FJÁRMÁLAEFTIRLITIÐ
THE FINANCIAL SUPERVISORY AUTHORITY, ICELAND

Unofficial translation
January 2014

No. 625/2013 4. July 2013

RULES
on Large Exposures of Financial Undertakings

Art. 1

Definitions

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

Subsidiary: A subsidiary according to the Act on Financial Undertakings, No. 161/2002, and any company which, in the estimation of the Financial Supervisory Authority, is under the dominant influence of a parent company.

Multilateral development banks and international institutions: Banks and institutions which have a risk weighting as referred to in Art. 14 of the Rules on the Capital Requirements and Risk-weighted Assets of Financial Undertakings, No. 215/2007.

Group of connected clients: A group of clients is considered connected if one or both of the following conditions is satisfied:

a. two or more natural or legal persons who, unless it is shown otherwise, constitute a single risk because one of them, directly or indirectly, has control over the other(s), or
b. two or more natural or legal persons between whom there is no relationship of control as set out in subparagraph a, but who are to be regarded as constituting a single risk because they are so financially interconnected that, if one of them were to experience financial difficulties, in particular in connection with funding or repayment of debt, the other or all of the others would be liable to encounter difficulties with funding or repayment of debt.

Parent company: A parent company according to the Act on Financial Undertakings, No. 161/2002, and any company which, in the estimation of the Financial Supervisory Authority, exerts a dominant influence on the activities of a subsidiary.

Large exposure: Exposure of a financial undertaking to a single client or group of connected clients is considered a large exposure if it amounts to 10% or more of its equity base.

Commercial real estate: Commercial and office premises and other real estate for services, the use of which can be easily altered, cf. Art. 2 of the Rules on the Capital Requirements and Risk-weighted Assets of Financial Undertakings, No. 215/2007.

Unless otherwise indicated, in these Rules these concepts have the same meaning as in the Act on Financial Undertakings, No. 161/2002.

Art. 2

Scope

These Rules shall apply to financial undertakings which have been licensed to operate as provided for in Points 1-3 of the first paragraph of Art. 4 of the Act on Financial Undertakings, No. 161/2002, i.e. commercial banks, savings banks and credit undertakings. The Rules shall also apply to investment firms, with the exception of investment firms which are not authorised to operate as referred to in subparagraphs c and f of Point 1 of the first paragraph of Art. 25 of the Act on Financial Undertakings, No. 161/2002.

The Rules shall apply to a financial undertaking's group and to parent companies and subsidiaries, including branches, in assessing their exposures.

In calculating the exposures of a financial undertaking, which is established and licensed to operate in Iceland, the exposures of subsidiaries and branches with the required licenses to operate outside the European Economic Area shall be included.

Art. 3

Calculation of exposures

The exposure of a financial undertaking towards individual clients or a group of connected clients is considered to be the total of loans granted, securities held, direct holdings and guarantees provided, together with other commitments by the financial undertaking towards the same parties.

The exposure of a financial undertaking towards individual clients or a group of connected clients includes asset items and off-balance-sheet items listed in Chapter V of the Rules on the Capital Requirements and Risk-weighted Assets of Financial Undertakings, No. 215/2007, without those risk weightings which it provides for.

Exposures in connection with derivative contracts, which are listed in Art. 9 of the Rules on the Capital Requirements and Risk-weighted Assets of Financial Undertakings, No. 215/2007, shall be calculated in accordance with the methods in Annex III, cf. Art. 55 A of the same Rules.

The asset items which are to be deducted in calculating own funds as referred to in Articles 84 and 85 of the Act on Financial Undertakings, No. 161/2002, are excluded in calculations as provided for in the first to third paragraphs of this Article.

The following items are not included in determining total exposures, as referred to in the first paragraph of this Article:

a. exposures due to foreign currency transactions which arise in connection with ordinary settlement two working days after payment;
b. exposures due to the purchase and sale of securities which arise in connection with ordinary settlement five working days after payment of the securities, or their delivery, whichever is the earlier;
c. delayed receipt of funds due to money transmission and other obligations in connection with clients' activities which do not extend beyond the next working day,

including execution of payment services, clearing and settlement in any currency, interbank transactions or settlement of financial instruments and settlement and custody services towards clients;

d. exposures due to intra-day money transmission towards institutions or undertakings providing these services, including the execution of payment services, clearing and settlement in any currency and interbank transactions.

Art. 4

Defining a group of connected clients

In defining a group of connected clients, a financial undertaking shall assess risks in connection with underlying assets in a collective investment undertaking, cf. subparagraph o of Art. 10 of the Rules on the Capital Requirements and Risk-weighted Assets of Financial Undertakings, No. 215/2007, by examining

i. the funds' schemes,
ii. their underlying risks or
iii. both their schemes and underlying risks.

In defining a group of connected clients, a financial undertaking must assess securitisation risk, cf. subparagraph m of Art. 10 of Rules No. 215/2007, or other exposures, cf. subparagraph p of Art. 10 of Rules No. 215/2007, in the same manner.

To analyse underlying risks as referred to in the first paragraph, a financial undertaking must assess the economic substance and risks involved in the structure of financial instruments.

If there is doubt as to who should be included in a group of connected clients, a financial undertaking is obliged to connect parties unless the financial undertaking concerned can provide evidence to the contrary.

Art. 5

Internal checks and controls

A financial undertaking must apply sound administrative and accounting procedures and have at its disposal internal control mechanisms through which all large exposures and changes to them are traceable.

A financial undertaking must have satisfactory and documented internal processes to identify and assess large exposures in order to monitor them. Internal processes shall be reassessed regularly to insure that they are always satisfactory.

Art. 6

Reporting

A financial undertaking must submit reports to the Financial Supervisory Authority on large exposures towards individual clients or a group of connected clients in such form as the Authority prescribes. Reports must be submitted no less frequently than quarterly, i.e. as of the end of March, June, September and December.

The reports must specify the following information on all the financial undertaking's large exposures:

a. the identification number of the financial undertaking's client or the Reg. Nos. and names of all parties in a group of connected clients of the financial undertaking;
b. the exposure value, before consideration is given to the effect of credit risk mitigation, as appropriate;
c. the exposure value after consideration has been given to the effect of credit risk mitigation, as referred to in Articles 8-12 of these Rules;
d. the type of funded or unfunded credit protection, if such protection is used.

A financial undertaking must analyse substantial concentration risk in proportion to its own funds in connection with an issuer of collateral or guarantees, a granter of unfunded credit protection or underlying assets as referred to in the first and second paragraphs of Art. 4 of these Rules, and take suitable measures to reduce such risk. The Financial Supervisory Authority must be notified regularly of the outcome of such analyses.

Art. 7

Limits on large exposures

Having regard to Articles 8-12 of these Rules, exposures to a client or a group of connected clients may not exceed 25% of the own funds of a financial undertaking.

An exposure to a client which is a financial undertaking, or to a group of connected clients which includes one or more financial undertakings, may not exceed 25% of a financial undertaking's own funds or ISK 500 million, whichever is higher. This is, however, subject to the total exposures to those parties in the group of connected clients concerned which are not financial undertakings not exceeding 25% of the financial undertaking's own funds, after taking into consideration risk mitigation as referred to in Articles 8-12.

When 25% of the own funds of a financial undertaking amounts to a lower figure than ISK 500 million, the exposure, taking into consideration risk mitigation as referred to in Articles 8-12, may not exceed a reasonable limit having regard to the financial undertaking's own funds. The financial undertaking must determine what is considered a reasonable limit in accordance with the policy and procedures on concentration risk provided for in Point 7 of Annex V, cf. Art. 55 A of the Rules on the Capital Requirements and Risk-weighted Assets of Financial Undertakings, No. 215/2007; the said limits, however, many not exceed 100% of the financial undertaking's own funds. The Financial Supervisory Authority may authorise a financial undertaking to set limits in excess of 100% of own funds on a case-by-case basis.

Financial undertakings must always respect the limits provided for in the first paragraph. If a financial undertaking's exposures exceed these limits, the Financial Supervisory Authority must be notified without delay of the amount of the exposures. FME may grant the undertaking a time limit for reducing its exposures to within the lawful limits.

Art. 8

Authorised methods for credit risk mitigation

The concept of “guarantee”, as referred to in Articles 9-12 of these Rules shall also apply to credit derivatives, as referred to in Part 2 of Annex VIII, cf. Art. 55 A of the Rules on the

Capital Requirements and Risk-weighted Assets of Financial Undertakings, No. 215/2007, with the exception of credit linked notes.

The methods which a financial undertaking is authorised to use in credit risk mitigation in connection with Articles 9-12 of these Rules must satisfy the requirements of Articles 31-34 of the Rules on the Capital Requirements and Risk-weighted Assets of Financial Undertakings, No. 215/2007.

A financial undertaking may not take into account collateral as referred to in Articles 20-22 of Part 1 of Annex VIII, cf. Art. 55 A of the Rules on the Capital Requirements and Risk-weighted Assets of Financial Undertakings, No. 215/2007, unless this is authorised under Section 11 of these Rules.

Art. 9

Deductions due to secure asset items

In calculating the amounts of exposures referred to in Art. 7 of these Rules a financial undertaking may exempt the following items:

1. Asset items which are claims on states, central banks, international institutions or multilateral development banks, which without collateral would be assigned a 0% risk weight in accordance with Chapter V of the Rules on the Capital Requirements and Risk-weighted Assets of Financial Undertakings, No. 215/2007.
2. Asset items which are claims or other exposures which can be attributed to or are guaranteed by states, central banks, international institutions, multilateral development banks or public enterprises and institutions, which without collateral would be assigned a 0% risk weight in accordance with Chapter V of the Rules on the Capital Requirements and Risk-weighted Assets of Financial Undertakings, No. 215/2007.
3. Asset items which comprise claims or other exposures to regional or local authorities of member states, where those claims would be assigned a 0% risk weight in accordance with Art. 12 of the Rules on the Capital Requirements and Risk-weighted Assets of Financial Undertakings, No. 215/2007.
4. Exposures to counterparties which are companies within the same group, if they would be assigned a 0% risk weight in accordance with Chapter V of the Rules on the Capital Requirements and Risk-weighted Assets of Financial Undertakings, No. 215/2007. Exposures to counterparties which are companies within the same group but are not assigned a 0% risk weight must be treated as exposures to a third party.
5. Asset items and other exposures which are secured by a pledge on cash deposits with the lending credit institution or with a financial undertaking which is its parent company or subsidiary. Cash paid to a financial undertaking for credit linked notes issued is covered by this item. Loans from counterparties to a financial undertaking and deposits of the same counterparties with the financial undertaking, which are covered by a netting agreement on the balance sheet which is recognised under Articles 33 and 34 of the Rules on the Capital Requirements and Risk-weighted Assets of Financial Undertakings, No. 215/2007, are also covered by this item.
6. Asset items and other exposures secured by a pledge on certificates of deposits issued by the lending credit institution or a financial undertaking which is its parent company or subsidiary.
7. Off-balance-sheet items which are low-risk, as referred to in Point 4 of Art. 8 of the Rules on the Capital Requirements and Risk-weighted Assets of Financial

Undertakings, No. 215/2007, provided the agreement authorising the loan or similar exposure to a client or group of connected clients does not result in exposure to the party concerned exceeding the limit referred to in Art. 7 of these Rules.

8. Covered bonds which fulfil the requirements of the Act on Covered Bonds, No. 11/2008.

Art. 10

Calculation and stress test for credit risk mitigation

In calculating the amounts of exposures referred to in Art. 7 of these Rules a financial undertaking may use the fully adjusted exposure value, cf. the first paragraph of Art. 34 of the Rules on the Capital Requirements and Risk-weighted Assets of Financial Undertakings, No. 215/2007, if the requirements for so doing are satisfied.

A financial undertaking which is authorised to use own estimates of loss given default (LGD) and conversion factors, as provided for in Chapter VI of the Rules on the Capital Requirements and Risk-weighted Assets of Financial Undertakings, No. 215/2007, may use the financial collateral comprehensive method, as provided for in Annex VIII, cf. Art. 55 A of the same Rules, in calculating the amount of exposures as referred to in Section 7 of these Rules. A financial undertaking which uses the financial collateral comprehensive method must conduct periodic stress tests for credit risk concentration. Such stress tests shall take into account risk arising from possible changes in market conditions and which could have a negative impact on the financial undertaking's own funds and risk in relation to the realisable value of collateral under stressed conditions. The financial undertaking must demonstrate to the Financial Supervisory Authority that the stress tests conducted give a satisfactory assessment of such risk.

When a stress test indicates a lower realisable value of collateral, its value shall be reduced accordingly.

A financial undertaking which avails itself of the above-mentioned authorisation must adopt policies and procedures with regard to concentration risk involving the following:

a. treatment of risk arising from a mismatch in the maturity of exposures and maturity of all credit protection of these exposures;
b. treatment of the outcome of a stress test indicating a lower realisable value of collateral than assumed when applying the financial collateral comprehensive method; and
c. treatment of concentration risk arising from mitigation of credit risk, and in particular of large indirect credit risk, e.g. towards one issuer of securities which are approved as collateral.

Art. 11

Exposures in connection with real estate mortgages

A financial undertaking may reduce the exposure value by up to 50% of the value of a residential property if either of the following conditions is met:

a. the exposure is secured by a mortgage on fully complete residential property which the owner occupies or leases out, or

b. the exposure relates to a leasing transaction under which the lessor retains full ownership of fully complete residential property, as long as the lessee does not exercise its option to purchase.

Claims advanced on the basis of Point 8 of Part 2 of Annex VIII, cf. Art. 55 A of the Rules on the Capital Requirements and Risk-weighted Assets of Financial Undertakings, No. 215/2007, shall be applied regarding the first paragraph.

A financial undertaking may reduce the exposure value by up to 50% of the value of commercial real estate provided the exposure is given a 50% risk weight as provided for in Chapter V of the Rules on the Capital Requirements and Risk-weighted Assets of Financial Undertakings, No. 215/2007, if either of the following conditions is met:

a. the exposure is secured by mortgages on fully complete commercial real estate, which is leased out and returns suitable rental income, or
b. the exposure relates to a leasing transaction for fully complete commercial real estate which returns a suitable rental income.

The value of residential or commercial real estate shall be calculated in accordance with the real estate assessment of the National Registry or other systematic assessment considered satisfactory by the Financial Supervisory Authority, on the basis of prudent valuation standards laid down by law, regulation or administrative provisions. Such assessment must be conducted at least once every three years.

Art. 12

Collateral from third parties

Where a financial undertaking's exposure to a client is guaranteed by a third party, the financial undertaking may treat the portion of the exposure which is guaranteed as an exposure to the guarantor rather than to the client. The requirement for so doing is that the unsecured exposure to the guarantor would be assigned an equal or lower risk weight than the risk weight of the unsecured portion of the exposure to the client.

If a guarantee as referred to in the first paragraph is in a currency other than that of the exposure, the amount of the exposure, which is considered to be guaranteed, shall be calculated in accordance with provisions on treatment of currency mismatch in connection with unfunded credit protection in Annex VII, cf. Art. 55 A, of the Rules on the Capital Requirements and Risk-weighted Assets of Financial Undertakings, No. 215/2007. Any mismatch between the maturity of the exposure and that of the protection shall be treated in accordance with the provisions on treatment of maturity mismatch in Annex VIII, cf. Art. 55 A, of the same Rules.

Partial recognition may be given to protection in accordance with the treatment set out in Annex VIII, cf. Art. 55 A, of the Rules on the Capital Requirements and Risk-weighted Assets of Financial Undertakings, No. 215/2007.

Where a financial undertaking's exposure to a client is secured by collateral provided by a third party, the financial undertaking may treat that portion of the exposure as an exposure to the pledgor rather than to the client. The requirement for so doing is that the collateralised portion of the exposure would be assigned an equal or lower risk weight than the risk weight of the unsecured portion of the exposure to the client.

A financial undertaking may not apply the method provided for in the fourth paragraph where there is a mismatch between the maturity of the exposure and the maturity of the risk protection.

A financial undertaking may not use both the financial collateral comprehensive method and the method provided for in the fourth paragraph.

Art. 13

Entry into force

These Rules transpose provisions of Directive 2006/48/EC of the European Parliament and of the Council relating to the taking up and pursuit of the business of credit institutions, as subsequently amended by Directive 2009/11/EC.

This Regulation, which is issued based on the authorisation in the fourth paragraph of Art. 30 of Act No. 161/2002, on Financial Undertakings, as subsequently amended, shall enter into force immediately. As of the same date Rules No. 216/2007, on large exposures incurred by financial undertakings, shall become invalid.

Financial Supervisory Authority, 10 June 2013

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Section B - Date of publication: 4 July 2013