accessible.

3.2. Quantitative Standards

3.2.1. Calculated on capital requirements to operational risk

a) The investment intermediary shall calculate their capital requirement to operational risk as comprising both expected loss and unexpected loss (in case of force majeure circumstances), unless they can demonstrate that expected loss is adequately captured in their internal business practices. The operational risk measure must capture potentially severe tail events, achieving a soundness standard comparable to a 99,9% confidence interval over a one year period.

b) The operational risk measurement system must have certain key elements for reliability, which must include the use of internal data, external data, scenario analysis and factors reflecting the business environment and internal control systems. An investment intermediary needs to have a well documented approach for weighting the use of these four elements in its overall operational risk measurement system.

c) The risk measurement system shall capture the major drivers of risk affecting the shape of the tail of the loss estimates.

d) The investment intermediary may use correlations in operational risk losses across individual operational risk estimates. In recognition for supervisory purposes, the investment intermediary must demonstrate to the satisfaction of the deputy chairman that their systems for measuring correlations are sound, implemented with integrity, and take into account the uncertainty surrounding any such correlation estimates, particularly in periods of stress. The investment intermediary shall validate its correlation assumptions using appropriate quantitative and qualitative techniques.

e) The risk measurement system shall be internally consistent and shall avoid the multiple counting of qualitative assessments or risk mitigation techniques recognized in other areas of the investment intermediary's capital adequacy framework.

3.2.2. Internal data

a) Internally generated by the investment intermediary operational risk measures shall be based on a minimum historical observation period of five years. When an investment intermediary first moves to an Advanced Measurement Approach, a three-year historical observation period is acceptable.

b) The investment intermediaries must be able to map their historical internal loss data into the business lines defined in Table 1 and 2 of this Annex, and to provide these data to the deputy chairman upon request. The operational risk losses that are related to credit risk and have historically been included in the internal credit risk databases must be recorded in the operational risk databases and be separately identified. Such losses will not be subject to the operational risk charge, as long as they continue to be treated as credit risk for the purposes of calculating minimum capital requirements. Operational risk losses that are related to market risks shall be included in the scope of the capital requirement for operational risk.

c) The investment intermediary's internal loss data must be comprehensive in that it captures all material activities and exposures from all structural units. An investment intermediary must be able to justify that any excluded activities or exposures, (both individually and/or in combination), would not have a material impact on the overall risk estimates. Appropriate minimum loss thresholds for internal loss data collection must be defined by the investment intermediary.

d) An investment intermediary shall maintain data base with minimum characteristics for any occurred loss event.

e) The investment intermediary shall apply specific criteria for assigning loss data arising from an event in a centralized function or an activity that spans more than one business line, as well as from related events over time.

f) An investment intermediary must have documented procedures for assessing the on-going relevance of historical loss data, including those situations in which judgment overrides, scaling, or other adjustments may be used, to what extent they may be used and who is authorized to make such decisions.

3.2.3. External data

The investment intermediary's operational risk measurement system shall use relevant external data, especially when there is reason to believe that the investment intermediary is exposed to infrequent, yet potentially severe, losses. An investment intermediary must have a systematic process for determining the situations for which external data must be used and the methodologies used to incorporate the data in its measurement system. The conditions and practices for external data use must be regularly reviewed, documented and subject to periodic independent review.

3.2.4. Scenario analysis

The investment intermediary shall use scenario analysis of expert opinion in conjunction with external data to evaluate its exposure to high severity events. In such cases, in order to be able to prepare valid assessment of the expected losses from such events, the investment intermediary shall rely on the experience and opinion of risk management experts. Over time, such assessments need to be validated and re-assessed through comparison to actual loss experience to ensure their reasonableness.

3.2.5. Business environment and internal control factors

a) The investment intermediary's risk assessment methodology must capture key business environment and internal control factors that can change its operational risk profile.

b) The choice of each factor needs to be justified as a meaningful driver of risk, based on experience and involving the expert judgment of the affected business areas.

c) The sensitivity of risk estimates to changes in the factors and the relative weighting of the various factors need to be well reasoned. In addition to capturing changes in risk due to improvements in risk controls, the investment intermediary’s framework must also capture potential increases in risk due to greater complexity of activities or increased business volume.

d) The activities applied under letters “a” – “c” must be documented and subject to independent review within the investment intermediary and by the deputy chairman. Over time, the process and the outcomes need to be validated and re-assessed through comparison to actual internal loss experience and relevant external data.

3.3. Risk mitigation by insurance and other risk transfer mechanisms

3.3.1. Investment intermediaries shall be able to recognize the risk mitigating impact from concluded insurance contracts and other risk transfer mechanisms under Advanced Measurement Approaches when shall meet the following conditions:

(a) the provider is authorized to provide insurance or re-insurance;

b) the provider has a rating awarded by an eligible ECAI to be associated with credit quality step 3 or above under the rules for Standardized Approach for credit risk;

c) the insurance policy must have an initial term of no less than one year. For policies with a residual term of less than one year, the investment intermediary must make appropriate haircuts reflecting the declining residual term of the policy – from 0% for policies with a residual term of 365 days up to a full 100% haircut for policies with a residual term of 90 days or less;

d) the insurance policy has a minimum notice period for cancellation of the contract of 90 days;

e) the insurance policy has no exclusions or limitations triggered by supervisory actions or, in the case of a failed investment intermediary, that preclude the investment intermediary receiver or liquidator, from recovering for damages suffered or expenses incurred by the investment intermediary, except in respect of events occurring after the initiation of receivership or liquidation proceedings in respect of the investment intermediary; provided that the insurance policy may exclude any fine, penalty, or other punitive damages resulting from coercive administrative actions imposed by the deputy chairman;

f) the risk mitigation calculations must reflect the insurance coverage in a manner that is transparent in its relationship to, and consistent with, the actual likelihood and impact of loss used by the investment intermediary in the overall determination of operational risk capital;

g) the insurance is provided by a third party entity. In the case of insurance through captives and affiliates, the exposure has to be laid off to an independent third party entity, for example through re-insurance, that meets the eligibility criteria;

h) the framework for recognizing insurance is well reasoned and documented.

3.3.2. The investment intermediary shall announce its methodology to use the insurance for operational risk mitigation.

3.3.3 The methodology of the investment intermediary for recognizing the cover of insurance policies shall capture the following elements through discounts or haircuts in the amount of insurance recognition:

(a) the residual term of an insurance policy, where less than one year, as noted above;

(b) a policy's cancellation terms, where less than one year; and

(c) the uncertainty of payment as well as mismatches in coverage of insurance policies.

3.3.4. The capital alleviation arising from the recognition of insurance shall not exceed 20% of the capital requirement for operational risk before the recognition of risk-mitigation techniques.
3.3.5. The investment intermediary shall be able to recognize risk reducing effect of other risk transfer mechanisms, in case it is able to prove before the deputy chairman that a substantial mitigating impact is achieved.

4. Use of Advanced Measurement Approaches in a group
4.1. In the cases where the Advanced Measurement Approach is used by a parent undertaking - investment intermediary in the European Union and its subsidiaries or subsidiaries of a financial holding company from the European Union, there must be a description of the methodology used for allocation of the capital for operational risk among the individual undertakings in the group.
4.2. The description of the methodology under item 4.1. shall also include description of the possibilities for the risk diversification and the reflection in the risk assessment system.

5. Combined use of different methodologies

5.1. Use of Advanced Measurement Approach in combination with other approaches

5.1.1. An investment intermediary may use an Advanced Measurement Approach in combination with either the Basic Indicator Approach or the Standardized Approach, subject to the following conditions:

(a) the combined use of the methodologies covers all operational risks in the investment intermediary; the methodology used shall cover different activities, geographical locations, legal structures or other relevant divisions of the investment intermediary;

(b) the qualifying criteria are fulfilled for the part of activities covered by the Standardized Approach and Advanced Measurement Approaches respectively.

5.1.2. On a case-by case basis, the deputy chairman may impose the following additional conditions:

(a) on the date of implementation of an Advanced Measurement Approach, a significant part of the investment intermediary's operational risks are captured by the Advanced Measurement Approach;

(b) the investment intermediary takes a commitment to implement the Advanced Measurement Approach for a material part of its operations within a time schedule agreed by the deputy chairman.

5.2. An investment intermediary may use a combination of the Basic Indicator Approach and the Standardized Approach only in exceptional circumstances which may require a transition period for the calculation by the Standardized Approach.
4.2.4. The combined use of the Basic Indicator Approach and the Standardized Approach, under item 5.2., shall be conditional and for fixed period of time, for which the investment intermediary has been granted an approval by the deputy chairman and after the expiration of that period, the Standardized Approach shall be applied.

6. Loss event type classification

Event-Type Category	Definition
Internal fraud	Losses due to acts of a type intended to defraud, misappropriate property or circumvent regulations, the law or company policy, excluding discrimination events, which involves at least one internal party
External fraud	Losses due to acts of a type intended to defraud, misappropriate property or circumvent the law, by a third party
Employment Practices and Workplace Safety	Losses arising from acts inconsistent with employment, health or safety laws or agreements, from payment of personal injury claims, or from discrimination events
Clients, Products & Business Practices	Losses arising from an unintentional or negligent failure to meet a professional obligation to specific clients (including fiduciary and suitability requirements), or from the nature or design of a product
Damage to Physical Assets	Losses arising from loss or damage to physical assets from natural disaster or other events
Business disruption and system failures	Losses arising from disruption of business or system failures
Execution, Delivery & Process Management	Losses from failed transaction processing or process management, from relations with trade counterparties and vendors

Annex 9

To Chapter IX
(Am. – SG, iss. 28 in 2009)

Calculating capital requirements for large exposures

1. (Am. – SG, iss. 28 in 2009) The requirement of Article 84, para. 5, item 2 shall be calculated by selecting those components of the total trading exposure to individual persons or group of related persons, arisen from the transactions in the trading portfolio, which attract the highest specific-risk requirements in Chapter VI and/or requirements in Chapter VII, the sum of which equals the amount of the excess over the limits for large exposures referred to in Article 84, para. 5, item 1.

2. Where the excess over the limits for large exposures has not persisted for more than 10 days, the additional capital requirement shall be 200% of the requirements referred to in point 1, on these components.

3. As from 10 days after the excess has occurred, the components of the excess, selected in accordance with point 1, shall be allocated to the appropriate line in column 1 of Table 1 in ascending order of specific-risk requirements in Chapter VI and/or requirements in Chapter VII.

4. The additional capital requirement shall be equal to the sum of the specific-risk requirements in Chapter VI and/or the Chapter VII requirements on these components, multiplied by the corresponding factor in column 2 of Table 1.

Table 1

Excess over the limits (on the basis of a percentage of own funds)	Factors
Up to 40%	200%
From 40% to 60%	300%
From 60% to 80%	400%
From 80% to 100%	500%
From 100% to 250%	600%
Over 250%	900%

Annex 10

(Am. – SG, iss. 68 in 2008)

List of derivative instruments

1. Interest-rate contracts:

(a) single-currency interest rate swaps;

(b) basis-swaps;

(c) forward rate agreements;

(d) interest-rate futures;

(e) interest-rate options purchased; and

(f) other interest-rate contracts of similar nature.

2. Foreign-exchange contracts and contracts whose underlying asset is gold:

(a) cross-currency interest-rate swaps;

(b) forward foreign-exchange contracts;

(c) currency futures;

(d) currency options purchased;

(e) other foreign-exchange contracts, as well as other contract similar to the contracts under (a) to (e) whose underlying asset is gold.

3. (Am. – SG, iss. 68 in 2008) Any other off-exchange derivative instruments of a nature similar to those in point 1, letters “a” to “e” and point 2, letters “a” to “d” concerning other reference items or indices, including as a minimum the derivative financial instruments specified in Art.3 of the Markets in Financial Instruments Act, letters “c” – “f”, and letters “h” and “i”.

4. Contacts for capital instrument and commodities

a) capital and commodities swaps;

b) capital and commodities forwards;

c) capital and commodities futures;

d) capital and commodities options and warrants;

e) others contacts with the similar characteristics.

5. Credit derivatives

a) credit default swap

b) total return swap;

c) securities, bound with credit;

d) others instruments with the similar characteristics