

# Finansinspektionen's Regulatory Code

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**FFFS 2010:10**

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## **Regulations amending Finansinspektionen's regulations and general guidelines (FFFS 2007:1) regarding capital adequacy and large exposures;**

decided on 6 December 2010.

Finansinspektionen prescribes<sup>1</sup> pursuant to Chapter 13, section 1, points 6, 10–12, 14, 17–19, 25, 29, 30 and 43 of the Capital Adequacy and Large Exposures Act (2006:1371), section 32, points 6, 10–12, 14, 17–19, 25, 29, 30 and 43 and section 34 of the Capital Adequacy and Large Exposures Ordinance (2006:1533) as regards Finansinspektionen's regulations and general guidelines (FFFS 2007:1) regarding capital adequacy and large exposures

*that* Chapter 16, section 15, Chapter 27, sections 2 and 3, Chapter 35, sections 9 and 10 and Chapter 57 sections 2 and 3 shall be repealed,

*that* Chapter 2, section 4, Chapter 7, sections 3, 6, 8a, 15–18, 20, 21 and sections 23–26, Chapter 8, section 10, Chapter 13, sections 36, 37, 45, 49 and 64, Chapter 15, sections 3 and 5, Chapter 16, sections 19 and 51, Chapter 18, sections 3, 14, 23 and 26, Chapter 24, section 6, Chapter 25, sections 4 and 14, Chapter 27, section 1, Chapter 34, section 3, Chapter 35, sections 6–8 and 12–14, Chapter 36, section 1, Chapter 37, section 11, Chapter 38, sections 10–12 and 18–20, Chapter 39, sections 13, 15 and 23, Chapter 40, sections 6 and 11, Chapter 42, section 3, Chapter 43, sections 6, 8 and 10, Chapter 44, section 18, Chapter 54, section 19, Chapter 55, section 5, Chapter 56, section 29, Chapter 57, sections 1 and 4, Chapter 60, sections 18, 38 and 39 and Chapter 61, section 6 shall have the following wording, *that* the heading immediately preceding Chapter 16, section 19 shall have the following wording,

<sup>1</sup> Cf. Directive of the European Parliament and of the Council (prel. no. 2010/76/EC) of 11 October 2010 amending Directives 2006/48/EC and 2006/49/EC as regards capital requirements for the trading book and for re-securitisations, and the supervisory review of remuneration policies (EUT xxx, xxx, Celex xxx), European Parliament and Council Directive 2009/111/EC of 16 September 2009 amending Directives 2006/48/EC, 2006/49/EC and 2007/64/EC as regards banks affiliated to central institutions, certain own funds items, large exposures, supervisory arrangements and crisis management (EUT L 302, 17.11.2009, pp. 97–119, Celex 32009L0111), Commission Directive 2009/83/EC of 27 July 2009 amending certain Annexes to Directive 2006/48/EC of the European Parliament and of the Council as regards technical provisions concerning risk management (EUT L 196, 28.07.2009, pp. 14–21, Celex 32009L0083) and Commission Directive 2009/27/EC of 7 April 2009 amending certain Annexes to Directive 2006/49/EC of the European Parliament and Council as regards technical provisions concerning risk management (EUT L 94, 8.4.2009, pp. 97–99, Celex 32009L0027).

*that* the heading immediately preceding Chapter 60, section 30 shall be worded "Insurance and other forms of risk transfer to a third party",  
*that* Appendix 5 to the regulations shall have the following wording,  
*that* nine new sections, Chapter 7, sections 16 a–c and 23 a, Chapter 9, section 4 a, Chapter 16, section 52, Chapter 27, section 4 a, Chapter 38, sections 19 a and 19 b, and a new heading immediately preceding Chapter 35, section 8 shall be introduced into the regulations with the following wording.

## Chapter 2

**Section 4** Credit derivative refers to a financial contract, usually bilateral, which is designed to transfer the credit risk in a loan, bond or other asset from one party (the protection purchaser/risk seller) to another (the protection seller/risk purchaser). The different types of credit derivatives are credit default swaps, credit linked notes and total return swaps. *Appendix 1* contains a more detailed description of these types of credit derivatives.

Reference instrument refers to the instrument that leads to the credit derivative becoming due for payment as a result of deteriorating credit quality. The reference asset may be a bond or another type of credit.

Protected asset refers to the asset that the credit derivative is intended to protect, i.e. the asset for which the protection purchaser wants to hedge the credit risk. A protected asset does not need to be identical to the instrument to which the credit derivative refers, i.e. the reference instrument. Standardised derivatives traded on a market can e.g. be used to a large or limited extent to protect specific instruments that a protection purchaser holds.

Credit event refers to an event that affects the reference instrument's credit quality and means that the credit derivative becomes due for payment (credit event payment). Items constituting a credit event are agreed in the contract between the parties and may cover one or more events. Examples of credit events are bankruptcy, failure to pay, a payment moratorium, payment rescheduling and a credit rating downgrade.

A credit derivative can be constructed to consist of several reference instruments, i.e. the credit derivative has a basket of underlying reference instruments. This type of credit derivative in its simplest form falls due for payment when a credit event occurs for one of the reference instruments and is usually referred to as a first-to-default credit derivative. If the credit derivative instead falls due for payment only when a credit event has occurred for two of the reference instruments, this is called a second-to-default credit derivative, etc. In general, one way to designate this type of credit derivative is as a credit derivative that falls due on the  $n$ th default, where  $n$  refers to the number of reference instruments that must default before payment occurs ( $n = 1, 2, 3$ , etc.).

## Chapter 7

**Section 3** An institution may include profit as original own funds in accordance with the recommendations to the annual accounts if the auditors have verified the profit. Profit refers to profit after estimated taxes.

The auditors' verification of the profit refers to an audit of the accounts that serves as a basis for the information regarding capital adequacy and large exposures that the institution shall submit to Finansinspektionen. The review shall as a minimum

have the same scope as that set out in the Standard for Review Engagements issued by FAR, the industry organisation for accountants and advisors.

If the Annual General Meeting or an equivalent body decides on a distribution of profits other than what was recommended, the institution and the financial group shall report the change using the form in *Appendix 2*.

**Section 6** Profit generated in the current financial year may be included in own funds as original own funds if the auditors have verified the profit in the manner set out in section 3, second paragraph. Profit refers to profit after estimated taxes.

An institution or financial group that later reports a smaller profit than what was most recently verified shall only include the smaller profit in the original own funds.

**Section 8a** An institution may include in the original own funds the percentage of equity of the reserves, funds and untaxed reserves set out in Chapter 3, section 2, first paragraph of the Capital Adequacy Act. Percentage of equity refers to the amount remaining after consideration for deferred tax.

**Section 15** In order for non-voting equity and other capital infusions set out in Chapter 3, section 4 of the Capital Adequacy Act to be included in own funds, the following general conditions shall be met. This applies to both original own funds and additional own funds.

A contribution shall

- have been paid in cash,
- be unsecured by the issuer or a related entity,
- not be cancellable by the investor and not be redeemable or repurchasable without the permission of Finansinspektionen,
- not have a guaranteed yield,
- have subordinated terms of payment, and
- be available to cover losses.

With regard to Tier 1 capital contributions and other items that can be included in original own funds with the permission of Finansinspektionen, specific requirements are set out in sections 16–27. Specific requirements applying to different items which can be included in the tier II capital are set out in Chapter 8.

**Section 16** In accordance with sections 16 a–c, when calculating own funds the total Tier 1 capital contribution may be a maximum of 50 percent after the reductions of original own funds in accordance with the Capital Adequacy Act and these regulations.

To include Tier 1 capital contributions in the financial group's own funds, the issuer of the Tier 1 capital contribution shall be the parent company in the financial group or a subsidiary subject to supervision that is part of the financial group.

**Section 16a** When calculating own funds, perpetual Tier 1 capital contributions may represent at the most 50 percent of the original own funds calculated in accordance with section 16, if the following conditions are met and the terms of the agreement state that

- the contribution may not be repaid or repurchased, rather may only be converted to instruments set out in Article 57a of the Credit Institution Directive,
- the issuer always has the right to convert the contribution,

– the contribution shall be converted in the event of a critical situation as defined in the agreement that shall occur before the institution or the financial group is in violation of the statutory capital requirements in accordance with Chapter 2, section 1 of the Capital Adequacy Act,

– the contribution shall be converted upon decision by Finansinspektionen as the result of an unsatisfactory financial situation at the institution or the financial group,  
– interest shall only be applied to the at any given time remaining portion of the Tier 1 capital contribution that has not been converted, and  
– upon conversion the investor receives a number of instruments calculated in accordance with the second paragraph.

The conversion rate for the Tier 1 capital contribution is determined on the day the contribution is issued and is based on the market value of the instruments to which the contribution shall be converted. The investor can receive fewer instruments if the market value increases but not more if the market value decreases. Finansinspektionen can approve an adjustment to the conversion rate.

**Section 16b** Perpetual Tier 1 capital contributions without incentives to redeem may, within the limit set out in section 16a and in combination with the contribution in accordance with section 16c, be included in the calculation of own funds at no more than 35 percent of the original own funds. However, the contribution may contain one or more pure call options.

**Section 16c** Fixed-term Tier 1 capital contributions without incentives to redeem other than the due date together with perpetual Tier 1 capital contributions as referred to in section 18, within the limits set out in sections 16a and 16b, may be included in the calculation of own funds at no more than 15 percent of the original own funds. Only the presence of a pure call option shall not be considered to provide such incentives as those set out in section 18.

**Section 17** The following conditions shall be met and the terms of the agreement for a Tier 1 capital contribution shall state that  
– with reference to its financial position, an issuer has the option to cancel interest payments for an unlimited period of time,  
– an interest payment shall be cancelled if the capital requirements set out in Chapter 2, section 1 of the Capital Adequacy Act are not met, and  
– interest payments shall be cancelled upon decision by Finansinspektionen as the result of an unsatisfactory financial situation at the institution or the financial group.

If an interest payment has been cancelled at the request of Finansinspektionen, the issuer can, following Finansinspektionen's consent, compensate the investor with instruments set out in Article 57a of the Credit Institution Directive, under the condition that the issuer can show that the institution or the financial group or both can preserve its financial resources.

Interest payments for Tier 1 capital contributions may only occur if distributable funds are available. If the payment of interest is cancelled, when it is resumed it may not cover the period for which interest payments were not made. In other words, the interest conditions for the Tier 1 capital contribution shall not be cumulative.

That which applies to interest payments in this section shall also apply to dividends.

**Section 18** An agreement for a perpetual Tier 1 capital contribution in accordance with section 16c may contain conditions stipulating that incentives can arise for the redemption of the contribution. These incentives shall be limited in nature. The incentive may, at the earliest, occur ten years after a contribution has been issued and may only take place once.

If an option with an incentive to redeem perpetual Tier 1 capital contributions is not exercised, the contribution may not be reclassified. This means that the contribution may still at the most consist of 15 percent of the original own funds.

If the terms of the agreement contain a call option and if, upon redemption the holder receives shares, the conversion rate may not be more than 150 percent of the conversion rate when the Tier 1 capital contribution was issued. The conversion rate is based on the market value of the shares.

If the agreement contains incentives which entail that the interest rate could be raised after a period (a so-called step-up), this may not result in the effective interest cost during the second period being greater than the index on which the interest shall be based after the step-up (stepped-up-index basis),

- plus the initial interest difference in relation to government borrowing with an equivalent term (initial index basis), i.e. credit spread,
- minus the initial interest difference between the stepped-up-index basis and initial index basis, i.e. swap spread, plus

- a) 1.0 percentage points, or
- b) 50 percent of the initial credit spread.

#### *General guidelines*

Example for calculating step-up:

1. A bank initially takes up a Tier 1 capital contribution with fixed interest at an effective borrowing cost of 6.5 percent. After ten years the contribution changes to a variable interest rate based on STIBOR (stepped-up-index basis). When it is taken up, the ten-year government bond (initial index basis) is traded at an actual yield of 5.5 percent and the STIBOR is 5.9 percent. The swap spread is 0.4 percent (= 5.9–5.5)..

Option a) The maximum permissible interest for the period after step-up is STIBOR + the initial credit spread (1.0 = 6.5–5.5) – the swap spread (0.4) + 1 percentage point = STIBOR + 1.6 percent.

Option b) The maximum permissible interest for the period after step-up is STIBOR + the initial credit spread (1.0) – the swap spread (0.4) + 50 percent of the initial credit spread (0.5 x 1.0) = STIBOR + 1.1 percent.

2. A bank initially takes up a Tier 1 capital contribution with fixed interest at an effective borrowing cost of 6.5 percent. After ten years a step-up takes place but the contribution still has a fixed interest rate (stepped-up-index basis). When the contribution is taken up, the ten-year government bond (initial index basis) is traded at an effective rate of 5.5 percent and the STIBOR is 5.9 percent. Because both the initial index basis and the stepped-up-index basis are the ten-year government borrowing cost, the swap spread is zero in this example.

Option a) The maximum permissible interest for the period after the step-up is  
 $6.5 + 1 \text{ percentage point} = 7.5 \text{ percent}$ .

Option b) The maximum permissible interest for the period after step-up is  
 $6.5 + 50 \text{ percent of the initial credit spread } (0.5 \times 1.0) = 7.0 \text{ percent}$ .

**Section 20** The terms of the Tier 1 capital contribution agreement shall state that the contribution

- is unsecured by the issuer or a related entity, and
- is perpetual or has an original maturity of at least 30 years.

**Section 21** The interest rate for a Tier 1 capital contribution may not be unreasonably high at the beginning of the term of the contribution only to then fall drastically (step-down). A credit agreement structure with a high interest rate at the beginning of the term of the loan and a large decline in the interest rate later can be considered a form of hidden amortisation of the loan.

**Section 23** The terms of the Tier 1 capital contribution agreement shall state that the investor has the right to repayment only if the issuer has been declared bankrupt or entered into liquidation.

After an application from the issuer and on obtaining Finansinspektionen's permission, Tier 1 capital contributions as referred to in sections 16b and 16c may be redeemed or repurchased. Such permission may be given at the earliest five years after the contribution has been taken up or issued. Permission from Finansinspektionen is also required when a subsidiary of the institution acquires notes pertaining to a Tier 1 capital contribution issued by the parent undertaking or institution.

Finansinspektionen may permit the Tier 1 capital contribution to be repurchased less than five years after the contribution was taken up or issued if the contribution, before it is repurchased, is replaced with at least an equal amount of capital with the same or higher quality.

After an application from the issuer Finansinspektionen may permit the early redemption or repurchase of Tier 1 capital contributions if there has been a change in the current tax regulations or provisions regarding regulatory classification of the contribution that could not be foreseen when it was taken up or issued.

Finansinspektionen can give its permission in accordance with the second, third and fourth paragraphs only if the financial situation of the institution or the financial group, or both, is satisfactory after the Tier 1 capital contribution has been redeemed or repurchased. However, Finansinspektionen can give its permission for the repayment of a fixed-term Tier 1 capital contribution on the due date if the requirements in Chapter 2, section 1 of the Capital Adequacy Act are met.

**Section 23a** When applying to Finansinspektionen for permission for the redemption or repurchase of a Tier 1 capital contribution in accordance with section 23, an issuer shall state the grounds for the repayment or repurchase and describe how this will affect the financial situation of the institution or the financial group, or both, in the foreseeable future.

**Section 24** An institution can apply to Finansinspektionen for general permission to buy back a portion of an issued Tier 1 capital contribution intended for resale as part of securities-related operations. An institution that has received general

permission shall at any time deduct the portion of the contribution repurchased from the original own funds. When later selling the repurchased Tier 1 capital contribution notes, a corresponding amount may again be included in the original own funds.

Repurchased Tier 1 capital contributions may not compose more than 10 percent of an individual Tier 1 capital contribution and not more than 3 percent of all of the Tier 1 capital contributions taken up by the institution and the financial group.

**Section 25** The Tier 1 capital contribution referred to in sections 16b and 16c shall fulfil the following conditions and the terms of the agreement shall state

- the extent to which the contribution, including accrued and unpaid interest, can be appropriated to cover losses and enable a recapitalisation of the institution or the financial group.

- the method that shall be used to appropriate Tier 1 capital contribution,
- that the contribution shall be appropriated to the extent defined in the agreement following a decision by Finansinspektionen, and
- that interest on the contribution shall at any time only be charged on the remaining portion of the contribution that has not been appropriated.

**Section 26** The issuer of the contributions referred to in sections 16b and 16c decides if the Tier 1 capital contribution and accrued interest shall be appropriated. Accrued interest amounts shall be entered as liabilities before they can be appropriated.

Appropriation shall be irrevocable and final. Provisions regarding the right of investors to future restitution of the appropriated amount for contributions referred to in sections 16b and 16c may only cover cases in which the restitution of the appropriated amount can be made from distributable profits in accordance with an adopted balance sheet following the decision of the Annual General Meeting. The restitution shall not prevent a recapitalisation of the institution or the financial group.

If the issuer decides to appropriate a Tier 1 capital contribution, including accrued interest referred to in sections 16b and 16c, the Annual General Meeting may decide to enter a provision into the articles of association with the following content. The issuer may not pay dividends or make other repayment to shareholders before the appropriated Tier 1 capital contribution, including appropriated interest, has been re-entered as a liability.

## Chapter 8

**Section 10** It shall be stated in the contract terms for a perpetual subordinated loan that the loan

- is unsecured by the issuer or a related entity, and
- is perpetual.

## Chapter 9

**Section 4a** If an institution or an undertaking in a financial group grants loans or pledges collateral and has knowledge that the borrower shall acquire items that may be included in the own funds for the institution or the financial group, these items shall be deducted from the institution's or financial group's original own funds.

## Chapter 13

**Section 36** A credit derivative which refers to more than one asset (a basket) and becomes due for payment if a default occurs among the assets in the basket, and such an event terminates the contract, the capital requirement for specific risk shall be the lowest of

- the sum of the capital requirement for specific risk for the reference assets included in the basket, and
- the maximum amount which can be paid out during the contract.

When an institution that sells risk receives credit protection for a basket of assets, the institution may deduct the capital requirement for specific risk for the reference asset that gives rise to the lowest capital requirement for specific risk.

**Section 37** A credit derivative which refers to more than one asset (a basket) and becomes due for payment if the  $n$ th default occurs among the assets in the basket, and such an event terminates the contract, the capital requirement for specific risk shall be the lowest of

- the sum of the capital requirement for specific risk for the reference assets included in the basket, and
- the maximum amount which can be paid out during the contract.

When calculating the capital requirement for specific risk, an institution that purchases risk may exclude the  $n-1$  reference assets that have the lowest capital requirements for specific risk.

When an institution that sells risk receives credit protection for a basket of assets the institution may apply the method set out in section 36, second paragraph in an appropriately adapted manner provided that

- credit protection is also available for default 1 to  $n-1$ , or
- $n-1$  default has already occurred.

**Section 45** Net positions in the following financial instruments shall have a weight that varies depending on the remaining maturity of the instrument:

$\leq 6$ months	$> 6 \leq 24$ months	$> 24$ months
0.25%	1.0%	1.6%

The remaining maturity of the instrument refers to the time until the instrument matures.

The following financial instruments shall have a weight in accordance with the first paragraph.

1. Financial instruments issued or guaranteed by governments that would qualify for credit quality steps 2 or 3.
2. Financial instruments issued by local governments or comparable entities within the EEA that would qualify for credit quality steps 2 or 3.
3. Financial instruments issued by authorities within the EEA that would qualify for credit quality steps 2 or 3.



4. Financial instruments issued by central banks that would qualify for credit quality steps 2 or 3.
5. Financial instruments issued by international organisations that would qualify for credit quality steps 2 or 3.
6. Financial instruments issued by multilateral development banks that would qualify for credit quality steps 2 or 3.
7. Financial instruments issued or guaranteed by institutions or foreign equivalents that would qualify for credit quality steps 1 or 2.
8. Financial instruments issued or guaranteed by firms that would qualify for credit quality steps 1, 2 or 3.

If the financial instruments comprise covered bonds or corresponding foreign debt securities which fulfil the conditions in Chapter 16, section 35, the following reduction in the capital requirement may be made. If the institution which issued the covered bonds qualifies for creditworthiness steps 1 or 2, they can be assigned a weight of 50 percent of that set out in the table in the first paragraph.

**Section 49** Net positions in the following financial instruments shall have a weight of 8 percent.

1. Financial instruments issued or guaranteed by governments that would qualify for credit quality steps 4 or 5.
2. Financial instruments issued by local governments or comparable entities within the EEA that would qualify for credit quality steps 4 or 5.
3. Financial instruments issued by authorities within the EEA that would qualify for credit quality steps 4 or 5.
4. Financial instruments issued by central banks that would qualify for credit quality steps 4 or 5.
5. Financial instruments issued by international organisations that would qualify for credit quality steps 4 or 5.
6. Financial instruments issued by multilateral development banks that would qualify for credit quality steps 4 or 5.
7. Financial instruments issued or guaranteed by institutions that would qualify for credit quality steps 3–5.
8. Financial instruments issued or guaranteed by firms that would qualify for credit quality step 4.
9. Financial instruments which have no credit assessment from a credit assessment institution.

**Section 64** The capital requirement for specific risk shall be set at 4 percent of the institution's gross position.

In exceptional cases the capital requirement for specific risk may be reduced to 2 percent of the institution's gross position for share portfolios that fulfil the following conditions:

- based on an objective evaluation the shares shall be considered to have a high liquidity,
- shares issued by the same issuer may not exceed 5 percent of the value of the share portfolio, or 10 percent if the total sum of such individual positions does not exceed 50 percent of the share portfolio, and
- the shares may not be issued by an issuer whose interest rate-linked financial instruments receive a capital requirement of 8 or 12 percent in accordance with sections 49-50.

Shares considered to have a high liquidity are listed in the index below.

Australia	ASX All Ordinaries Index	Norway	OBX
Belgium	BEL 20	Switzerland	SMI
Denmark	OMXC20	Spain	IBEX 35
Finland	OMXH25	United Kingdom	FTSE 100
France	CAC 40	United Kingdom	FTSE Mid 250
Hong Kong	Hang Seng	Sweden	OMXSPI
Italy	FTSE MIB	Germany	DAX
Japan	Nikkei 225	U.S.	S&P 500
Canada	TSX Composite Index	Austria	ATX
Netherlands	AEX		

Gross position refers to the sum of all of the institution’s net positions in financial instruments irrespective of whether they are long or short.

*General guidelines*

Example:

Sum of long net position (+) in, for example, Ericsson B is SEK 100,000  
 Sum of long net position (+) in, for example, Electrolux B is SEK 100,000  
 Sum of short net position (-) in, for example, Volvo B is SEK 50,000

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 In this example the gross position is SEK 250,000.

**Chapter 15**

**Section 3** The exposure amount for items on the balance sheet shall be the written-down value.

In a leasing transaction, the exposure amount for the leasing object shall be the book value.

In a leasing transaction, the exposure amount for the minimum lease charges shall be their present value. The minimum lease charges are the payments during the lease term that the lessee is or can be required to pay, and all favourable call options which are likely to be exercised.

If a leasing transaction contains a guaranteed residual value, this shall be included as a part of the minimum lease charges, provided that

- the guarantor is assigned to one of the issuers of credit protection referred to in Chapter 24, section 3, and

– the requirements set out in Chapter 24, sections 4–6 and section 14 are met.

When calculating the capital requirement for risks in non-trading activities, receivables and liabilities may only be netted in those cases set out in Chapter 26. This applies irrespective of the rules that apply to external accounting. The exposure amount for off-balance sheet commitments shall consist of the nominal amount multiplied by a conversion factor as set out in Chapter 17.

The exposure amount for counterparty risk in derivative contracts shall be calculated in accordance with Chapter 18.

For counterparty risk in derivative instruments, repurchase transactions, margin lending transactions and securities and commodities lending and borrowing transactions, the exposure amount may be set to 0 (zero) if the following requirements are met:

1. The exposures are to a clearing organisation.
2. Participants in the clearing post collateral on a daily basis for the exposure they represent to the clearing organisation.
3. The collateral covers both current exposure and any potential future exposure.

Counterparty risk for derivative contracts, repurchase transactions, margin lending transactions and securities and commodities borrowing and lending transactions may instead, after receiving permission from Finansinspektionen, be calculated in accordance with sub-part L6.

**Section 5** When the leasing agreement is designed such that the institution carries the financial risk associated with the leasing object, the leasing object shall be treated as a tangible asset.

The present value of the minimum lease charges, including a guaranteed residual value that fulfils the requirements set out in section 3, shall be considered an exposure to the leasee and assigned to the leasee's exposure class. A guaranteed residual value that does not fulfil the requirements set out in section 3 shall be assigned to other items and risk-weighted in accordance with Chapter 16.

## Chapter 16

*Exposures to corporates with short-term credit assessments*

**Section 19** Exposures to corporates for which a short-term credit assessment for the specific exposure is available may be assigned a risk weight according to Table 4.

Table 4

Credit quality step	1	2	3	4	5	6
Risk weight	20%	50%	100%	150%	150%	150%

**Section 51** In a leasing transaction where the residual value of leased assets is not included in the exposure to the leasee in accordance with Chapter 15, section 5, a risk-weighted exposure amount for the residual value shall be determined for each individual year of the term of the leasing contract using the following calculation:

Risk-weighted exposure amount =  $1/t \times 100\% \times$  Exposure amount

where t is the greater of one (1) and the nearest number of whole years remaining in the term of the leasing contract.

**Section 52** Exposures in the form of other items for which risk-weighted amounts are not provided in sections 45-51 shall be assigned a risk weight of 100 percent.

## Chapter 18

**Section 3** An institution that purchases credit protection through credit derivatives for an exposure that is not assigned to the trading book or for an exposure to counterparty risk may

1. include all credit derivatives when calculating the exposure amount, or
2. set the exposure amount for all credit derivatives to zero (0).

**Section 14** For a credit default swap, the risk position consists of the notional value of the reference debt instrument multiplied by the remaining maturity of the credit default swap.

For a reference debt instrument included in a basket of underlying instruments for a credit default swap that becomes due on the  $n$ th default, the risk position consists of the effective notional value of the reference debt instrument multiplied by the modified duration of the credit default swap with regard to a change in the credit spread for the reference debt instrument.

**Section 23** There is one hedging set for each

- issuer of one of the reference debt instruments that is an underlying instrument for a credit default swap,
- reference instrument in a basket that is underlying a credit default swap on the  $n$ th default.

**Section 26** Multipliers for counterparty risk (CCRM) for the different categories of hedging sets shall be assigned as follows:

	Hedging set categories	CCRM
1.	Interest rates	0.2%
2.	Interest rates for risk positions from a reference debt instrument that underlies a credit default swap and for a credit default swap that becomes due on the $n$ th default provided that, in accordance with Chapter 13, sections 44-48, they shall be assigned a weight of no more than 1.6%	0.3%
3.	Interest rates for risk positions from a debt instrument or reference instrument and a reference debt instrument that underlies a credit default swap that becomes due on the $n$ th default provided that, in accordance with Chapter 13, sections 42 and 49–50, they shall be assigned a weight of more than 1.6%	0.6%
4.	Exchange rates	2.5%
5.	Electric power	4.0%
6.	Gold	5.0%
7.	Shares	7.0%
8.	Precious metals (except gold)	8.5%
9.	Other commodities (except precious metals and electric power)	10.0%
10.	Underlying financial instruments of derivative contracts that are not in any of the above categories	10.0%

The underlying instruments of derivative contracts according to point 10 and credit default swaps that become due on the  $n$ th default in the above table shall be assigned to separate hedging sets for each category of underlying financial instrument.

## Chapter 24

**Section 6** In order for a counter-guarantee, i.e. a guarantee that guarantees another guarantee, to be eligible, the following requirements must be met:

1. The issuer of the counter-guarantee is a counterparty whose commitments are assigned to one of the following exposure classes:
  - a) governments and central banks,
  - b) local authorities and comparable associations as well as agencies,
  - c) public sector entities treated as governments and central banks or institutions, or
  - d) multilateral development banks or international organisations assigned a 0 per cent risk weight.
2. The counter-guarantee covers all aspects of credit risk elements in the exposure (not just counterparty risk, but also dilution risk, transfer risk, etc.).
3. The direct guarantee meets the conditions in sections 4-5.
4. The counter-guarantee meets the conditions in sections 4-5, except that protection does not need to be direct.

A counter-guarantee which does not meet the requirement in the first paragraph, point 1 may be eligible if the counter-guarantee in its turn has a direct guarantee which meets the requirement, provided that all other conditions in the first paragraph have been met.

The institution shall notify Finansinspektionen that it has a counter-guarantee before the institution takes it into account when calculating risk-weighted exposure amounts. In this notification, the institution shall certify that the counter-guarantee meets the requirements contained in the first paragraph and that there is no evidence that the counter-guarantee is inferior to a direct guarantee from the issuer. If the institution has several counter-guarantees from the same issuer, the institution only needs to give notice for each issuer if the conditions in the counter-guarantees are similar.

## Chapter 25

**Section 4** CIU units are eligible if

1. the value of units in CIUs is updated and made public daily, and
2. the fund rules only allow the fund's assets to be invested in securities recognisable in accordance with sections 2 and 3. However, this does not eliminate the use of derivative instruments in the fund to hedge investments in such securities.

If the fund's assets are partly invested in types of assets other than those recognisable in accordance with sections 2 and 3, the units in CIUs are eligible but only for the portion of their value that corresponds to assets that are recognisable. The institution shall calculate this value based on the assumption that the fund's assets have been invested in assets that are not recognisable to the maximum extent allowed by the fund's investment limitations in accordance with legislation, Finansinspektionen's regulations and the fund rules. The institution shall calculate the total value of the assets in the fund that are non-recognisable with deductions for other liabilities. If the total value is negative, the value of the recognisable assets is deducted to the same extent.

**Section 14** When determining risk-weighted exposure amounts the institution may use recognisable financial collateral by using either the simple method pursuant to sections 15-19 or the comprehensive method pursuant to sections 20-44.

An institution that has received approval in accordance with Chapter 38, sections 14–22 to use the standardised approach for credit risk when calculating the risk-weighted exposure amount may use by the simple method or the comprehensive method provided that the institution can demonstrate that the methods are not used selectively to achieve a lower capital requirement. The simple method may not be used when risk-weighted amounts are calculated using an IRB approach.

## Chapter 27

**Section 1** A life insurance policy pledged or assigned to the institution may be considered to be recognised collateral if the life insurance provider is subject to Directives 2002/83/EC and 2001/17/EC of European Parliament and Council or is subject to supervision by a competent authority of a third country, the supervision and regulations of which correspond to those applied within the EEA and the following conditions are met:

1. The insurance provider shall have been notified of the pledge or assignment.
2. The insurance provider may not make any payments under the terms of its contract without the permission of the institution.
3. The insurance must have a declared surrender value that cannot be reduced.
4. The institution must have the right to cancel the insurance and obtain the surrender value without undue delay if the counterparty defaults.
5. Payment of the surrender value may not occur without the permission of the institution.
6. The institution shall be given information concerning any premiums unpaid by the policyholder.
7. The agreement regarding the grant of collateral shall be legally binding in all jurisdictions relevant at the time the agreement is entered into.
8. The credit protection shall be provided throughout the entire term of the loan. If this is not possible due to the termination of the insurance before the credit relationship ends, the institution shall ensure that an amount equal to the insurance amount functions as collateral for the institution until the term of the loan matures.

**Section 4a** The protected amount shall be assigned a risk weight based on the risk weight applied to a senior unsecured exposure to the life insurance provider in accordance with the following:

1. If an exposure to the provider is assigned a 20 percent risk weight the protected amount shall be assigned a 20 percent risk weight.
2. If an exposure to the provider is assigned a 50 percent risk weight the protected amount shall be assigned a 35 percent risk weight.
3. If an exposure to the provider is assigned a 100 percent risk weight the protected amount shall be assigned a 70 percent risk weight.
4. If an exposure to the provider is assigned a 150 percent risk weight the protected amount shall be assigned a 150 percent risk weight.

## Chapter 34

**Section 3** When an exposure to a client is protected by a third party through a recognisable guarantee or a recognisable credit derivative, except credit-linked notes, or when there is recognisable financial collateral issued by a third party, the institution may

- a) treat the guaranteed portion of the exposure as if it applies to the guarantor rather than the client, if the unguaranteed exposure to the guarantor would be assigned the same or a lower risk weight in accordance with the standardised approach for credit risk compared to the risk weight for the unguaranteed exposure to the client, and
- b) treat the portion of the exposure for which financial collateral has been pledged as if it applies to a third party instead of to the client, if the unsecured portion of the exposure would be assigned the same or a lower risk weight in accordance with the standardised approach for credit risk compared to the risk weight for the unsecured exposure to the client.

If a lien on property or a tenant-owner association was received as collateral it may be taken into account in accordance with Chapter 35, section 11.

The method set out in the first paragraph, point b may not be used if the exposure and the protection have different maturities.

To determine an exposure amount for large exposures, an institution may use the comprehensive method for financial collateral and the method set out in the first paragraph, point b only if the institution may use both the comprehensive method and the simplified method for financial collateral when calculating the capital requirement for credit risk.

## Chapter 35

**Section 6** In addition to the exemptions referred to in Chapter 7 of the Capital Adequacy Act and section 16 of the Capital Adequacy Ordinance, the following exposures shall also be exempted when determining an institution's large exposures:

1. Exposures to international organisations, multilateral development banks or public sector entities which attract a 0 percent risk weight in accordance with Chapter 16.
2. Exposures for off-balance sheet commitments to undrawn credit facilities classified as low risk commitments in accordance with Chapter 17, section 5. One condition for an institution to exempt these exposures, however, is that an agreement has been concluded with the client under which the credit facility may be drawn only if the limit for large exposures in accordance with Chapter 7, sections 3 and 5 of the Capital Adequacy Act has not been exceeded.
3. Exposures for which there is adequate collateral in the form of cash on deposit with the lending institution or with an institution which is the parent undertaking or a subsidiary of the lending institution, or in the form of cash received for a credit-linked note issued by the institution or deposits or loans received from a counterparty to the institution that are included in a netting agreement for on-balance sheet items approved in accordance with Chapters 26 and 56.

Exposures for which there is adequate collateral in the form of certificates of deposit issued by the lending institution or an institution which is the parent undertaking or subsidiary of the lending institution and lodged with either of them.

4. Exposures to an institution within the EEA if they

- in accordance with the agreement become due on the following business day,
- are in DKK, NOK or SEK, and
- are not included in these institutions' own funds.

5. Exposures to one or more connected institutions totalling EUR 150 million if the exposures are no higher than 100 percent of the own funds. Exposures exceeding EUR 150 million or 100 percent of the own funds may not be exempted at all. Investment firms as referred to in Chapter 2, sections 8 and 9 of the Capital Adequacy Act may exempt all exposures to institutions. Institution also refers to equivalent foreign firms.

6. Exposures caused by delayed receipts in funding and other exposures arising from client activities when providing money transmission, e.g. execution of payment services, clearing and settlement in all currencies and corresponding banking services, or for clearing, settlement and safekeeping services for financial instruments on behalf of clients which do not last longer than the following business day.

7. Exposures that have a maximum maturity of one banking day (intraday exposures), are caused by the provision of money transmission, e.g. the execution of payment services, clearing and settlement in currencies and corresponding banking services, and are to a credit institution or an equivalent foreign firm that provides these services.

**Section 7** An institution shall include the following exposures using the values set out below when determining large exposures:

1. Debt securities issued in accordance with the Covered Bonds (Issuance) Act (2003:1223) and equivalent foreign debt securities shall be included at 10 percent of their value. In no case may the items constitute the issuing institution's own funds.

2. Documentary credits of a medium to low risk character for which delivered goods constitute the collateral shall be included at 50 percent of the nominal amount.

**Exposures which, after being granted permission, may be included with a reduced value when determining large exposures**

**Section 8** After receiving permission from Finansinspektionen an institution may include the following exposures at the values decided by Finansinspektionen:

1. Exposures to central banks arising from statutory requirements on minimum reserves denominated in each country's national currency.

2. Exposures to governments in the form of statutory liquidity requirements held in government securities which are denominated and funded in each country's



national currency, provided that the government has an external credit assessment of credit quality step 3 or higher.

**Section 12** After receiving permission from Finansinspektionen, institutions which apply Chapter 25, sections 20-43 or Chapter 55, sections 11–30 may use an adjusted exposure amount when determining large exposures in accordance with Chapter 7, sections 3 and 5 of the Capital Adequacy Act. The adjusted exposure amount shall be a minimum of  $E_{\text{unsec}}$  calculated in accordance with Chapter 25, section 20.

**Section 13** An institution which has obtained permission to use own estimates of LGD and conversion factors in accordance with the IRB approach in sub-part L1 may, after receiving permission from Finansinspektionen, instead of calculating the exposure amount in accordance with section 12, use these estimates when determining large exposures in accordance with Chapter 7, sections 3 and 5 of the Capital Adequacy Act.

In order for such permission to be received, the institution must be able to estimate the effect of the financial collateral on the relevant exposures separately from other LGD-related aspects.

An institution which has received permission to use own estimates of LGD and conversion factors in accordance with the IRB approach in sub-part L1 and which does not calculate the value of its exposures in accordance with the first paragraph may use the comprehensive method for financial collateral or the method set out in Chapter 34, section 3, first paragraph, point b when determining large exposures.

**Section 14** An institution which has received permission to use one of the methods set out in sections 12–13 or the comprehensive method for financial collateral in accordance with section 13 when determining large exposures in accordance with Chapter 7, sections 3 and 5 of the Capital Adequacy Act, shall conduct periodic stress tests of their credit-risk concentrations, including for the realisable value of any collateral taken.

These stress tests shall address risks arising from potential changes in market conditions that could adversely impact the institution's capital adequacy and risks arising from the hurried realisation of collateral.

The institution shall be able to demonstrate that the stress tests carried out are adequate and appropriate for the assessment of such risks.

In the event that such a stress test indicates a lower realisable value of collateral taken than would be permitted to be taken into account under sections 12-13, the value of collateral permitted to be recognised in calculating the value of exposures in accordance with Chapter 7, sections 3 and 5, first paragraph of the Capital Adequacy Act shall be reduced accordingly.

An institution shall include the following in its strategies for addressing concentration risk:

1. Strategies and procedures for addressing risks arising from maturity mismatches between exposures and any credit protection on those exposures.
2. Strategies and procedures in cases where a stress test indicates a lower realisable value of collateral than taken into account under sections 12–13.
3. Strategies and procedures relating to concentration risk arising from credit protection and, in particular, large indirect credit exposures (for example to a single issuer of securities taken as collateral).

## Chapter 36

**Section 1** This section sets out the requirements and conditions which shall be met in order for an institution in accordance with Chapter 4, section 7 of the Capital Adequacy Act to be granted permission to use an IRB approach to calculate the capital requirement for credit risk.

Subsidiaries within a financial group are not required to meet the minimum requirements individually, rather they may be met together with the parent company and other subsidiaries within the group. The aforesaid shall not apply to Chapter 44, sections 39–42.

If an institution that obtained permission to use an IRB approach would like to make significant changes to the approach, the institution shall apply to Finansinspektionen for permission to do so.

## Chapter 37

**Section 11** The present value of minimum lease charges, including a guaranteed residual value that meets the conditions set out in Chapter 40, section 6, shall be considered an exposure to the leasee and be assigned to the leasee's exposure class. A guaranteed residual value that does not meet the conditions in Chapter 40, section 6 shall be assigned to non credit-obligation assets and risk-weighted in accordance with Chapter 39, section 15.

## Chapter 38

**Section 10** Risk-weighted exposure amounts for exposures to a CIU shall be calculated as if the underlying exposures are held directly by the institution provided that the following conditions are met:

1. The CIU is managed by a company subject to supervision within the EEA.
2. The institution is aware of the underlying exposures of the CIU.
3. The CIU's prospectus or equivalent document includes
  - a) the categories of assets in which the CIU is authorised to invest, and
  - b) if investment limits apply, the relative limits and the methodologies to calculate them.
4. The business of the CIU shall be reported on at least an annual basis to make it possible to assess the assets and liabilities, income and operations over the reporting period.

Finansinspektionen may grant the institution permission to treat a CIU managed by a company subject to supervision in a country outside the EEA in accordance with the first paragraph. The criteria in the first paragraph, points 3-4 shall be met for permission to be granted. If a supervisory authority within the EEA approves a third country CIU as eligible, the institution may make use of this recognition without permission from Finansinspektionen.

For the exposures in the CIU that the institution cannot reasonably be aware of or if it is unduly burdensome for the institution to identify the CIU's underlying exposures, the risk-weighted exposure amount for this portion of the CIU shall be calculated in accordance with section 12.

**Section 11** Where the institution does not meet the conditions in these regulations for using the IRB approach for the CIU's underlying exposures, the following approach shall be used:

1. For equity exposures included in the CIU, the risk-weighted exposure amount shall be calculated in accordance with Chapter 39, sections 16–18. If the institution does not know to which categories of equities the exposures belong, it shall for this purpose treat them as other equity exposures.

2. For all other exposures included in the CIU, the risk-weighted exposure amount shall be calculated in accordance with the standardised approach for credit risk with the following modifications:

a) For exposures assigned a specific risk weight because they lack a credit assessment, or have been assigned to the credit quality step with the highest risk weight, the risk weight shall be multiplied by 2 but given a maximum risk weight of 1,250 percent.

b) For all other exposures the risk weight shall be multiplied by 1.1 and not be lower than 5 percent.

**Section 12** For exposures to CIUs that do not meet the criteria set out in section 10, first paragraph, or when section 10, third paragraph is applicable, the risk-weighted exposure amount shall be calculated in accordance with one of the following approaches:

1. The institution shall use the CIU rules and assume that the CIU first invests to the maximum extent allowed under its mandate, in exposures attracting the highest capital requirement in accordance with the standardised approach for credit risks and then continues making investments in descending order in exposures with lower capital requirements. Risk-weighted exposure amounts for exposures established in this way shall then be calculated in accordance with the provisions set out in section 11.

2. If sufficient information is not available to identify with reasonable certainty the exposures as set out in point 1, the institution shall calculate risk-weighted exposure amounts in accordance with Chapter 39, sections 16–18. If the institution does not know to which of the three categories of equities the CIU's equity exposures belong, it shall treat the exposures concerned as other equity exposures. Exposures for which the institution cannot identify the category shall also be treated as other equity exposures. Exposures that are not equity exposures shall be assigned to one of the three categories of equities.

3. The institution may allow the manager of the CIU to calculate the capital requirement for the holding in the CIU on behalf of the institution provided that the institution is ensured that correctness of the calculation is adequately ensured. The calculations shall be carried out in accordance with the provisions set out in section 11.

**Section 18** The institution may calculate the capital requirement for all equity exposures in accordance with the standardised approach for credit risks if the aggregate value of the equity exposures is less than 10 percent of the institution's own funds, calculated as an average over the past year. If the number of equity exposures is less than 10 individual holdings, the threshold shall be 5 percent of the institutions' own funds. Such equity exposures that apply to companies as referred to in section 16 as well as equity exposures referred to in section 17 may be excluded from the calculation of the aggregate value. Equity exposures assigned to other equity exposures in accordance with section 11, point 1 shall be included in the calculation of the aggregate value.

In conjunction with the application for permission to use an IRB approach, the institution may obtain permission to exclude, until 31 December 2017, equity exposures that the institution held on 31 December 2007 from the IRB approach in addition to that set out in the first paragraph.

**Section 19** An institution may be permitted to phase in the IRB approach that does not require own estimates for conversion factors and LGD in accordance with

Chapter 38, section 6 per exposure class for retail exposures per sub-group or business line. Permission cannot be obtained for equity exposures. A gradual implementation may take place over a period not exceeding three years from the date on which the institution was granted permission. Permission may only be granted where the following conditions are met:

1. The institution applies the IRB approach for at least 30 percent of the total exposure amount at the group level. Exposure amounts shall in this respect be calculated in accordance with the standardised approach for credit risk.
2. The institution can demonstrate that the determinative factor for the order in which the implementation is taking place is the institution's ability to comply with minimum requirements and not the order which results in the lowest capital requirement.
3. The institution has submitted a realistic plan to Finansinspektionen for the implementation of the IRB approach.

**Section 19a** When an institution that only uses the standardised approach for credit risk applies for permission to use an IRB approach with own estimates for conversion factors and LGD in accordance with Chapter 38, section 6, the institution also automatically applies for permission to use an IRB approach for exposures that are not exposures to governments, institutions and corporates. In conjunction with this application, the institution can be granted permission to phase in the IRB approach per exposure class, in respect of retail exposures per sub-group or business line. Permission cannot be granted for equity exposures. A gradual implementation may take place over a period of three years from the date on which the institution was granted permission. Permission may only be granted where the following conditions are met:

1. The institution applies an IRB approach with own estimates for conversion factors and LGD in accordance with Chapter 38, section 6 for at least 30 percent of the exposures to governments, institutions and corporates at group level and an IRB approach for at least 30 percent of the total exposure amount at group level. Exposure amount in this respect shall be calculated in accordance with the standardised approach for credit risk.
2. The institution can demonstrate that the determinative factor for the time and the order in which the implementation is taking place is the institution's ability to comply with minimum requirements and not the manner which results in the lowest capital requirement.
3. The institution has submitted a realistic plan to Finansinspektionen for the implementation of the IRB approaches.

At the latest six months prior to the expiry of the permission the institution can apply for a time-limited permission in order to use a less advanced IRB approach with internal estimates only for PD for a portion of the exposures to governments, institutions and corporates when calculating risk-weighted exposure amounts for credit risk. Such a permission can only be granted if the institution can demonstrate that

- the institution has gathered all internal data but still does not have sufficient data to meet the minimum requirements set out in these regulations, and
- external data that meets the minimum requirements of these regulations is not available.

**Section 19b** An institution that has permission to use an IRB approach and that is applying to use own estimates for conversion factors and LGD in accordance with Chapter 38, section 6 can be granted a time-limited permission in order to use a less advanced IRB approach with internal estimates only for PD for a portion of the exposures to governments, institutions and corporates when calculating risk-

weighted exposure amounts for credit risk. Permission can be granted where the following conditions are met:

1. The institution applies an IRB approach with own estimates for conversion factors and LGD in accordance with Chapter 38, section 6 for at least 30 percent of the total of the exposures to governments, institutions and corporates at group level and an IRB approach for at least 30 percent of the total exposure amount at group level. The exposure amount shall be calculated in accordance with the approach(es) used at the time of the application to calculate the exposures amount in these exposure classes.
2. The institution can demonstrate that the determinative factor for the time and the order in which the implementation is taking place is the institution's ability to comply with minimum requirements and not the manner which results in the lowest capital requirement.
3. The institution has submitted a realistic plan to Finansinspektionen for the implementation of the IRB approach.

Permission can be granted for a maximum of three years. At the latest six months prior to the expiry of the permission the institution can apply for a new time-limited permission. A new time-limited permission can only be granted if the institution can demonstrate that

- the institution has gathered all internal data but still does not have sufficient data to meet the minimum requirements set out in these regulations, and
- external data that meets the minimum requirements of these regulations is not available.

**Section 20** An institution may be granted a time-limited permission to apply the standardised approach for credit risks for portfolios of insignificant size. This permission cannot be granted for equity exposures. Permission may only be granted where the following conditions are met:

1. The total risk-weighted exposure amount for the exposures for which the longer implementation period is used is less than 15 percent of the risk-weighted exposure amount at group level calculated in accordance with the approaches used by the institution or in accordance with the standardised approach for credit risk.
2. It would be unreasonably burdensome for the institution to implement the IRB approach for the relevant exposures within the prescribed three-year period.

The institution can apply for a new time-limited permission at the latest six months prior to the expiry of the permission. Permission may only be granted if the above conditions are met.

## Chapter 39

**Section 13** The exposure-weighted average LGD used when calculating risk-weighted exposure amounts may not be lower than 10 percent for real estate credits where the security consists of

- tenant-owner associations,
- collateral in properties for residential purposes on a third party's site,
- liens on residential property or site-leasehold rights to such real estate.

Where the average is lower than 10 percent an adjustment must be made such that the average is not lower than 10 percent. This adjustment shall be made using the same factor for all LGD classes.

This section does not apply to exposures benefiting from government guarantees.

The provisions in this section apply until 31 December 2012.

**Section 15** The risk weight for non-credit obligation assets is 100 percent. The formula for risk-weighted exposure amounts is as follows:

Risk-weighted exposure amount = 100% × Exposure amount

For a leasing transaction where the residual value of leased assets is not included in the exposure to the lessee in accordance with Chapter 37, section 11, a risk-weighted exposure amount for the residual value shall be determined for each year during the term of the lease contract and be calculated in accordance with the following.

Risk-weighted exposure amount =  $1/t \times 100\% \times$  Exposure amount

where t is the greater of one (1) and the nearest number of whole years remaining in the term of the leasing contract.

**Section 23** An institution may obtain permission to calculate risk-weighted exposure amounts using a Value-at-Risk model (VaR model) which meets the requirements set forth in Chapter 45.

Risk-weighted exposure amounts shall be calculated by multiplying VaR by 12.5.

For an equity portfolio, the risk-weighted exposure amount may not be less than the sum of the risk-weighted exposure amounts calculated in accordance with the PD/LGD approach and the expected loss amounts in accordance with section 33 multiplied by 12.5. When calculating risk-weighted exposure amounts, PD and LGD shall have the following values:

1. PD shall be 0.09 percent.
2. LGD for equity exposures in venture capital firms not traded on a regulated market but included in a well-diversified portfolio shall be 65 percent. LGD for other equity exposures shall be 90 percent.

## Chapter 40

**Section 6** In a leasing transaction where an institution carries the financial risk associated with the leasing object, the exposure amount for the leasing object shall be the book value.

In a leasing transaction, the exposure amount for the minimum lease charges shall be their present value. The minimum lease charges are the payments during the lease term that the lessee is or can be required to pay, and all favourable call options which are likely to be exercised.

If a leasing transaction contains a guaranteed residual value, this shall be included as a part of the minimum lease charges, provided that

- the guarantor is assigned to one of the issuers of credit protection referred to in Chapter 53, section 3, and
- the requirements set out in Chapter 53, sections 4–6 and section 14 are met.

**Section 11** An institution that purchases credit protection through credit derivatives for an exposure that is not assigned to the trading book or for an exposure to counterparty risk may

1. include all credit derivatives when calculating the exposure amount, or
2. set the exposure amount for all credit derivatives to zero (0).

## Chapter 42

**Section 3** The value of LGD for covered bonds under the Covered Bonds (Issuance) Act (2003:1223) and equivalent foreign debt commitments shall be 11.25 percent if collateralised by any of the following assets:

1. Exposures to or guaranteed by governments and central banks within the EEA.
2. Exposures to or guaranteed by governments, central banks, multilateral development banks and international organisations that meet the requirements for credit quality step 1.
3. Exposures to or guaranteed by public bodies, local authorities and comparable entities and local authorities within the EEA.
4. Exposures to or guaranteed by public sector entities, local authorities and comparable entities, as well as authorities that are assigned a risk weight as exposures to governments and central banks or institutions and meet the requirements for credit quality step 1. Exposures to or guaranteed by public bodies, local authorities and comparable associations, as well as authorities that have a risk weight as exposures to governments and central banks or institutions and meet the requirements for credit quality step 2 provided that exposures do not exceed 20 percent of the notional amount of the issuing institution's outstanding covered bonds.
5. Exposures to institutions that meet the requirements for credit quality step 1. Total exposure of this type may not exceed 15 percent of the notional amount of the issuing credit institution's outstanding covered bonds or equivalent foreign debt commitments. Exposures caused by transmission and management of payments by the obligors of or liquidation proceeds in respect of, loans secured by real estate to the holders of covered bonds or equivalent foreign debt instruments shall not be encompassed by this limit of 15 percent. It is sufficient for exposures to an institution in the EEA with a maturity not exceeding 100 days to qualify for credit quality step 2.
6. Exposures secured by liens on real estate properties or tenant-owner associations in accordance with Chapter 54, if the liens combined with any more senior liens amount to a maximum of 80 percent of the value of the pledged property. Exposures secured with the equivalent foreign collateral within the EEA may also be assigned here provided that the relevant supervisory authorities permit it.
7. Exposures secured by liens on commercial properties, if the liens combined with any more senior liens amount to a maximum of 60 percent of the value of the pledged property. Exposures secured with the equivalent foreign collateral within the EEA may also be assigned here provided that the relevant supervisory authorities permit it.
8. Loans secured by ships where liens combined with any more senior liens amount to a maximum of 60 percent of the value of the pledged ship.

### *General guidelines*

Equivalent foreign collateral in points 6 and 7 mean the French Fonds Communs de Créances or equivalent organisations for securitisation.

## Chapter 43

**Section 6** With respect to exposures with contractual payment flows, M shall be calculated individually in accordance with the following:

M = 1 where the estimated maturity is less than one year.

M = 5 where the estimated maturity exceeds five years.

M = Calculated maturity, where such is between one and five years.

$$\text{Calculated maturity} = \frac{\sum t * BF_t}{\sum BF_t}$$

Here,  $CF_t$  denotes the cash flows (amortisation/repayment, interest payments and fees) payable by the obligor in period  $t$  years calculated from the calculation date.

When the agreement terms for a loan that is initially fixed-term contain conditions stipulating the loan on one or several occasions can be terminated for early repayment, the institution may not take these conditions into consideration when calculating the maturity.

When the terms of the agreement for a loan that is initially fixed-term contain conditions stipulating that the loan on one or more occasions is extended if termination does not occur, the institution shall calculate the maturity based on the assumption that the loan will always be extended.

**Section 8** With respect to derivative exposures subject to a netting agreement that meet the requirements in Chapter 56 and are collateralised, and to exposures referring to margin lending, repos or securities or commodities borrowing and lending transactions, which are also subject to a netting agreement in accordance with the aforementioned provisions, the calculated maturity shall be the weighted average of the individual instruments' remaining maturity in accordance with the same formula as in section 6.

The notional amount of each exposure shall be used for the weighting.

For the derivative instruments and margin lending referred to in the first paragraph, the floor for M shall be set at ten days.

For the repos or securities or commodities borrowing and lending transactions referred to in the first paragraph, the floor for M shall be set at five days.

**Section 10** An institution may disregard the restrictions set out in sections 6-9 regarding how short the maturity may be if the following requirements are met:

1. The exposure shall consist of securitised derivative instruments, margin lending, repurchase transactions, and securities or commodities borrowing and lending transactions.

2. The securitisation agreement shall

a) stipulate that the security requirement shall be calculated daily based on daily valuation of the exposure and the collateral,

b) stipulate that collateral shall be posted/pledged on a daily basis,

c) contain provisions that permit fast realisation or clearing of collateral in the event of default or if the counterparty is not pledging/posting collateral.

## Chapter 44

**Section 18** An institution shall document the design and operational details of its rating systems. The documentation shall describe the institution's compliance with provisions in the Capital Adequacy Act and these regulations. The institution shall also document changes in the risk rating system.



## Chapter 54

**Section 19** Collateral in real estate in a country within the EEA that applies the provisions of the Credit Institution Directive, Appendix VII-3:73 may be included if the institution uses a risk weight of 50 percent for the part of the exposure that is protected. One condition is that the institution meets the conditions and provisions applied by that country.

## Chapter 55

**Section 5** CIU units are eligible if

1. the value of units in CIUs is updated and made public daily, and
2. the fund rules only allow the fund's assets to be invested in securities recognisable in accordance with sections 2 and 3. However, this does not eliminate the use of derivative instruments in the fund to hedge investments in such securities.

If the fund's assets are partly invested in types of assets other than those recognisable in accordance with sections 2 and 3, the units in CIUs are eligible but only for the portion of their value that corresponds to assets that are recognisable. The institution shall calculate this value based on the assumption that the fund's assets have been invested in assets that are not recognisable to the maximum extent allowed by the fund's investment limitations in accordance with legislation, Finansinspektionen's regulations and the fund rules. The institution shall calculate the total value of the assets in the fund that are non-recognisable with deductions for other liabilities. If the total value is negative, the value of the recognisable assets is deducted to the same extent.

## Chapter 56

**Section 29** For the receivables covered by the netting agreement the exposure amount may be replaced by  $E_{\text{unsec}}$  when calculating capital adequacy in accordance with Chapter 39.

$$E_{\text{unsec}} = \max\{0, (\sum \text{Exposure amount} - \sum C_{\text{VA}})\}$$

$$C_{\text{VA}} = C \times (1 - H_{\text{fx}})$$

The exposure amount is calculated in accordance with Chapter 40.

$C$  is the book value of the liabilities.

$C_{\text{VA}}$  is the volatility-adjusted amount of the liabilities.

$H_{\text{fx}}$  is the factor for volatility adjustment with regard to changes in exchange rates and is determined in accordance with Chapter 55.

## Chapter 57

**Section 1** A life insurance policy pledged or assigned to the institution may be considered to be recognisable collateral if the life insurance provider is subject to Directives 2002/83/EC and 2001/17/EC of the European Parliament and Council or is subject to supervision by a competent authority of a third country, the supervision and regulations of which correspond to those applied within the EEA and the following conditions are met:

1. The insurance provider shall have been notified of the pledge or assignment.
2. The insurance provider may not make any payments under the terms of its contract without the permission of the institution.
3. The insurance must have a declared surrender value that cannot be reduced.
4. The institution must have the right to cancel the insurance and obtain the surrender value without undue delay if the counterparty defaults.
5. Payment of the surrender value may not occur without the permission of the institution.
6. The institution shall be given information concerning any premiums unpaid by the policyholder.
7. The agreement regarding the grant of collateral shall be legally binding in all jurisdictions relevant at the time the agreement is entered into.
8. The credit protection shall be provided throughout the entire term of the loan. If this is not possible due to the termination of the insurance before the termination of the credit, the institution shall ensure that an amount equal to the insurance amount functions as collateral for the institution until the term of the loan matures.

**Section 4** Recognisable life insurance policies shall be considered to be a guarantee issued by the insurance provider. The protected amount shall consist of the surrender value of the insurance policy adjusted in accordance with Chapter 53 where applicable. The protected amount shall be assigned an LGD of 40 percent provided that the exposure is not covered by the institution's own estimates of LGD.

## Chapter 60

**Section 18** The institution shall be able to attribute its internal loss data to the business lines defined in Chapter 30, section 8 and the event types defined in Table 1.

An institution may attribute loss events arising from special circumstances that affect the entire institution to a separate business line, Corporate items.

### *General guidelines*

Internally, the institution may classify losses by some other means, but losses shall also be able to be classified in accordance with the predefined business lines and event types.

Table 1

Event type	Definition
Internal Fraud	Losses due to acts of a type intended to defraud, misappropriate property or circumvent regulations, the law or company policy, excluding losses due to diversity/discrimination events, which involve 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, including losses due to diversity/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
Transaction Processing & Process Management	Losses from failed transaction processing or process management, from relations with trade counterparties and vendors.

**Section 38** The capital alleviation arising from the institution's recognition of insurances and other forms of risk transfer, or both, may not exceed 20 percent of the capital requirement for operational risk before the recognition of risk mitigation techniques.

**Section 39** The institution may use other forms of risk transfer to third parties if it can demonstrate that a noticeable risk mitigating effect is achieved. Outsourcing of an activity may not be considered as another form of risk transfer.

## Chapter 61

**Section 6** For each netting amount the exposure amount shall be calculated in accordance with sections 7–14. All netting sets with a single counterparty may be treated as a single netting set if negative simulated market values of the individual netting sets are set at zero (0) in the calculation of the expected exposure (EE).

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## Entry into force and transition provisions

1. These regulations shall enter into force on 31 December 2010. However, the provisions in Chapter 39, section 13 and Chapter 42, section 3 shall enter into force on 1 January 2011.

2. If an issuer obtained permission before 31 December 2010 to include Tier 1 capital contributions in original own funds, until 31 December 2020 the Tier 1 capital contributions may be included to the extent stipulated in the wording on 30 December 2010 of Finansinspektionen's regulations and general guidelines (FFFS 2007:1) regarding capital adequacy and large exposures.

From 31 December 2020 until 31 December 2030 the Tier 1 capital contributions referred to in the first paragraph may be included at no more than 20 percent of the original own funds. The Tier 1 capital contributions with incentives to redeem may be included during this period at no more than 15 percent.

From 31 December 2030 until 31 December 2040 the Tier 1 capital contributions referred to in the first paragraph may be included at no more than 10 percent of the original own funds.

These thresholds shall be calculated after the original own funds are reduced in accordance with the Capital Adequacy and Large Exposures Act (2006:1371) and Finansinspektionen's regulations and general guidelines regarding capital adequacy and large exposures.

Tier 1 capital contributions included in the original own funds pursuant to these transitional provisions together with the contributions referred to in Chapter 7, sections 16b and 16c may not exceed the thresholds stated there.

3. When applying Chapter 7, sections 3 and 5 of the Capital Adequacy Act for exposures to institutions arising before 31 December 2009, institutions may continue to apply until 31 December 2012 Chapter 35, section 7, first paragraph, points 1 and 3 and Chapter 35, sections 8–9 of Finansinspektionen's regulations and general guidelines regarding capital adequacy and large exposures with the wording as of 30 December 2010.

MARTIN ANDERSSON

Camilla Edvardsson

*Appendix 5*

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