

**RULES**  
**on the Capital Requirement and Risk Weighted Assets**  
**of Financial Undertakings**  
**No. 215 of 2 March 2007**

**CHAPTER I**  
**Scope and Definitions**

Article 1

These Rules shall apply to the following:

1. Financial Undertakings which have received an operating licence cf. Act 161/2002 on Financial Undertakings, Article 4, paragraph 1, points 1 to 3 and 5 to 7, i.e. commercial banks, savings banks, credit undertakings, securities companies, securities brokerages and management companies of UCITS.
2. Consolidated undertakings where the parent undertaking is one of the undertakings mentioned in item 1 above.

The entities mentioned in paragraph 1 of this Article are called financial undertakings in the following Articles.

Article 2

For the purposes of these Rules the following definitions shall apply:

*"Exposure"*: Applies to assets items and off-balance sheet items.

*"Hedged position"*: Any position in financial instruments taken by a financial undertaking in order to hedge against the market risk of asset and liability items or the market risk of positions in derivatives.

*"Maturity-based method"*: A method used to calculate the interest rate risk of a financial undertaking according to the maturity of the bonds included in the financial undertaking's trading book. Maturity, in this context, is the maturity of the interest rate which is the same as residual maturity in the case of fixed-rate instruments. Where a debt instrument contains a clause on the possibility of variable interest rate before final maturity, the period until the interest rate is next set shall be used. See also *"durationbased method"*.

*"Stock financing"*: Positions where physical stock has been sold forward and the cost of funding has been locked in until the date of the forward sale.

*"Convertible security"*: A security which, at the option of the holder, can be exchanged for another security, usually the equity of the issuer.

*"Delta of an option"*: The delta of an option shall mean the expected change in the option price as a proportion of a small change in the price of the instrument underlying the option. Delta indicates the probability of an option having a value on the expiration date.

*"Delta value of an option"*: The delta value of an option is equal to the amount of the underlying instrument to which the option refers, multiplied by the delta of the option.

*"Competent authorities:"* The national authorities in each state which are empowered by law or regulation to supervise financial undertakings.

*"Residual maturity:"* The remaining time until the due date of a debt instrument.

*"Exposure value:"* See *"exposure"*.

*"Financial instrument:"*

- a. A *security*, i.e. any transferable receivable for payment in cash or cash equivalents, and any transferable document conveying title to property other than real estate or specific assets, such as shares, bonds, subscription rights, exchangeable and convertible securities;
- b. A *derivative*, i.e. a contract where the settlement clause is based on the development of some underlying variable over a specific period, such as an interest rate, currency exchange rate, securities price, securities index or commodity price. Derivatives shall include:
  - i. *forward non-transferable financial instruments*, i.e. contracts providing for an to purchase or sell a certain asset for a specific price at a predetermined time;
  - ii. *forward contracts*, i.e. standardised and transferable contracts providing for an obligation of a contracting party to purchase or sell a certain asset for a specific price at a predetermined time;
  - iii. *swaps*, i.e. contracts providing for each of the contracting parties to pay the other an amount based on the development of two variables respectively during the period of the contract;
  - iv. *options*, i.e. contracts granting one contracting party, the purchaser, the right to purchase (call option) or sell (put option) a specific asset (the object of an agreement) at a pre-determined price (the option price) at a specific time (closing day) or within a specific length of time (validity period of an option). As compensation for this right the other contracting party, the issuer, receives a certain fee indicating the market price of the option at the beginning of the contract period;
- c. *unit share certificates*;
- d. *money market instruments*;
- e. *transferable mortgage rights* in real estate and moveable assets.

*"Funded credit protection:"* A technique of credit risk mitigation where, in the event of the default of the counterparty, a financial undertaking has taken as collateral certain assets or amounts.

*"Forward transaction:"* A transaction which is settled three working days or later from the trade day. See also *"spot transaction"*.

*"FRA - forward rate agreement:"* An agreement providing for a reference rate for a specific period where the interest is calculated on a predetermined underlying principal amount which does not come up for payment. At the end of the contract period the FRA is settled on the pre-agreed settlement date.

*"Undertaking connected with the financial sector (financial institution)":* An undertaking which is not a credit institution and operates, in particular, in acquiring holdings or pursues any of the activities referred to in Points 2 to 12 of the first paragraph of Article 20.

*"Currency swap":* A contract stipulating that the contracting parties shall at a specific time in the future swap the principal in two different currencies at the exchange rate at that time. At the end of the contract period, but often also at the beginning, the principal is swapped.

*"Long position":* A position in financial instruments which gives, or may at some time in the future give, the relevant undertaking the right, or obligation, to receive payment in cash, securities or other assets. Call options and put options are considered as a part of a long position. See also *"short position"*.

*"Underlying principal/notional amount/underlying principal instrument":* The amount, security or notional position underlying a derivative instrument.

*"Basis interest rate swap":* See *"interest rate swap"*.

*"Share":* An asset holding in a limited liability company. For the purposes of these Rules a share shall furthermore include the part of derivative instruments in the trading book of a financial undertaking which is related to shares, the share price or the development of a share price index.

*"A financial undertaking's overall net foreign-exchange position":* The higher of the following two totals: the total open foreign-exchange position in currencies in which there is a net long position or the total open foreign-exchange position in currencies in which there is a net short position.

*"Call option":* The right to buy a product, security or currency at a predetermined price, either on or before a specific date. Such a contract is binding for the seller of the contract while the buyer may choose whether to exercise this right or not. See also *"option"* and *"put option"*.

*"Tranche":* A contractually established segment of the credit risk associated with an exposure or number of exposures, where a position in the segment entails a risk of credit loss greater than or less than a position of the same amount in each other such segment.

*"Credit institution":* An undertaking which has received an operating licence according to points 1 to 4 in the 1st paragraph of Article 4 in Act No. 161/2002 on Financial Undertakings.

*"Credit derivatives":* Derivative contracts where the settlement is dependent on the creditworthiness of the counterparty, for example a CDS.

*"Non-trading book items (banking book items)":* All balance sheet items and offbalance sheet items of an undertaking excluded from the trading book.

*"Probability of default, PD":* The probability of default of a counterparty over a one year period.

*"Market risk"*: An undertaking's risk of financial loss on account of balance sheet items or off-balance sheet items caused by changes in the market value of these items, in particular changes in interest and foreign-exchange rates or share value.

*"Market securities"*: A transferable security (a debenture, a share or a unit share) which is offered for sale to natural and/or legal persons by a prospectus in which all securities in each series have all principal characteristics in common, including the identity of the issuer (the debtor), the first day of interest payment, and provisions concerning repayment, interest and redemption, as applicable.

*"Parent undertaking"*: An undertaking as defined in Article 97, paragraph 1, of Act No. 161/2002 on Financial Undertakings.

*"Counterparty risk"*: The risk of the counterparty of a financial contract defaulting on its provisions. One type of counterparty risk is delivery risk, which is the risk of the counterparty not delivering securities in accordance with the provisions of a financial contract. Another type of counterparty risk is settlement risk which arises from the possibility that the counterparty of, for example, a derivative contract does not meet the provisions of the contract on the settlement date. The third type of counterparty risk is credit risk. See also *"credit equivalent"*.

*"Credit risk mitigation"*: Techniques used by financial undertakings to reduce the credit risk associated with exposures which the undertaking holds.

*"Net position"*: Net position shall mean the difference between the long position and short position in identical securities.

*"Spot position"*: A position in financial instruments which will be settled no later than two working days after a specified date.

*"Spot transaction"*: A transaction which is settled no later than two working days after the trade date. See also *"forward transaction"*.

*"Public body"*: Central government or local authorities in Iceland or comparable authorities in other countries.

*"Public sector entities"*: For the purposes of these rules public sector entities shall mean non-commercial undertakings which are wholly owned or controlled by the state or local authorities or comparable authorities in other countries. Public sector entities, operated in competition with other commercial undertakings, are excluded. The Financial Supervisory Authority publishes a list of public sector entities to which this definition applies on its website.

*"Official exchange rate"*: The prevailing spot exchange rate of the Central Bank of Iceland on the accounting date.

*"Net open position in a currency"*: The difference between the long position and short position in the relevant currency. See also *"net foreign-exchange position"*.

*"Unfunded credit protection"*: A technique of credit risk mitigation which derives from the undertaking of a third party to pay an amount in the event of the default of the borrower, for example a guarantor of a loan or a CDS. See also *"funded credit protection"*.

*"Duration-based method"*: A method for calculating the interest rate risk of a financial undertaking. This method reflects the calculated duration of a debt instrument/financial contract instead of its amortisation time. The duration of a debt instrument is its weighted average amortisation time, taking account of all payments on the instrument, both interest and instalments, after computing their present value with the calculated yield of the instrument. When calculating the yield of the debt instrument, account shall be taken of the market value of the instrument on the settlement date. The modified duration of a debt instrument is its calculated duration divided by one plus the calculated yield requirement. See also *"maturity-based method"*.

*"Genuine sale and repurchase transactions"*: Sale and repurchase transactions where the transferee is obliged to return the assets. See also *"sale with an option to repurchase"*.

*"Operational risk"*: The risk of loss resulting from inadequate or failed internal processes, people and systems or from external events including legal risk.

*"Sale with an option to repurchase"*: Sale and repurchase transactions where the transferee is merely entitled, but not obliged, to return the assets. See also *"genuine sale and repurchase transactions"*.

*"Contractual netting"*: A contract between two or more entities under which mutual claims and obligations are automatically amalgamated in such a way that this netting fixes one single net amount each time the netting applies instead of settlement of each individual claim and obligation.

*"Consolidation, consolidated undertakings"*: A parent undertaking and its subsidiary undertakings.

*"Organised securities exchange"*: An organized securities exchange that satisfies the definition given in the Act on Activities of Stock Exchanges and Regulated OTC Markets.

*"Short position"*: A position in financial instruments which commits or may at a specific time in the future commit the undertaking or entitle it to deliver payment in cash, securities or other assets. The put and call option owned by the undertaking or the option contract which it has concluded is considered a part of the short position. See also *"long position"* and *"net position"*.

*"Short sale"*: The sale of securities or other assets which the seller does not possess at the time the deal is made.

*"Quoted security"*: A security which has been registered on an organised securities exchange. See also *"organised securities exchange"*.

*"Debt instrument"*: A financial contract which includes a promise to repay.

*"Venture capital and private equity instruments"*: Investments characterised by direct or indirect investments in unquoted, private companies with the objective of adding value to these companies, usually in 3 to 5 years, and reselling them at the end of that period. Private equity instruments are usually categorised as alternative investments and are divided into three main sub-categories; venture capital, buyouts and special situations. Private equity investors invest in companies in all stages, from the seed stage when financing initial concepts of entrepreneurs to large companies with a large market share.

*"Futures contract"*: A standardised derivative contract traded on an organised securities exchange, which is secured and gives the holder the right to buy or sell a designated financial instrument at a predetermined date at a predetermined price. Changes in the market value of a contract are settled each day and/or the contract is secured in another way by an organised securities exchange, market maker or clearing house.

*"Large exposure"*: An exposure subject to Rules on large exposures of financial undertakings, issued by the Financial Supervisory Authority.

*"Position risk"*: A risk related to an undertaking's position in a particular financial instrument arising from the possible changes in the price of the instrument. Specific position risk 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, the issuer of the underlying instrument. General position risk is the risk of a price change in the instrument due to circumstances unrelated to its issuer or, in the case of a derivative, the issuer of the underlying instrument.

*"Sale and repurchase transactions"*: Transactions which involve the transfer by an undertaking or customer (the transferor) to another undertaking or customer (the transferee) of assets, for example bills of exchange, debentures or other transferable securities, subject to an agreement that the same assets will be transferred back to the transferor at a specified price. See also *"genuine sale and repurchase transactions"*; *"sale with an option to repurchase"*.

*"Put option"*: The right to sell a product, security or currency at a predetermined price, either on or before a specific date. Such a contract is binding for the writer of the contract while the buyer may choose whether to exercise this right or not. See also *"option"* and *"call option"*.

*"Loss given default (LGD)"*: The ratio of the loss on an exposure due to the default of a counterparty to the amount outstanding at default.

*"Credit equivalent"*: Off-balance sheet items which have been calculated as credit equivalents. The counterparty risk of an undertaking arising from off-balance sheet items is computed from the credit equivalent of these items.

*"Option"*: Call option or put option.

*"Cross currency swap"*: A contract stipulating both interest and currency swap, i.e. that the contracting parties shall at some time in the future swap the principal in two different currencies with a fixed exchange rate, plus the payment of interest over a specified period. The principal is swapped at the end, but also often at the beginning of a contract period.

*"Interest rate swap/single currency swap"*: A contract stipulating that the contracting parties shall swap interest payments, taking account of the change in the level of interest rates in a specified currency. *The underlying principal amount* is not swapped, only the difference in interest which is calculated from the underlying principal amount. There are three main types of interest rate swaps:

- a contract based on the difference in the change of the level of floating-rate interest in single currency, for example the difference in the change of the level of treasury bill interest rates and interbank rates *a basis interest rate swap*;
- a contract based on the difference between fixed rates and the change in the level of floating-rate interest in single currency;
- *cross currency interest rate swap*.

*"Cross currency interest rate swap"*: An interest rate swap contract stipulating that the contracting parties shall swap interest payments, taking account of the change in the level of interest in at least two different currencies. *The underlying principal amount* is not swapped only the difference in interest calculated on the underlying principal amount.

*"Securities- or commodities-lending/securities- or borrowing-lending"*: Any transaction in which an undertaking or its counterparty transfers securities or commodities contracts against appropriate collateral subject to a commitment that the borrower will return equivalent securities or commodities contracts at a specified future date or when requested to do so by the transferor, being securities- or commodities-lending for the undertaking transferring the securities and securities- or commodities-borrowing for the undertaking to which they are transferred.

*"Securitisation"*: A transaction or scheme, whereby the credit risk associated with an exposure or pool of exposures is tranced, having the following characteristics:

1. Payments in the transaction or scheme are dependent upon the performance of the exposure or pool of exposures; and
2. the subordination of tranches determines the distribution of losses during the ongoing life of the transaction or scheme.

*"Commercial real estate"*: Commercial real estate means particularly various commercial and office buildings and other service buildings which may easily be converted for other use.

*"Expected loss (EL) when assessing credit risk"*: The ratio of the amount expected to be lost on an exposure from a potential default of a counterparty over a one year period to the amount outstanding at default.

*"Dilution risk"*: The risk that an amount receivable is reduced through cash or non-cash credits to the obligor. Dilution risk is a part of credit risk.

## **CHAPTER II** **Reporting Requirements**

### **Article 3**

Securities companies shall each month send a solvency ratio report to the Financial Supervisory Authority and other financial undertakings shall send such a report on a quarterly basis. Financial undertakings, other than securities companies, which do not calculate separately the risk weighted exposure amounts related to trading book items, cf. the provisions of Article 6, shall, however, send a report to the Financial Supervisory Authority

on a half-year basis. Provisions on the reporting of financial undertakings on less than a quarterly basis do not apply if the solvency ratio of the undertaking is less than 12% at the beginning of the year. The Financial Supervisory Authority can under certain circumstances allow a submission of reports on a yearly basis, i.e. end of year figures only.

The monthly reports from securities companies, cf. paragraph 1 of this Article, shall have reached the Financial Supervisory Authority not later than 15 days from the accounting date. The reports from financial undertakings, other than securities companies, shall have reached the Financial Supervisory Authority not later than 30 days from the accounting date.

### **CHAPTER III Capital Requirements**

#### **Article 4**

The own funds of financial undertakings shall at all times be more than or equal to the sum of the following capital requirements:

1. For credit risk and dilution risk in respect of all of their business activities, with the exception of their trading book business and illiquid assets if deducted from own funds, 8% of the total of their risk weighted exposure amounts calculated in accordance with Chapter V (standardised approach) and Chapter VI (internal ratings based approach).
2. In respect of their trading-book business, for position risk, settlement and counterparty risk the capital requirements determined in accordance with Chapter IV, and in accordance with Chapter X in relation to Excess Due to Large Exposures.
3. In respect of all of their business activities, for foreign exchange risk and for commodities risk, both on-balance sheet and off-balance sheet items, the capital requirements determined according to Annex III and Annex IV of Article 55 B.
4. In respect of all of their business activities, for operational risk, the capital requirements determined in accordance with Chapter IX.

Additional capital requirements as specifically determined by the Financial Supervisory Authority pursuant to Article 84, paragraph 1, of the Financial Undertakings Act shall be calculated separately.

Financial undertakings shall use the standardised approach or the internal ratings based approach, but special permission must be sought from the Financial Supervisory Authority to use the internal ratings based approach to calculate the capital requirements, cf. paragraph 1, point 1.

Having obtained special permission from the Financial Supervisory Authority, financial undertakings may base their calculations of foreign exchange positions on the net present value of asset and liability items and off-balance sheet items. Net present value in this respect means the total value of all future payments and receipts at their present value in terms of current market rates.

### **CHAPTER IV Trading Book**

#### **Article 5**

The trading book of an institution shall consist of all positions in financial instruments and commodities held, either with trading intent or in order to hedge other elements of the trading book, and which are either free of any restrictive covenants on their tradability or able to be hedged.

Positions held with trading intent are those held 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. The term 'positions' shall include proprietary positions and positions arising from client servicing and market making.

Trading intent shall be evidenced on the basis of the strategies, policies and procedures set up by the institution to manage the position or portfolio in accordance with Part A of Annex VII of Article 55 B.

Financial undertakings shall establish and maintain systems and controls to manage their trading book in accordance with Parts B and D of above-mentioned Annex VII. All trading book positions shall be subject to prudent valuation rules as specified in Annex VII, Part B, according to which financial undertakings must at all times ensure that valuations of trading book positions appropriately reflect their market value. The valuation shall contain an appropriate degree of certainty having regard to the dynamic nature of trading book positions, the demands of prudential soundness and the mode of operation and purpose of capital requirements in respect of trading book positions. Trading book positions shall be revalued on a daily basis. In the absence of readily available market prices, the Financial Supervisory Authority may permit financial undertakings to use other valuation methods provided that they are sufficiently prudent and have been approved by the Financial Supervisory Authority.

Internal hedges may be included in the trading book, in which case Part C of the above-mentioned Annex VII shall apply.

When assessing the risk weight of covered bonds Article 21, paragraph 4, shall apply.

#### Article 6

Capital requirements related to trading-book business shall be calculated in accordance with Annex I of Article 55 B in the case of a position risk, Annex II of same Article in the case of a settlement and counterparty risk and as appropriate in accordance with Annex V when using internal models provided that the Financial Supervisory Authority has given its permission.

Notwithstanding the provisions of paragraph 1, where the trading book of an undertaking does not exceed the criteria of paragraph 3 of this Article, that undertaking may calculate its risk weighted exposure amounts according to the provisions of Chapter III for asset items which otherwise would be included in the trading book. These undertakings shall continue, however, to calculate the capital requirement related to foreign exchange risk, cf. the provisions of Annex III of Article 55 B.

The criteria for exemptions from the provisions of Annexes I-II and IV-VI of Article 55 B regarding assessment of the risk weighted exposure amounts for trading book items are as follows:

1. An undertaking's trading book positions do not normally exceed 5% of its total positions and do not normally exceed Euro 15 million calculated on the base of the official exchange rate of ISK/Euro (approximately ISK 1,350 million).
2. An undertaking's trading book positions never exceed 6% of its total positions and never exceed Euro 20 million calculated on the base of the official exchange rate of ISK/Euro (approximately ISK 1,800 million).

The term "total positions" means the total amount of trading book items and non-trading book items. In calculating the total positions, debts instruments and equities shall be valued at market price or the original purchase price, equities shall be valued at market price and derivative contracts shall be valued at the market value of the underlying instruments or the market price of the contract. In calculating trading book positions the long positions and the short positions shall be summed regardless of their signs.

If a financial undertaking should happen for more than a short period to exceed either or both of the limits imposed in paragraph 3, points 1 and 2, of this Article it shall be required to

meet the requirements imposed in paragraph 1 of this Article in respect of its trading-book business and to notify the Financial Supervisory Authority thereof.

## **CHAPTER V** **Standardised Approach**

### Article 7

#### *Valuation and External Credit Assessment Institutions*

The exposure value of an asset shall be its balance sheet value unless otherwise specified in this Chapter. To calculate risk weighted exposure amounts, risk weights shall be applied to all exposures which are determined in accordance with the provisions of this Chapter and with reference to the relevant exposure classes, cf. Article 10.

An external credit assessment may be used to determine the risk weight of an exposure on the condition that the ECAI which provides it has been recognised as eligible by the Financial Supervisory Authority and that its assessment methodology complies with the requirements of objectivity, independence, ongoing review and transparency. Recognition of ECAIs shall be based on the technical criteria set out in Annex VI Part 2 pursuant to Article 55 A. If an ECAI has been recognised as eligible by the competent authorities of an EEA Member State, the Financial Supervisory Authority may recognise that ECAI as eligible without carrying out its own assessment process. ECAIs must receive recognition by the Financial Supervisory Authority concerning their eligibility to conduct unsolicited ratings. The Financial Supervisory Authority publishes a list of recognised ECAIs on its official website. This list shall also indicate whether the Financial Supervisory Authority recognises both solicited and unsolicited ratings by the ECAIs concerned.

Each rating corresponds to a specific credit quality step published by the Financial Supervisory Authority. The credit quality steps correspond, in turn, to risk weights as further stipulated in provisions on specific exposure classes pursuant to Articles 11-25. When the competent authorities of an EEA Member State have made a determination as to which credit quality step shall be used, the Financial Supervisory Authority may recognise that determination without carrying out its own determination process.

A financial undertaking which decides to use a credit assessment provided by an eligible ECAI for determining the risk weight of a given exposure class must use that assessment for all exposures of that class in a consistent way. A financial undertaking opting to use the ratings of two ECAIs, the rating which results in the higher risk weight to each exposure shall be assigned. If ratings from more than two ECAIs are used, the rating generating the second lowest risk weight shall be applied. For further reference, see Annex VI, Part 3, pursuant to Article 55 A.

The exposure value of off-balance sheet items shall be calculated as stated in Article 8 for the items listed there.

Derivatives as specified in Article 9 shall be valued as described in that Article.

Risk weighted exposure amounts subject to credit protection may be revalued in accordance with Chapter VII.

Securitised exposures shall be calculated as stated in Chapter VIII.

### Article 8

#### *Off-balance sheet items, conversion factors*

The exposure value of off-balance sheet items listed in this Article shall be multiplied by the following conversion factors. These exposures are assigned to different exposure classes to which the appropriate risk weight is attributed.

*1. Full risk, conversion factor 1.0:*

- a. guarantees 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 where the credit risk remains with the undertaking, and
- k. other items carrying full risk.

2. *Medium risk, conversion factor 0.5:*

- 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 (agreement 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), and
- f. other items carrying medium risk.

3. *Medium/low risk, conversion factor 0.2:*

- a. documentary credits in which underlying shipment acts as collateral and other similar transactions,
- b. undrawn credit facilities (agreements to lend, purchase securities, provide guarantees or acceptance facilities) with an original maturity of up to and including one year or which may 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, and
- c. other items carrying medium/low risk.

4. *Low risk, conversion factor 0.0:*

- 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, and
- b. other items carrying low risk.

## Article 9

### *Classification of off-balance sheet items*

Off-balance sheet items shall be classified as follows. They shall be calculated according to the methods described in Annex III pursuant to article 55 A. Financial undertakings shall notify the Financial Supervisory Authority of the methods they intend to use and justify all subsequent changes to such decisions. Financial undertakings may, however, apply to the Financial Supervisory Authority for permission to use evaluation methods based on their own models (IMM) to which specific rules apply.

The impact of novation and other contractual netting shall be calculated as described in Annex III. The exposure value of derivatives listed under point 3 may not be determined using the original exposure method.

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 contracts of a similar nature.
2. *Foreign-exchange contracts and contracts concerning gold:*
- a. cross-currency interest-rate swaps;
  - b. forward foreign-exchange contracts;
  - c. currency futures;
  - d. currency options purchased;
  - e. other contracts of a similar nature; and
  - f. contracts concerning gold of a nature similar to a. to e.
3. *Contracts of a nature similar to those in points 1.a. to 1.e. and 2.a to 2.d. concerning other reference items or indices concerning:*
- a. equities;
  - b. precious metals except gold;
  - c. commodities other than precious metals; and
  - d. other contracts of a similar nature.

Derivative contracts which are both interest-rate and foreign exchange related shall be classified as foreign-exchange contracts when calculating the risk weighted exposure amounts.

#### Article 10

##### *Exposure classes*

Each exposure shall be assigned to one of the following exposure classes:

- a. claims or contingent claims on central governments or central banks;
- b. claims or contingent claims on regional governments or local authorities;
- c. claims or contingent claims on administrative bodies and non-commercial undertakings;
- d. claims or contingent claims on multilateral development banks;
- e. claims or contingent claims on international organisations;
- f. claims or contingent claims on financial undertakings;
- g. claims or contingent claims on corporates;
- h. retail claims or contingent retail claims;
- i. claims or contingent claims secured on real estate property;
- j. past due items;
- k. items belonging to regulatory high-risk categories;
- l. claims in the form of covered bonds;
- m. securitisation positions;
- n. short-term claims on financial undertakings and corporates;
- o. claims in the form of collective investment undertakings ('CIU'); or
- p. other items.

The risk weight shall be 100% unless the provisions of this Chapter state differently. The risk weight of exposures subject to credit risk mitigation may be lower, cf. Chapter VII.

#### Article 11

##### *Central governments and central banks*

Exposures to central governments and central banks (exposure class a.) shall be assigned a 100% risk weight unless otherwise provided for in this Article.

Central governments and central banks for which a credit assessment by a recognised ECAI is available may be assigned a risk weight according to the following table:

**Central governments and central banks**

Credit quality step	1	2	3	4	5	6
Risk weight	0%	20%	50%	100%	100%	150%

Exposures to EEA Member States' central governments and central banks denominated and funded in the domestic currency of that central government and central bank shall be assigned a risk weight of 0%. The same applies to the European Central Bank. When the competent authorities of a third country assign a risk weight which is lower than indicated in paragraphs 1 and 2 to exposures to their central government, the Financial Supervisory Authority may permit the use of such a risk weight on the condition that supervisory and regulatory arrangements in the country concerned are at least equivalent to those applied within the EEA.

## Article 12

*Regional governments and local authorities*

Exposures to local authorities in Iceland (exposure class b.) shall be assigned a 20% risk weight.

Exposures to regional and local authorities in other EEA Member States shall be assigned the same risk weight as exposures to financial undertakings unless the Member State concerned has notified the Financial Supervisory Authority that they may be treated as exposures to the central government of that Member State.

The Financial Supervisory Authority can decide that exposures to third country regional governments and local authorities be risk weighted as exposures to the central government of the state in question.

## Article 13

*Administrative bodies and non-commercial undertakings*

Administrative bodies and non-commercial undertakings in Iceland (exposure class c.) shall be assigned a 100% risk weight unless the Financial Supervisory Authority notifies on its website that they may be assigned a risk weight comparable to that of financial undertakings.

When competent authorities in another EEA Member State have decided to implement the provisions stated in paragraph 1 above, Icelandic financial undertakings may risk weight exposures in the same manner.

When competent authorities of a third country permit the treatment of exposures to public sector entities and non-commercial undertakings as exposures to financial undertakings, the Financial Supervisory Authority may allow the exposures of such entities and undertakings to be risk weighted in the same manner.

## Article 14

*Multilateral development banks and international organisations*

Exposure 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.

Other multilateral development banks, such as the Inter-American Investment Corporation, the Black Sea Trade and Development Bank and the Central American Bank for Economic Integration, shall be assigned the same risk weight as credit institutions.

Exposures to the European Community, the International Monetary Fund and the Bank for International Settlements shall be assigned a 0% risk weight.

#### Article 15

##### *Financial undertakings*

Exposures to financial undertakings (exposure class f.) shall be assigned a risk weight according to the credit quality step to which exposures to their own central government are assigned in accordance with the following table:

##### **Financial undertakings**

Credit quality step to which central government is assigned	1	2	3	4	5	6
Risk weight	20%	50%	100%	100%	100%	150%

For exposures to financial undertakings incorporated in countries where the central government is unrated, the risk weight shall not be more than 100%.

For short-term exposures to financial undertakings with an original effective maturity of three months or less shall be risk weighted 20%.

Notwithstanding the provisions of this Article, investments in equity issued by financial undertakings shall be risk weighted at 100%, unless deducted from the own funds.

#### Article 16

##### *Corporates*

Exposures to corporates (exposure class g.) which are not covered by Article 15 (on financial undertakings) and for which a credit assessment by a recognised ECAI is not available, shall be risk weighted at 100%. If the central government of the home state of the corporate has been assigned a higher risk weight (cf. exposure class a.) this shall also apply to the corporate.

Exposures for which a credit assessment by a recognised ECAI is available shall be assigned a risk weight in accordance with the following table:

##### **Corporates**

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

#### Article 17

##### *Retail exposures*

Exposures to individuals, small and medium sized enterprises (exposure class h.) that comply with the following criteria shall be assigned a risk weight of 75%:

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; and
3. the total amount owed to the credit institution and parent undertakings and its subsidiaries, including any past due exposure, by the obligor client or group of connected clients, but excluding claims or contingent claims secured on residential real estate collateral, shall not, to the knowledge of the credit institution, exceed EUR 1 million (approximately ISK 90 million). The credit institution shall take reasonable steps to acquire this knowledge.

Securities shall not be eligible for the retail exposure class.

#### Article 18

##### *Exposures secured by real estate property*

Exposures fully secured by real estate property shall be assigned a risk weight of 100% unless otherwise provided for in this Article.

A risk weight of 35% may be assigned to exposures fully and completely secured by mortgages on residential property which is or will be occupied or let by the obligor. This applies to exposures, or any parts of exposures, amounting to 80% or less of the property evaluation of the Land Registry of Iceland or the market price, whichever is lower. Other forms of systematic evaluation than those of the Land Registry of Iceland may be used, subject to approval by the Financial Supervisory Authority, provided they meet with the requirements set out in Annex VIII pursuant to Article 55 A. This risk weight may also be applied to exposures secured by mortgages on residential property in other EEA Member States if permitted by competent authorities in the state concerned.

Conditions for applying a 35% risk weight are as follows:

1. The value of the property does not materially depend upon the credit quality of the obligor. This requirement does not preclude situations where purely macroeconomic factors affect both the value of the property and the performance of the borrower;
2. the risk of the borrower does not materially depend upon the performance of the underlying property;
3. the minimum requirements set out in Annex VIII pursuant to Article 55 are met concerning the format and valuation of the collateral.

A risk weight of 50% may be assigned to exposures fully and completely secured by mortgages on commercial real estate in Iceland, provided such property is used or let by the obligor and yields acceptable rental income. This applies to exposures or parts of exposures amounting to 50% or less of the property valuation of the Land Registry of Iceland or market price, whichever is lower. Other forms of systematic evaluation than those of the Land Registry of Iceland may be used, subject to approval by the Financial Supervisory Authority, provided they meet with the requirements set out in Annex VIII pursuant to Article 55 A. Any exceeding amounts shall be assigned a 100% risk weight. This risk weight may also be assigned to exposures fully and completely secured by mortgages on commercial real estate in other EEA Member States if permitted by competent authorities in the state concerned.

Conditions for applying a 50% risk weight are as follows:

1. The value of the property does not materially depend upon the credit quality of the obligor. This requirement does not preclude situations where purely macroeconomic factors affect both the value of the property and the performance of the borrower;

2. the risk of the borrower does not materially depend upon the performance of the underlying property;
3. the minimum requirements set out in Annex VIII pursuant to Article 55 are met concerning the format and evaluation of the collateral.

#### Article 19

##### *Past due items*

For any item that is past due for more than 90 days and where value adjustments of the exposure are less than 20%, the unsecured part of the exposure net of value adjustments shall be assigned a risk weight of 150%. If value adjustments of the exposure are no less than 20%, the unsecured part of the exposure net of value adjustments shall be assigned a 100% risk weight. The secured part of a past due item is the part covered by eligible collateral and guarantees as defined in Chapter VII on credit risk mitigation.

Exposures secured by mortgages on residential property meeting the conditions set out in Article 18, paragraphs 2 and 3, and which are past due for more than 90 days shall be assigned a risk weight of 100%. If value adjustments are no less than 20% of the exposure gross of value adjustments, the risk weight to be assigned to the remainder of the exposure may be reduced to 50%.

Exposures secured by mortgages on commercial real estate meeting the conditions set out in Article 18, paragraphs 4 and 5, and which are past due for more than 90 days shall be assigned a 100% risk weight.

Higher risk weights in accordance with paragraphs 1-3 apply to the principal of settled exposures plus past due items.

#### Article 20

##### *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%.

#### Article 21

##### *Covered bonds*

Covered bonds issued by financial undertakings in Iceland or other EEA Member States are by law subject to special public supervision designed to protect the rights of the bondholders. Funds deriving from the issue of these bonds must be invested in assets which are guaranteed to cover the exposure for the lifetime of the bond, both outstanding balances and accrued interest, in the event the issuer fails to meet payment obligations.

Covered bonds shall be collateralised by any of the following eligible assets:

1. Exposures to or guaranteed by central governments, central banks, public sector entities, regional governments and local authorities in the EEA;
2. exposures to or guaranteed by non-EEA central governments, non-EEA central banks, non-EEA public sector entities, non-EEA regional governments/local authorities and multilateral development banks that qualify for credit quality step 1. The exposure amount of covered bonds guaranteed by these parties may not exceed 20% of the nominal amount of outstanding covered bonds of the issuing institution;
3. exposures to financial undertakings that qualify for the credit quality step 1. The total exposure of this kind shall not exceed 15% of the nominal amount of outstanding covered bonds of the issuing institution;
4. loans secured by residential real estate up to 80% of the value of the pledged properties;



5. loans secured by commercial real estate up to 60% of the value of the pledged properties The Loan to Value ratio can be up to 70% if the 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%;
6. loans secured by ships within 60% of the value of the pledged ship.

If residential real estate mortgages are used as collateral, the issuer shall comply with the provisions of Annex VIII, pursuant to Article 55 A, on the format and valuation of the collateral.

Covered bonds shall be assigned a risk weight on the basis of the risk weight assigned to senior unsecured exposures to the issuer in accordance with the following:

1. If the exposures to the issuer are assigned a risk weight of 20%, the covered bond shall be assigned a risk weight of 10%;
2. if the exposures to the issuer are assigned a risk weight of 50%, the covered bond shall be assigned a risk weight of 20%;
3. if the exposures to the issuer are assigned a risk weight of 100%, the covered bond shall be assigned a risk weight of 50%; and
4. if the exposures to the issuer are assigned a risk weight of 150%, the covered bond shall be assigned a risk weight of 100%.

#### Article 22

##### *Items representing securitisation positions*

Risk weight exposures amounts for securitisation positions shall be determined in accordance with the provisions of Chapter VIII.

#### Article 23

##### *Short-term exposures*

Short-term exposures to a financial undertaking or corporate for which a credit assessment by recognised ECAI is available shall be assigned a risk weight according to the following table:

##### **Short-term exposures of financial undertakings and other undertakings**

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

#### Article 24

##### *Exposures in the form of Collective Investment Undertakings (CIUs)*

Unit share certificates or shares in collective investment undertakings shall be assigned a risk weight of 100% unless otherwise provided for in this Article.

If the CIU has an external credit assessment from an eligible ECAI it shall be risk weighted according to the following table:

##### **Collective investment undertakings (CIUs)**

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

The Financial Supervisory Authority may decide that unit share certificates or shares in collective investment undertakings be assigned a risk weight of 150% if the exposure is believed to be associated with particularly high risks.

If a competent authority in an EEA Member State has approved a third country CIU as eligible, in accordance with paragraph 6, the Financial Supervisory Authority may make use of this recognition without conducting its own assessment.

Financial undertakings may determine the risk weight for CIUs as set out in paragraphs 6, 7 and 8 of this Article if the following eligibility criteria are met:

- a. The CIU is managed by an entity which is subject to supervision within EEA or subject to approval of the Financial Supervisory Authority;
- b. the CIU's prospectus or equivalent document includes the categories of assets in which the CIU is authorised to invest and, if investment limits apply, the relative limits and the methodologies to calculate them; and
- c. the balance sheet and profit and loss statement 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.

Where the financial undertaking 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 to the standardised approach.

Where the financial undertaking is not aware of the underlying exposures of a CIU, it may calculate an average risk weight for the CIU in accordance with the standardised approach subject to the following rules: It will be assumed that the CIU first invest, 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.

Financial undertakings may rely on a third party to calculate a risk weight related to paragraphs 6 and 7 of this Article, provided that the correctness of the calculation is adequately ensured.

## Article 25

### *Other items*

Tangible assets shall be assigned a risk weight of 100%.

Prepayments and accrued income for which a financial undertaking is unable to determine the counterparty shall be assigned a risk weight of 100%.

Cash items in the process of collection shall be assigned a 20% risk weight. Cash in hand and equivalent cash items shall be assigned a 0% risk weight.

The Financial Supervisory Authority may allow a risk weight of 10% for exposures to financial undertakings specialising in the inter-bank and public-debt markets and subject to close supervision where those asset items are fully secured by items assigned a 0% or a 20% risk weight and recognised by the Financial Supervisory Authority as constituting adequate collateral.

Holdings of equity and other participations, except where deducted from own funds, shall be assigned a risk weight of at least 100%.

Gold bullion held in own vaults or on an allocated basis to the extent backed by bullion liabilities shall be assigned a 0% risk weight.

In the case of asset sale and repurchase agreements and outright forward purchases, the risk weight shall be that assigned to the assets in question and not to the counterparties to the transactions.

Where a financial undertaking provides credit protection for a number of exposures under terms that the  $n^{\text{th}}$  default among the exposures shall trigger payment and that this credit event shall terminate the contract, and where the product has an external credit assessment from an eligible ECAI, the risk weights prescribed in Chapter VIII shall be assigned. 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.

## **CHAPTER VI**

### **Internal Ratings Based Approach**

#### Article 26

In accordance with this Chapter, the Financial Supervisory Authority may permit financial undertakings to calculate their risk weighted exposure amounts using the internal ratings based approach (IRB approach). Explicit permission shall be required in the case of each financial undertaking. Permission shall be given only if the Financial Supervisory Authority is satisfied that the financial undertaking's systems for the management and rating of credit risk exposures are sound and implemented with integrity and, in particular, that they meet the following standards in accordance with Annex VII, Part 4 of Article 55A:

- a. The financial undertaking's rating systems provide for a meaningful assessment of obligor and transaction characteristics, a meaningful differentiation of risk and accurate and consistent quantitative estimates of risk;
- b. 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 credit institution;
- c. the financial undertaking has a credit risk control unit responsible for its rating systems that is appropriately independent and free from undue influence;
- d. the financial undertaking collects and stores all relevant data to provide effective support to its credit risk measurement and management process; and
- e. the financial undertaking documents its rating systems and the rationale for their design and validates its rating systems.

A financial undertaking applying for the use of the IRB approach shall demonstrate that it has been using, for the IRB exposure classes in question, rating systems that were broadly in line with the minimum requirements set out in points a. to e. of paragraph 1 for internal risk measurement and management purposes for at least three years prior to its qualification to use the IRB approach. In the case of financial undertakings applying for the use of the IRB approach before 2010, this period may be reduced to two years until 31 December 2009.

A financial undertaking applying for permission to use own estimates of LGDs and conversion factors shall demonstrate that it has been using estimates that in all major respect meet the above-mentioned conditions for three years before the permission can be granted. This period may be reduced to two years until 31 December 2008.

If a financial undertaking ceases to comply with the requirements set out in this Chapter, it shall either present a plan for timely return to compliance or demonstrate that the effect of non-compliance is immaterial.

Financial undertakings shall implement the internal ratings based approach for all exposures, including equity exposures, unless otherwise stated in this Chapter.

The Financial Supervisory Authority may permit that the IRB approach be implemented sequentially across the different exposure classes.

A financial undertaking which has obtained permission to use own estimates of LGDs and conversion factors, cannot revert to the use of other methods when assessing its exposures' LGD values and conversion factors.

## Article 27

### *Exposure classification*

Each exposure shall be assigned to one of the following exposure classes and the methodology used shall be appropriate and consistent over time:

- a. claims or contingent claims on central governments and central banks;
- b. claims or contingent claims on financial undertakings;
- c. claims or contingent claims on corporates;
- d. retail claims or contingent retail claims;
- e. equity claims;
- f. securitisation positions; or
- g. other non credit-obligation assets.

Exposures to regional governments, local authorities or public sector entities, which are treated as exposures to central governments under the standardised approach, shall be treated as exposures to central governments and central banks. The same applies to exposures to Multilateral Development Banks and International Organisations which are assigned a risk weight of 0% under the standardised approach.

Exposures to regional governments and local authorities which are not treated as exposures to central governments under the standardised approach, exposures to Public Sector Entities which are treated as exposures to financial undertakings under the standardised approach, and exposures to Multilateral Development Banks which are not assigned a 0% risk weight under the standardised approach shall be treated as exposures to financial undertakings.

The retail exposure class shall meet the criteria of Article 17. They shall be treated by the financial undertaking in its risk management consistently over time and in a similar manner.

Non-debt exposures conveying a subordinated, residual claim on the assets or income of the issuer and debt exposures the economic substance of which is similar to the non-debt exposures shall be classed as equity exposures.

Within the corporate exposure class, financial undertakings shall separately identify as specialised lending exposures, exposures which possess the following characteristics:

- a. The exposure is to an entity which was created specifically to finance and/or operate physical assets;
- b. the contractual arrangements give the lender a substantial degree of control over the assets and the income that they generate; and
- c. the primary source of repayment of the obligation is the income generated by the assets being financed.

Any credit obligation not assigned to the exposure classes referred to in points a., b., and d. to f. of paragraph 1 shall be assigned to the exposure class referred to in point c. of that paragraph.

The exposure class referred to in point g. of paragraph 1 shall include the residual value of leased properties if not included in the lease exposure as defined in Annex VII, Part 3, paragraph 4, of Article 55A.

## Article 28

### *Valuation of risk weighted exposures*

The risk weighted exposure amounts for credit risk for exposures belonging to the exposure classes referred to in Article 27, except securitisation positions, shall, unless deducted from own funds, be calculated in accordance with Annex VII, Part 1, points 1 to 27 of Article 55A.

The risk weighted exposure amounts for dilution risk for purchased receivables shall be calculated according to Annex VII, Part 1, point 28 of Article 55A. Where a financial undertaking has full recourse in respect of purchased receivables for default risk and for dilution risk, to the seller of the purchased receivables the exposure may be treated as a collateralised exposure.

The calculation of risk weighted exposure amounts for credit risk and dilution risk shall be based on the relevant parameters associated with the exposure in question. These shall include probability of default (PD), loss given default (LGD), maturity (M) and exposure value of the exposure. PD and LGD shall be assessed in accordance with the above-mentioned Annex VII.

Notwithstanding paragraph 3, the calculation of risk weighted exposure amounts for credit risk for all exposures belonging to the exposure class referred to as equity claims shall be calculated in accordance with Annex VII, Part 1, points 17 to 26 of Article 55A subject to the approval of the Financial Supervisory Authority. The approval is restricted to the use of the approach set out in Annex VII, Part 1, points 25 and 26 if the financial undertaking meets the minimum requirements set out in Annex VII, Part 4, points 115 to 123 of Article 55A.

The calculation of risk weighted exposure amounts for credit risk for specialised lending exposures may be calculated in accordance with Annex VII, Part 1, point 6 of Article 55A. The Financial Supervisory Authority shall publish guidance on how financial undertakings should assign risk weights to specialised lending exposures and shall approve financial undertaking's assignment methodologies.

For exposures belonging to the exposure classes referred to in points a. to d. of Article 27, paragraph 1, financial undertakings shall provide their own estimates of PDs and for the exposure class referred to in point d. of the same Article, financial undertakings shall provide own estimates of LGDs and conversion factors in accordance with Article 26 and Annex VII, Part 4 of Article 55A. For exposures belonging to the exposure classes referred to in points a. to c. of Article 27, the Financial Supervisory Authority may permit financial undertakings to use own estimates of LGDs and conversion factors in accordance with Article 26 and Annex VII, Part 4 of Article 55A. Otherwise the financial undertakings shall apply the LGD values set out in Part 2, point 8 of the same Annex.

The risk weighted exposure amounts for securitised exposures shall be calculated in accordance with Chapter VIII.

Where exposures in the form of a collective investment undertaking (CIU) meet the criteria set out in Article 24, paragraphs 5 and 6, the financial undertaking shall look through to those underlying exposures in order to calculate risk weighted exposure amounts in accordance with the methods set out in this Chapter.

#### Article 29

##### *Expected loss*

The expected loss amounts for exposures belonging to one of the exposure classes referred to in points a. to e. of Article 27, paragraph 1 shall be calculated in accordance with the methods set out in Annex VII, Part 1, points 29 to 35 of Article 55A. The calculation 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 28. For defaulted exposures expected loss ('EL') shall be in accordance with the above-mentioned Annex VII, Part 4, point 80.

The expected loss amounts for securitised exposures shall be calculated in accordance with Chapter VIII.

The expected loss amount for exposures belonging to the exposure class referred to in point g. of Article 27, paragraph 1 shall be zero.

The expected loss amounts for dilution risk of purchased receivables shall be calculated in accordance with the methods set out in Annex VII, Part 1, point 35 of Article 55A.

The expected loss amounts for exposures in the form of collective investment undertaking (CIU) shall be calculated in accordance with the methods set out in the above-mentioned Annex VII, Part 1, points 29 to 35.

#### Article 30

##### *Exemptions from applying internal ratings based approach*

Subject to the approval of the Financial Supervisory Authority, financial undertakings permitted to use the IRB approach may apply the standardised approach for the following:

- a. The exposure class referred to in points a. and b. of Article 27, paragraph 1, where the number of material counterparties is limited and it would be unduly burdensome for the financial undertaking to implement a rating system for these counterparties;
- b. exposures in non-significant business units as well as exposure classes that are immaterial in terms of size and perceived risk profile;
- c. exposures to the Icelandic Government;
- d. exposures of a financial undertaking to a counterparty which is its parent undertaking or its subsidiary;
- e. equity exposures to entities whose credit obligations qualify for a 0% risk weight under the standardised approach. Equity exposures shall be considered significant when the total exposure value is on the average more than 10% of the own funds during the preceding year. The criteria shall be 5% of own funds in the case of equity exposures representing fewer than 10 companies;
- f. the exposures identified as reserve requirements of central banks; and
- g. State and State-reinsured guarantees pursuant to Annex VIII, Part 2, point 19 of Article 55A.

Without prejudice to paragraph 1, the Financial Supervisory Authority shall allow the application of the rules of the standardised approach for equity exposures which have been allowed for this treatment in other Member States.

## **CHAPTER VII**

### **Credit Risk Mitigation**

#### Article 31

For the purposes of this Chapter, 'lending credit institution' shall mean the financial undertaking which has the exposure in question, whether or not deriving from a loan.

#### Article 32

Financial undertakings using the standardised approach or the IRB approach, but not using their own estimates of LGD and conversion factors under Articles 28 and 28, may recognise credit risk mitigation in accordance with this Chapter in the calculation of risk weighted exposure amounts for the purposes of Article 4 or as relevant expected loss amounts in accordance with the IRB approach.

#### Article 33

The technique used to provide the credit protection shall be legally effective and enforceable in all relevant jurisdictions.

The lending credit institution shall take all appropriate steps to ensure the effectiveness of the credit protection arrangement and to address related risks.

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. Eligibility for credit risk mitigation (CRM) shall be limited to the assets set out in Annex VIII, Part 1 of Article 55A. In the case of funded credit protection, the lending credit institution shall have the right to liquidate or retain, in a timely manner, the assets from which the protection derives in the event of the default, insolvency or bankruptcy of the obligor or where applicable, of 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 undue.

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. Eligibility for credit risk mitigation (CRM) shall be limited to the protection providers and types of protection agreement set out in Annex VIII, Part 1 of Article 55A.

Furthermore the minimum requirements set out in the above-mentioned Annex, Part 2 shall be complied with.

#### Article 34

Where the requirements of Article 33 are met, the calculation of risk weighted exposure amounts, and, as relevant, expected loss amounts, may be modified in accordance with Annex VIII, Parts 3 to 6 of Article 55A.

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.

Where the risk weighted exposure amount already takes account of credit protection under the standardised approach or the internal ratings based approach, as relevant, the calculation of the credit protection shall not be further recognised under this Chapter.

### **CHAPTER VIII**

#### **Securitisation**

#### Article 35

The risk weighted exposure amount for a securitisation position shall be calculated in accordance with Annex IX, Part 4, points 1 to 5 and 37 to 76 of Article 55A. Where, however, a financial undertaking uses the standardised approach it shall classify the securitisation positions in relevant exposure classes cf. Article 10, and calculate the risk weighted exposure amount for a securitisation position in accordance with the above-mentioned Annex, Part 4, points 1 to 36.

Where significant credit risk associated with securitised exposures has been transferred from the originator financial undertaking in accordance with the terms of Annex IX, Part 2 of Article 55A, that financial undertaking may:

- a. 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.
- b. 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 above-mentioned Annex, Part 2.

Where paragraph 2 applies, the originator financial undertaking shall calculate the risk weighted exposure amounts prescribed in the above-mentioned Annex IX for the positions

that it may hold in the securitisation. Where the originator financial undertaking fails to transfer significant credit risk in accordance with paragraph 2, it need not calculate risk weighted exposure amounts for any positions it may have in the securitisation in question.

#### Article 36

##### *Risk weights of securitisation positions*

Securitisation positions, including exposures to a securitisation arising from interest rate or currency derivative contracts, shall be assigned risk weights in accordance with Annex IX of Article 55A, based on the credit quality of the position, which may be determined by reference to an ECAI credit assessment or otherwise, as set out in the above-mentioned Annex IX. Where there is an exposure to different tranches in a securitisation, the exposure to each tranche shall be considered a separate securitisation position. The providers of credit protection to securitisation positions shall be considered to hold positions in the securitisation.

Where a securitisation position is subject to funded or unfunded credit protection the risk weight to be applied to that position may be modified in accordance with Articles 33 to 36, read in conjunction with the above-mentioned Annex IX. The riskweighted exposure amounts related to securitisation positions shall be included in the financial undertaking's total of risk weighted exposure amounts for the purposes of Article 4, paragraph 1, point 1. Securitisation positions assigned a risk weight of 1,250% can be deducted from the own funds provided that they are not included in the above-mentioned calculation.

#### Article 37

##### *Credit assessment of External Credit Assessment Institutions (ECAI)*

An ECAI credit assessment may be used to determine the risk weight of a securitisation position if the ECAI has been recognised as eligible by the Financial Supervisory Authority for this purpose and that it has a demonstrated ability in the area of securitisation, which may be evidenced by a strong market acceptance. Each credit assessment shall be associated with credit quality steps disclosed by the Financial Supervisory Authority.

#### Article 38

##### *Securitisation of revolving exposures*

Where there is a securitisation of revolving exposures subject to an early amortisation provision, the originator financial undertaking shall calculate an additional risk weighted exposure amount in respect of the risk that the levels of credit risk to which it is exposed may increase following the operation of the early amortisation provision. For those purposes, 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. Furthermore, 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.

#### Article 39

##### *Support to securitisation*

An originator financial undertaking which has made use of Article 35 in the calculation of risk weighted exposure amounts shall not, with a view to reducing potential losses to investors, provide support to the securitisation beyond its contractual obligations.

If an originator financial undertaking fails to comply with paragraph 1 in respect of a securitisation, the financial undertaking shall, at a minimum, hold capital against all of the securitised exposures as if they had not been securitised. The financial undertaking shall



disclose publicly that it has provided non-contractual support and the regulatory capital impact of having done so.

**CHAPTER IX**  
**Operational Risk**

Article 40

Own funds requirements against operational risk shall be calculated in accordance with the approaches set out in Articles 41, 42 to 44 and 45.

Financial undertakings using the approach set out in Articles 42 to 44 (standardised approach) shall not revert to the use of the approach set out in Article 41 (basic indicator approach), except for demonstrated good cause and subject to approval by the Financial Supervisory Authority. Same applies to financial undertakings using the approach set out in Article 45, i.e. they cannot revert to the use of the approaches set out in Article 41 or Articles 42 – 44.

The Financial Supervisory Authority may allow financial undertakings to use a combination of approaches in accordance with Annex X, Part 4 of Article 55A.

Article 41

*Basic Indicator Approach*

The capital requirement for operational risk under the Basic Indicator Approach shall be a certain percentage of a relevant indicator.

The capital requirement for operational risk is equal to 15% of the relevant indicator defined in following paragraphs:

The relevant indicator is the average over three years of the sum of net interest income and net non-interest income calculated on the basis of the last three twelvemonthly observations at the end of the financial year. When audited figures are not available, business estimates may be used.

If for any given observation, 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 three-year average. The relevant indicator shall be calculated as the sum of positive figures divided by the number of positive figures.

The relevant indicator shall be comprised of the following elements, cf. furthermore Article 27 of Directive 86/635/EEC:

1. Interest receivable and similar income
2. Interest payable and similar charges
3. Income from shares and other variable/fixed-yield securities
4. Commissions/fees receivable
5. Commissions/fees payable
6. Net profit or net loss on financial operations
7. Other operating income

The indicator shall be calculated before the deduction of any provisions and operating expenses.

Following elements shall not be used in the calculation of the relevant indicator:

- a. realised profits/losses from the sale of non-trading book items,
- b. income from extraordinary or irregular items,
- c. income derived from insurance.

When revaluation of trading book items is part of the profit and loss statement, revaluation could be included.

## Article 42

### *Standardised approach*

Under the standardised approach a financial undertaking shall divide its operations into business lines in accordance with the following table:

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 research and financial analysis and other forms of general recommendation relating to transactions in financial instruments	18%
Trading and sales	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 Facilities	18%
Retail brokerage  (Activities with individual physical persons or with small and medium sized entities meeting the criteria set out in Article 79 for the retail exposure class)	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	Acceptance of deposits and other repayable funds Lending Financial leasing Guarantees and commitments	15%
Retail banking  (Activities with individual physical persons or with small and medium sized entities meeting the criteria set out in Article 79 for the retail exposure class)	Acceptance of deposits and other repayable funds  Lending  Financial leasing Guarantees and commitments	12%
Payment and settlement	Money transmission services, Issuing and administering means of payment	18%
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 forms of asset management	12%

The capital requirement for operational risk for each business line shall be the percentage of the relevant indicator as specified in the above-mentioned table. The relevant indicator is the average of the total of net interest income and other income calculated on the basis of the last three fiscal years (three twelve-monthly periods) for each business line. When audited figures are not available, business estimates may be used.

The capital requirement for operational risk shall be the total of the capital requirement for each business line. A negative capital requirement in one business line shall be imputed to the whole. However, where the aggregate capital charge across all business lines is negative, the input to the average shall be zero.

#### Article 43

##### *Principles for business line mapping*

A financial undertaking using the standardised approach when calculating capital requirement for operational risk must follow the principles for business line mapping.

Financial undertakings must develop and document specific policies and criteria for mapping the relevant indicator for current business lines and activities into the standardised framework. The criteria must be reviewed and adjusted as appropriate for new or changing business activities and risks. The principles for business line mapping are:

- a. all activities must be mapped into the business lines in a mutually exclusive and jointly exhaustive manner;
- b. 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;
- c. 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;
- d. 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;
- e. the mapping of activities into business lines for operational risk capital purposes must be consistent with the categories used for credit and market risks;
- f. senior management is responsible for the mapping policy; and
- g. the mapping process to business lines must be subject to independent review.

#### Article 44

##### *Alternative indicators for certain business lines*

The Financial Supervisory Authority may authorise the financial undertaking to use an alternative relevant indicator for the business lines: retail banking and commercial banking.

For these business lines, the relevant indicator shall be a normalised income indicator equal to the three-year average of the total nominal amount of loans and advances multiplied by 0.035.

For the retail and/or commercial banking business lines, the loans and advances shall consist of the total drawn amounts in the corresponding credit portfolios. For the commercial banking business line, securities held in the non trading book shall also be included.

Conditions to use alternative relevant indicators shall be subject to the following:

1. The financial undertaking is overwhelmingly active in retail and/or commercial banking activities, which shall account for at least 90% of its income.
2. The financial undertaking is able to demonstrate to the Financial Supervisory Authority that a significant proportion of its retail and/or commercial banking

activities comprise loans associated with a high PD, and that the alternative standardised approach provides an improved basis for assessing the operational risk.

3. The financial undertaking must meet the qualifying criteria of Article 45.

#### Article 45

##### *Qualifying criteria for using the standardised approach for operational risk*

Financial undertakings must follow general risk management standards having regard to the size and scale of activities and to the principle of proportionality. Furthermore, the qualifying criteria listed below must be met:

- a. financial undertakings shall have a well-documented assessment and management system for operational risk with clear responsibilities assigned for this system. They shall identify their exposures to operational risk and track relevant operational risk data, including material loss data. This system shall be subject to regular independent review.
- b. the operational risk assessment system must be closely integrated into the risk management processes of the financial undertaking. Its output must be an integral part of the process of monitoring and controlling the credit institution's operational risk profile.
- c. financial undertakings shall implement a system of management reporting that provides operational risk reports to relevant functions within the credit institution. Furthermore, financial undertakings shall have procedures for taking appropriate action according to the information within the management reports.

#### Article 46

##### *Advanced Measurement Approach*

The Financial Supervisory Authority may grant permission for financial undertakings to use an Advanced Measurement Approach based on their own operational risk measurement system. The permission is exclusively granted for the use of own models for calculating own funds requirements due to operational risk. Financial undertakings must meet the qualifying criteria set out in Annex X, Part 3, pursuant to Article 55 A. When an Advanced Measurement Approach is used for consolidated groups operating in more than one EEA Member State, the competent authorities of the different legal entities shall cooperate closely on licensing and supervision.

When an Advanced Measurement Approach is used on a consolidated basis, the Financial Supervisory Authority may conduct its own assessment as to whether the financial undertakings meet the qualifying criteria set out in Annex X, Part 3, pursuant to Article 55.

## **CHAPTER X**

### **Capital Requirements Related to Excess Due to Large Exposures**

#### Article 47

Undertakings may exceed the limits specified in the Rules on large exposures incurred by financial undertakings, provided that the Financial Supervisory Authority has given its permission in writing and the excess is in accordance with the provisions of this Chapter.

The exposures to individual clients and connected clients exceeding 25% of the financial undertaking's total own funds, based on the provision for authorisation laid down in these Rules, shall be called excess in the following Articles.

The conditions for the excesses of an undertaking are as follows:

1. The part of an exposure to an individual client in excess of the limits must be a trading book exposure.

2. The undertaking must meet an additional capital requirement on the excess due to large exposures.

#### Article 48

The capital requirement on the excess due to individual clients or connected clients shall be determined by adding to the risk weighted exposure amounts an amount computed in accordance with the provisions of Articles 49 and 50.

The capital requirement on the excess shall be in addition to the capital requirement calculated for the same items in accordance with the provisions of other chapters of these Rules.

When calculating exposures to individual clients or connected clients, account shall be taken of the total exposure as a proportion of own funds parts A and B. When calculating the capital requirement of an undertaking arising from the part of an exposure which is considered an excess, it is permitted to take account of the part of the undertaking's capital coming under own funds part C.

#### Article 49

The risk weighted exposure amounts related to an excess which has persisted for 10 days or less shall be calculated by multiplying by the factor 2.00 the risk weighted exposure amounts related to the specific position risk on the relevant trading book item, cf. the provisions of Chapter V and/or the risk weighted exposure amounts related to settlement risk and counterparty risk, cf. the provisions of Chapter VI.

The general position risk on trading book items shall not be taken into account when calculating the risk weighted exposure amounts related to the excess due to large exposures.

#### Article 50

Where the excess has persisted for more than 10 days the components of the excess shall, when calculating the undertaking's risk weighted exposure amounts, be grouped with regard to their weightings before further calculation takes place. The weighting of items in this context shall mean the weighting of individual items, included in the risk weighted exposure amounts, for the risk components as referred to in Article 40. The excess component with the highest weighting shall be used last in the further calculation.

The risk weighted exposure amounts related to an excess which has persisted for more than 10 days shall then be calculated by multiplying the risk weighted exposure amounts related to the specific position risk on a trading book item, cf. the provisions of Chapter V, and/or the risk weighted exposure amounts related to settlement and counterparty risk, cf. the provision of Chapter VI, by the relevant factor according to the table below.

<i>Exposures in excess of 25% of own funds (A + B + C)</i>	<i>Factor</i>
Excess of up to 40%, i.e. 25%-40%	2.00
Excess of 40% to 60%	3.00
Excess of 60% to 80%	4.00
Excess of 80% to 100%	5.00
Excess of 100% to 250%	6.00
Over 250%	9.00

Where a period of 10 days or less has elapsed since the excess due to individual clients or connected clients occurred, the undertaking's excess due to that client or connected clients

must not exceed 500% of the part of the undertaking's own funds coming under own funds parts A, B and C altogether.

Where the excess has persisted for more than 10 days the excess due to individual clients or connected clients must not exceed 600% of the undertaking's own funds parts A, B and C altogether.

Undertakings shall report to the Financial Supervisory Authority every three months all cases where an excess has occurred during the preceding three months. The name of the client concerned and the amount of the excess must be reported.

## **CHAPTER XI** **Supervision and Disclosure**

### Article 51

#### *Internal control*

Financial undertakings shall at all times have in place a sound and comprehensive risk management system covering every aspect of their activities. Financial undertakings shall have adequate and documented internal processes to assess the amounts, types and distribution of internal capital to cover the risks to which their operations are exposed to at any given time. The processes shall be subject to internal review to ensure they remain comprehensive and proportionate to the nature, scale and complexity of each undertaking's activities.

### Article 52

#### *Supervision of the Financial Supervisory Authority*

The Financial Supervisory Authority reviews the arrangements, strategies, processes and mechanisms implemented by financial undertakings to comply with these Rules by reference to the qualifying criteria set out in Annex XI pursuant to Article 55 A. The Financial Supervisory Authority also assesses the risks to which financial undertakings are or might be exposed.

The Financial Supervisory Authority shall determine whether the arrangements implemented by financial undertakings are adequate, their management is sound and the own funds held by them ensure a sound coverage of their risks.

The Financial Supervisory Authority establishes the frequency and intensity of reviews and evaluations having regard to the size, systemic importance, nature, scale and complexity of activities of the financial undertakings. The review and evaluation shall be updated at least on an annual basis.

The Financial Supervisory Authority examines the impact of interest rate risk from non-trading activities. Financial undertakings shall be required to take corrective action if a sudden and unexpected change in interest rates of 200 basis points causes their own funds to decline by more than 20%.

### Article 53

#### *Disclosure by Financial Undertakings*

Financial undertakings shall publicly disclose the information laid down in Annex XII, Parts 2 and 3, pursuant to Article 55 A. Information which is regarded as immaterial in the understanding of Part 1, paragraph 1, of the same Annex may be omitted. Confidential information in the understanding of Part 1, paragraphs 2 and 3, of the same Annex may also be omitted. Financial undertakings shall, however, state whether the information in question has been disclosed and give justifiable reasons for non-disclosure.

Financial undertakings shall adopt a formal policy concerning the disclosure of information and for assessment of the appropriateness and frequency of their disclosures.

**CHAPTER XII**  
**Consolidated Accounts**  
Article 54

The provisions of these Rules shall also apply to the consolidation of the undertakings listed in Article 1 of these Rules.

When calculating the risk weighted exposure amounts of a consolidation it is permitted to offset position in debt instruments, equities and commodities when assessing position risk in the trading book, cf. the provisions of Chapter IV, between the undertakings belonging to the consolidation. The same applies to positions in currencies and gold, cf. the provisions of Chapter IV.

When calculating the risk weighted exposure amounts of the part of a consolidation outside of Iceland but within the EEA, the rules of the host country shall apply, a bottom up approach.

**CHAPTER XIII**  
**References to Annexes of EC Directives**  
Article 55

Pursuant to Temporary Provisions III of Act no. 170/2006 amending the Financial Undertakings Act no. 161/2002, the Financial Supervisory Authority refers to the English version of the following Annexes to Directive 2006/48/EC relating to the taking up and pursuit of the business of credit institutions which is published in the Official Journal of the European Union and Directive 2006/49/EC on the capital adequacy of investment firms and credit institutions.

A.

[Directive 2006/48/EC](#) of the European Parliament and of the Council of 14 June 2006 relating to the taking up and pursuit of the business of credit institutions (recast), OJ L 177, 30.6.2006, p.1:

ANNEX III - The treatment of counterparty credit risk of derivative instruments, repurchase transactions, securities or commodities lending or borrowing transactions, long settlement transactions and margin lending transactions

ANNEX V - Technical criteria concerning the organisation and treatment of risks

ANNEX VII - Internal ratings based approach

ANNEX VIII - Credit risk mitigation

ANNEX IX –Securitisation

ANNEX X –Operational risk

ANNEX XI –Technical criteria on review and evaluation by the competent authorities

ANNEX XII - Technical criteria on disclosure.

B.

[Directive 2006/49/EC](#) of the European Parliament and of the Council of 14 June 2006 on the capital adequacy of investment firms and credit institutions (recast), OJ L 177, 30.6.2006, p. 201:

ANNEX I - Calculating capital requirements for position risk

ANNEX II - Calculating capital requirements for settlement and counterparty credit risk

ANNEX III - Calculating capital requirements for foreign-exchange risk

ANNEX IV - Calculating capital requirements for commodities risk

ANNEX V - Use of internal models to calculate capital requirements

ANNEX VI, Part 2 –Recognition of ECAIs and mapping of their credit assessments

ANNEX VII –Trading.

**CHAPTER XIV**

**Entry into force**

Article 56

These Rules are laid down with reference to Article 84, paragraph 3, of Act No. 161/2002 on Financial Undertakings, with later amendments, and enter into force immediately. At the same time Rules No. 530/2003, on the Solvency Ratio of Financial Undertakings, will cease to apply. Rules No. 530/2003, however, continue to remain valid for financial undertakings covered by interim provisions I and II of Act no. 170/2006 for the period specified therein.

Reykjavík, 2 March 2007

**FJÁRMÁLAEFTIRLITIÐ**

(The Financial Supervisory Authority, Iceland)

Jónas Friðrik Jónsson

Ragnar Haflíðason



**Annex 1**

**Standardised Approach: Mapping of ECAI's credit assessments to credit quality steps**

Long term mapping

Credit Quality Step	Fitch's Assessments	Moody's assessments	S&P's assessments	Corporate	Institutions (includes banks)			Sovereign
					Sovereign method	Credit Assessment method		
						Maturity > 3 months	Maturity 3 months or less	
1	AAA to AA-	Aaa to Aa3	AAA to AA-	20%	20%	20%	20%	0%
2	A+ to A-	A1 to A3	A+ to A-	50%	50%	50%	20%	20%
3	BBB+ to BBB-	Baa1 to Baa3	BBB+ to BBB-	100%	100%	50%	20%	50%
4	BB+ to BB-	Ba1 to Ba3	BB+ to BB-	100%	100%	100%	50%	100%
5	B+ to B-	B1 to B3	B+ to B-	150%	100%	100%	50%	100%
6	CCC+ and below	Caa1 and below	CCC+ and below	150%	150%	150%	150%	150%

Short term mapping

Credit Quality Step	Fitch	Moody's	S&P	Risk weight
	F1+, F1	P-1	A-1+, A-1	20%
	F2	P-2	A-2	50%
3	F3	P-3	A-3	100%
4	Below F3	NP	B-1, B-2, B-3, C	150%
5				150%
6				150%

**Securitisation:**

Long term mapping: Standardised approach

Credit Quality Step	Fitch	Moody's	S&P	Risk weight
1	AAA to AA-	Aaa to Aa3	AAA to AA-	20%
2	A+ to A-	A1 to A3	A+ to A-	50%
3	BBB+ to BBB-	Baa1 to Baa3	BBB+ to BBB-	100%
4	BB+ to BB-	Ba1 to Ba3	BB+ to BB-	350%
5	B+ and below	B1 and below	B+ and below	1250%

## Long term mapping: IRB approach

Credit Quality Step	Credit Assessments			Risk Weights		
	Fitch	Moody's	S&P	Most senior tranche	Base	Non-granular pool
1	AAA	Aaa	AAA	7%	12%	20%
2	AAA	Aaa	AA	8%	15%	25%
3	A+	A1	A+	10%	18%	35%
4	A	A2	A	12%	20%	35%
5	A-	A3	A-	20%	35%	35%
6	BBB+	Baa1	BBB+	35%	50%	50%
7	BBB	Baa2	BBB	60%	75%	75%
8	BBB-	Baa3	BBB-	100%	100%	100%
9	BB+	Ba1	BB+	250%	250%	250%
10	BB	Ba2	BB	425%	425%	425%
11	BB-	Ba3	BB-	650%	650%	650%
Below 11	Below BB-	Below Ba3	Below BB-	1250%	1250%	1250%

## Short term mapping: Standardised Approach

Credit Quality Step	Fitch	Moody's	S&P	Risk weight
1	F1+, F1	P-1	A-1+, A-1	20%
2	F2	P-2	A-2	50%
3	F3	P-3	A-3	100%
All other Credit assessments	Below F3	NP	All short term ratings below A-3	1250%

## Short term mapping: IRB Approach

Credit Quality Step	Credit Assessments			Risk Weights		
	Fitch	Moody's	S&P	Most senior tranche	Base	Non-granular pool
1	F1+, F1	P-1	A-1+, A-1	7%	12%	20%
2	F2	P-2	A-2	12%	20%	35%
3	F3	P-3	A-3	60%	75%	75%
All other Credit assessments	Below F3	All short-term ratings below A3, P3 og F3	All short-term ratings below A3	1250%	1250%	1250%

**Collective investment undertakings (CIUs)**

The mapping for CIUs is the same as the mapping for long-term fundamental credit ratings. Fitch and Moody's use the same rating scale for their Managed Funds Credit Quality Ratings as for their fundamental credit ratings, while S&P's uses a slightly different rating scales for Principal Stability Fund Ratings (subscript "m") and for Fund Credit Quality Ratings (subscript "f"), the rating scales are identical in terms of number of rating categories.

<b>Credit Quality Step</b>	<b>Fitch</b>	<b>Moody's</b>	<b>S&amp;P Principal stability fund ratings</b>	<b>S&amp;P Fund credit quality ratings</b>	<b>Risk Weights</b>
1	AAA to AA-	Aaa to Aa3	AAA (m) to AA- (m)	AAA (f) to AA- (f)	20%
2	A+ to A-	A1 to A3	A+(m) to A-(m)	A+(f) to A-(f)	50%
3	BBB+ to BBB-	Baa1 to Baa3	BBB+(m) to BBB-(m)	BBB+(f) to BBB-(f)	100%
4	BB+ to BB-	Ba1 to Ba3	BB+(m) to BB-(m)	BB+(f) to BB-(f)	100%
5	B+ to B-	B1 to B3	B+(m) to B-	B+(f) to B-	150%
6	CCC+ and below	Caa1 and below	CCC+ and below	CCC+ and below	150%