Translation from the Icelandic

RULES
on the Solvency Ratio of Financial Undertakings
No. 530 of 30 June 2003

CHAPTER 1
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 1above.

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

Article 2

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

"Hedge position:" Any positions in financial instruments taken by an undertaking in order to hedge against the market risks of asset and liability items or the market risks of positions in derivatives.

"Maturity-based method": A procedure used to calculate the interest rate risk of an undertaking according to the maturity of the bonds included in the 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 *duration-based 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 an 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.

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

"Investment security": A market security and a share which an undertaking has formally decided to hold for the long-term, at least one year. Shares in associated undertakings or affiliated undertakings are excluded. See also *trading security.*

"Financial instrument":

a. a *security*, i.e. any transferable claim for payment in cash or cash equivalents, and any transferable document conveying title to property other than real estate or specific chattels, 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 instrument*, i.e. a contract providing for an obligation of a contracting party to purchase or sell a certain asset for a specific price at a predetermined time;

ii. *forward contract*, i.e. a standardised and transferable contract providing for an obligation of a contracting party to purchase or sell a certain asset for a specific price at a predetermined time;

iii. *swap,* i.e. a contract 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. *option,* i.e. a contract granting one contracting party, the purchaser, the right but not the obligation 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 certificate*;

d. .money market instrument;

e. *transferable mortgage rights* in real estate and moveable assets.

"Multi purpose commercial building": The term multi purpose commercial building shall in particular mean various commercial and office buildings and other service buildings which may easily be converted. It is essential that the building be completed. Not included in the definition of the term multi purpose commercial building are single purpose industrial buildings, fish processing plants, hotels and school buildings, etc.

"Multilateral development banks": For the purposes of these Rules "multilateral development banks" means the International Bank for Reconstruction and Development, the International Finance Corporation, the European Investment Fund, the Inter-American Investment Corporation, the European Bank for Reconstruction and Development, the Nordic Investment Bank, the African Development Bank, the Inter-American Development Bank, the Asian Development Bank, the Caribbean Development Bank and the Council of European Resettlement Fund.

"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 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.

"Qualifying item": Long position or short position in the items under Article 12, paragraph 2. Furthermore, the Financial Supervisory Authority may permit other debt instruments to be considered as qualifying items. For a debt instrument to be considered as a qualifying item it must be listed on a recognized securities exchange, be sufficiently liquid and its counterparty risk must be comparable to or lower than that of the assets under Article 12, paragraph 2, of these Rules.

“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 some time in the future swap the principal in two different currencies with a fixed exchange rate. 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 oblige it, to receive payment in cash, securities or other assets. Call option and put option are considered as a part of a long position. See also *short position*.

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

"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 an undertaking which is related to shares, share price or the development of share price index.

"An 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.*

"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 .

"Non-trading book items": All balance sheet items and off balance sheet items of an undertaking excluded from the trading book.

"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 values 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 acceleration, as applicable. See also investment security and trading security.

"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*.

"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 undertakings and institutions": For the purposes of these rules public undertakings and institutions shall mean non-profit undertakings and institutions which are wholly owned or controlled by the state or local authorities or comparable authorities in other countries. Public undertakings and institutions, operated in competition with other commercial undertakings, are excluded. Annex II lists the undertakings and institutions in Iceland coming under this definition.

"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*.

"Duration-based method": A system for calculating the interest rate risk of an undertaking. This method reflects the calculated duration of a debt instrument/financial contract instead of its amortization time. The duration of a debt instrument is its weighted average amortization time, taking account of all payments on the instrument, both interest and instalments, after their present value has been computed 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.*

"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 amalgated in such a way that this novation fixes one single net amount each time novation applies instead of settlement of each individual claim and obligation.

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

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

"Short position": A position in financial instruments which commits or may at some 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 organized securities exchange. See also *organized securities exchange.*

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

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

"Futures contract": A standardized derivative contract, traded on an organized 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 organized 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 seller of the contract while the buyer may choose whether to exercise this right or not. See also *option* and *call option*.

"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 the calculated 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": 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 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.

"Trading book": The trading book comprises of financial instruments and commodities which are acquired and held by a financial undertaking for resale and/or with the intention of benefitting in the short-term from variations in the market value of these instruments or from other price or interest-rate variations. The trading book also includes positions in financial instruments and commodities arising from matched principal broking, or positions taken in order to hedge other elements of the trading book. The trading book furthermore includes exposures due to unsettled transactions, free deliveries and over-the-counter (OTC) derivative instruments, as well as exposures related to the obligations of a financial undertaking due to transactions with financial instruments and commodities included in the trading book.

"Trading security": A market security which is not acquired with the intention of holding it for the long-term. See also *investment security.*

"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 some 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.

CHAPTER 2
Valuation Methods and Reporting Requirements

Article 3

The solvency ratio of an undertaking shall express its own funds as a proportion of a risk weighted base assessed in accordance with these Rules and their Annexes.

When calculating solvency ratio, own funds shall mean the total of own funds parts A, B and C, cf. the provisions of Article 84 in the Act No. 161/2002 on Financial Undertakings.

The risk-weighted base shall be assessed in the following manner:

1. The risk weighted base related to the credit risk on asset items and off-balance-sheet items excluded from the trading book shall be assessed in accordance with the provisions of Chapter 3.
2. The risk weighted base related to the foreign-exchange risk on foreign currency and gold items and items related to foreign-exchange rate and gold, irrespective of whether they are included in the trading book or not, shall be assessed in accordance with Chapter 4.
3. The risk weighted base related to the risk on asset items and off-balance sheet items included in the trading book shall be assessed in accordance with the provisions of Chapters 5 to 7, without prejudice to Article 6 on exemptions from the provisions of the trading book on further capital requirements.

Article 4

The following positions shall be included in the trading book of an undertaking without prejudice to the exemption provision of Article 6:

1. Positions in market securities, other financial instruments and commodities which are taken on or held by an undertaking for resale and/or with the intention of benefitting in the short-term from variations in their market value or from other price or interest-rate variations.
2. Calculated positions arising from settlement and counterparty risks due to free deliveries and unsettled transactions in securities and commodities, securities- or commodities-lending, short sale of securities, derivatives and other positions connected to asset items, arising from transactions in securities and commodities included in the trading book, cf. the provisions of Chapter 6 of these Rules.
3. Positions in financial instruments and commodities arising from matched principal swapping.
4. Positions in financial instruments and commodities taken in order to hedge other elements of the trading book.
5. Claims relating to fees, commission, interest, dividends and margin on futures contracts and call options included in the trading book and traded on a recognized securities exchange.

Securities assessed at current market values in the annual accounts of an undertaking shall normally be included in the trading book. When dividing the investment securities of an undertaking between the trading book and non-trading book, account shall be taken of the definition of a trading security in Article 2 of these Rules.

The following items shall not be included in the trading book:

1. Investment securities, as defined in Article 2 of these Rules.
2. Derivative contracts which the undertaking has truly acquired in order to hedge non-trading book positions.
3. The liabilities of an undertaking, other than calculated debts due to derivative contracts included in the trading book and debts due to repo transactions.

Article 5

The trading book of an undertaking shall be divided into debt instruments, equities and commodities.

Debt instruments in this respect shall include positions in bonds and convertibles and such derivative contracts as are included in the undertaking's trading book and not based on equities, equity indices or commodities.

Equities, in this context, shall include positions in equities, other holdings, units in collective-investment undertakings, as well as such derivative contracts as are included in the undertaking's trading book and are based on equities or equity indices.

Commodities, in this context, shall include positions in financial instruments and derivatives related to commodities.

Article 6

Notwithstanding the provisions of Article 4 an undertaking, the trading book of which does not exceed the criteria of paragraph 2 of this Article, may calculate its risk weighted base according to the provisions of Chapter 3 for asset items which otherwise would be included in the trading book. These undertakings shall continue, however, to calculate the risk weighted base related to foreign exchange risk, cf. the provisions of Chapter 4.

The criteria for exemptions from the provisions of Chapters 5 to 7 regarding assessment of the risk weighted base 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 ISK 1.240 million, and
2. An undertaking's trading book positions never exceed 6% of its total positions and never exceed ISK 1.650 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, according to generally accepted accounting principles, be valued at market price or the original purchase price and derivative contracts shall be valued at the market value of the underlying instruments or the market price of the contract. An undertaking may, however, value those derivative contracts which are not connected to securities at nominal price. In calculating trading book positions the long positions and the short positions shall be summed regardless of their signs. The Financial Supervisory Authority may permit an undertaking to exempt forward currency contracts from the trading book in this calculation.

The amounts mentioned in paragraph 2, points 1 and 2, of this Article shall be linked to the exchange rate of the Euro based on the buying rate of the Euro on the date of entry into force of these Rules.

Article 7

Undertakings shall daily assess its trading book at market value, provided the trading book positions are in excess of the criteria inArticle 6 and thus the risk weighted base related to these items iscalculated according to the provisions of Chapters 5 to 7.

Undertakings shall, in accordance with the provisions of these Rules, formulate their own rules of procedure as regards classification of asset items and off balance sheet items into trading book items and non-trading book items.

Article 8

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 base 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 institution 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 fiancial undertakings, other than securities companies,,shall have reached the Financial Supervisory Authority not later than 30 days from the accounting date.

Article 9

The Financial Supervisory Authority may permit an undertaking to use a more simplified variant of the calculation methods prescribed in these Rules, provided the result does not give a higher solvency ratio.

CHAPTER 3
The Risk-Weighted Base Related to Non-Trading Book Items

Article 10

The risk weighted base related to asset items and off balance sheet items not included in the undertaking's trading book, see however the provisions of Article 6, shall be the total amount of asset items and off balance sheet items calculated in accordance with the provisions of this Chapter.

In addition to the risk weighted base calculated in accordance with the provisions of this Chapter, the undertaking shall calculate the risk-weighted base related to foreign-exchange risk, cf. the provisions of Chapter 4, regardless of whether it is a question of trading book items or non-trading book items.

Article 11

The risk weighted base related to non-trading book items shall be calculated as follows:

1. Each asset item shall be weighted with the appropriate risk weightings specified in Article 12.

2. Off balance sheet items shall first be multiplied by appropriate conversion factors and percentages for the purpose of calculating the credit equivalent of these items, cf. Articles 13 and 14, and thereafter weighted with appropriate risk weightings, cf. Article 12. In the case of repurchase agreements, asset sales or outright forward purchases, the weightings shall be those attached to the assets in question and not to the counterparties to the transactions.
   Where off balance sheet items carry explicit guarantees, they shall be weighted as if they had been incurred on behalf of the guarantor rather than the counterparty. Where the potential exposure arising from off balance sheet transactions is fully secured by collateral in the form of securities recognized as collateral, cf. Article 12 points 1 and 2, weighting of 0% or 20% shall apply, depending on the collateral in question.
3. Where asset and off balance sheet items are given a lower weighting because of the existence of explicit guarantees or collateral, the lower weighting shall apply only to that part which is fully guaranteed or covered by the collateral.

Article 12

Risk weightings for individual items shall be as follows:

l. Risk weighting 0.0:

a. cash in hand and equivalent items,
b. asset items constituting claims on Zone A central governments and central banks, cf. Annex I to these Rules,
c. asset items constituting claims on the European Union,
d. asset items constituting claims carrying the guarantees of Zone A central governments and central banks or of the European Union,
e. asset items constituting claims on Zone B central governments and central banks, cf. Annex I to these Rules, denominated and funded in the national currency of the borrower,
f. asset items constituting claims carrying the guarantees of Zone B central governments and central banks, denominated and financed in the national currency common to the guarantor and borrower,
g. asset items secured by collateral in the form of Zone A central government or central bank securities, or securities issued by the European Union, provided these securities are valued at less than 90% of the quoted value on an organized securities exchange,
h. asset items secured by cash deposits placed with the undertaking or by certificates of deposit or similar instruments lodged with the latter, and
i. asset items which are deducted from own funds when calculating own funds in accordance wit the own funds' provisions of laws.

2. Risk weighting 0.2:

a. asset items constituting claims on or carrying the guarantee of the European Investment Bank (EIB) and multilateral development banks, cf. the definition of multilateral development banks in Article 2.
b. asset items constituting claims on or carrying the guarantee of Zone A regional governments or local authorities, cf. Annex I to these Rules.
c. asset items constituting claims on or carrying the guarantee of Zone A public undertakings and institutions, covered by the definition in Article 2, provided that risk weighting 0.0 does not apply to these claims. Annex II to these Rules specifies those public undertakings and institutions in Iceland to which this provision applies,

d. asset items constituting claims on or carrying the guarantee of Zone A credit institutions but not constituting such institutions' own funds; Icelandic savings banks' claims on Icebank Ltd, however, shall have the risk weighting 0.1,
e. asset items constituting claims on or carrying the guarantee of secrities companies and securities brokerages in the European Economic Area, recognized securities companies and securities brokerages outside the European Economic Area, organized securities exchanges or recognized clearing houses, but not considered as their own funds.
f. asset items, with a maturity of one year or less, constituting claims on or carrying the guarantee of Zone B credit institutions, cf. Annex I to these Rules, and undertakings engaged in securities services other than those listed in point e, but not securities issued by such institutions which are recognized as components of their own funds,
g. asset items secured by collateral in the form of securities issued by the European Investment Bank or by multilateral development banks, provided these securities are valued at less than 90% of the quoted value on an organized securities exchange,
h. asset items secured by collateral in the form of securities issued by Zone A regional governments or local authorities, provided these securities are valued less than 90% of the quoted value on an organized securities exchange,
i. asset items secured by cash deposits placed with Zone A credit institutions, other than the credit institution itself, or by certificates of deposits or similar instruments issued by those credit institutions, and
j. cash items in the process of collection.

3. *Risk weighting 0.5:*
a. loans secured by mortgages on completed residential property which is or will be occupied or let by the borrower to within 80% of the assessed real estate value of the Valuation Office of Iceland,
b. loans, granted before July 21st 2000, fully secured by mortgages in a multi-purpose commercial building to within 60% of its assessed real estate value of the Valuation Office of Iceland, provided that the building is occupied or let by the borrower and yields a reasonable rental income,
c. loans, granted July 21st 2000 and later, fully secured by mortgages in a multi-purpose commercial building to within 50% of its assessed real estate value of the Valuation Office of Iceland, provided that the building is occupied or let by the borrower and yields a reasonable rental income. If the value of the collaterals decreases more than 10% from the latest assessed value the Financial Supervisory Authority can issue another rules on risk weighting of loans according to this subitem,
d. securities, including securities which have participation in securities portfolio, secured by mortgeges as specified in subitems a. - c. above and within the same limits as mentioned there. Such securities must be fully and directly backed by a pool of mortgages which are fully performing when the mortgage-backed securities are created. A priority charge on the underlying mortgage asset items must be held either directly by the investors in mortgage-backed securities or on their behalf by a trustee or mandated representative in the same proportion to the securities which they hold.

4. *Risk weighting 1.0:*
All other asset items not included in the trading book.

Risk weighting 1.0 shall apply to that part of loans mentioned in paragraph 1, item 3, subitems a., b., c. and d., which are in excess of the limts named there.

The provisions of paragraph 1, item 3, subitems b. and c. are valid to the end of the year 2006. Loans granted before end of year 2006 and which fulfil the conditions of subitems b. and c. shall keep their riskweightings unchanged until their expire date.

Article 13

Conversion factors for individual off balance sheet items, cf. Article 11, other than mentioned in Article 16.

1. *High risk, conversion factor 1.0:*
   a. guarantees having the character of credit substitutes,
   b. acceptances,
   c. asset sale and repurchase guarantees where the credit risk remains with the undertaking, and
   d. other items carrying high 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. undrawn credit facilities (agreement to lend, purchase securities, provide guarantees or acceptance facilities) with an original maturity of more than one year,
   d. note issuance facilities (NIFs) and revolving underwriting facilities (RLTFs), and
   e. 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, and
   b. other items carrying medium/low risk.

4. *Low risk, conversion factor 0.0:*
   a. undrawn credit facilities (undrawn overdraft facilities, agreement to lend, purchase securities, provide guarantees or acceptance facilities) with an original maturity of up to and including one year or which may be cancelled unconditionally at any time without notice, and
   b. other items carrying low risk.

Article 14

To calculate the credit equivalent of off balance sheet items mentioned in Article 16, paragraph 1, items 1. and 2. as well as other OTC derivative contracts, the undertaking can choose to use method 1, the "marking to market" approach, or method 2, the "original exposure" approach. Undertakings not applying to the exemption provision of Article 6 shall use method 1. When assessing the credit equivalent of contracts mentioned in Article 16, paragraph 1, item 3 every financial undertaking shall use method 1.

Method 1: The "marking to market" approach.

According to this method the credit equivalent of derivative contracts is the sum of the current replacement cost of all derivative contracts with positive value on the one hand and potential future credit exposure on the other hand. In the case of

single-currency “floating/floating” interest rate swaps only the current replacement cost will be calculated, not the potential future credit exposure.

The current replacement cost of a derivative contract with positive value can be obtained by attaching current market value to the contract.

The potential future credit exposure of derivative contracts can be obtained by multiplying the notional principal amounts or values of the underlying contracts, disregarding whether these contracts are long or short, by the following percentages:

Residual maturity	*Interest-rate Contracts*	*Contracts concerning foreign-exchange rates and gold*	*Contracts concerning equities*	*Contracts concerning precious metals except gold*	*Contracts concerning commodities other than precious metals*
One year or less	0,0%	1,0%	6,0%	7,0%	10,0%
More than one year but less than five years	0,5%	5,0%	8,0%	7,0%	12,0%
More than five years	1,5%	7,5%	10,0%	8,0%	15,0%

- Contracts which do not fall within one of the five categories indicated in this table shall be treated as contracts concerning commodities other than precious metals.
- For contracts with multiple exchanges of principal, the percentages have to be multiplied by the number of remaining payments still to be made according to the contract.
- For contracts that are structured to settle outstanding exposure following specified payment dates and where the terms are reset such that the market value of the contract is zero on these specified dates, the residual maturity would be equal to the time until the next reset date. In the case of interest-rate contracts that meet these criteria and have a remaining maturity of over one year, the percentage shall be no lower than 0.5%.

Method 2: The "original exposure" approach.

According to this method the credit equivalent of a derivative contract is calculated by multiplying the underlying principal amount by the following percentages, taking into consideration the original maturity of the contract:

Original maturity	*Interest-rate contracts*	*Contracts concerning foreign-exchange rates and gold*
One year or less	0.5%	2.0%
More than one year but not exceeding two years	1.0%	5.0%
Additional allowance for each additional year	1.0%	3.0%

Regarding methods 1 and 2 it must be assured that the notional amount to be taken into account is an appropriate yardstick for the risk inherent in the contract. Where, for instance, the contract provides for a multiplication of cash flows, the notional amount must be adjusted in order to take into account the effects of the multiplication on the risk stucture of that contract. In the case of derivative contracts of which the underlying principal amount will decrease during the maturity of the contract, for example because of instalments of loans, the undertaking may take notice of this. This

shall be done by calculating the credit equivalent of each instalment. In the case of interest-rate contracts, the undertaking may furthermore apply to the Financial Supervisory Authority for authorisation to take into consideration the residual maturity instead of the original maturity.

When calculating the solvency ratio, apply contractual netting in the case of contracts listed in Article 16.

The use of paragraph 3 is dependent on following conditions:
1. The undertaking must have a contractual netting agreement with its counterparty creating a single legal obligation which covers all transactions included in the agreement, such that in the event of a counterparty's failure to perform owing to default, bankruptcy, liquidation or any other similar circumstance, the undertaking would have a claim to receive or an obligation to pay only the net sum of included individual transactions.
2. Contracts according to subparagraph 1 must always be legally valid under the law of each of the relevant jurisdictions under which the counterparties are incorporated. The same applies if a foreign branch of an undertaking is involved. The relevant undertakings shall submit to the Financial Supervisory Authority necessary information in this respect that shall be verified by the competent authorities of the jurisdictions under which the counterparties are incorporatied.

When calculating the credit equivalent of a contractual netting the "marking to market" method shall be used, cf. paragraph 1. In the case of forward foreign-exchange contracts and other similar contracts, where the notional principal amount is equivalent to the net cash flow, the calculation of the potential future credit exposure may only take into account the single net receipts if the cash flows fall due on the same value date and the same currency.

Article 15

In spite of the provisions of Article 14, foreign-exchange contracts, except those concerning gold, with an original maturity of 14 calendar days or less are excluded when calculating the undertaking's risk weighted base. It is also permitted to exclude off balance sheet items mentioned in Article 16 which are traded on an organized securities exchange or contracts which are secured by daily settlements approved by the Financial Supervisory Authority.

Article 16

Off balance sheet items shall be classified as follows:

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.-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 base.

CHAPTER 4
The Risk-Weighted Base Related to Foreign Exchange Items and Gold

Article 17

The provisions of this Chapter cover all asset and liability items and off-balance sheet items in foreign currency, gold and items in ISK, provided that these items are foreign exchange related but regardless of whether they are included in or excluded from the trading book.

The risk-weighted base related to the foreign-exchange risk of these items shall be an undertaking's overall net foreign exchange and gold position provided it is in excess of 2% of its total equity.

Until end of year 2004 the risk wighted base can, in spite of paragraph 2, be calculated as the part of an undertaking's overall net foreign exchange and gold position which is in excess of 2% of its total equity.

The calculation of an undertaking's foreign exchange and gold position involves a two-stage procedure. Firstly, the undertaking's open position in each currency and gold shall be calculated in accordance with the provisions of Articles 18 to 20. Secondly, the undertaking's overall net foreign exchange and gold position shall be calculated in accordance with the provisions of Article 21.

Article 18

Open position in a currency and in gold shall mean the difference between the long and short positions in the relevant currency and gold, as calculated in accordance with the provisions of Articles 19 and 20.

Composite currencies, such as SDR and ECU, may be broken down into the component currencies according to the quotas in force when calculating the net open position in a currency and in gold.

Article 19

When calculating an undertaking's open position in each currency and gold it is necessary, where the undertaking itself carries the foreign-exchange risk, to include all assets and liabilities and off balance sheet items in the relevant currency and gold.

The following positions shall be included in the calculation:

1. The net spot position, i.e. all asset items less all liability items, including accrued interest not due. The allowance account for credit losses shall be deducted from assets in this connection.
2. The net forward position, i.e. the undertaking's position in forward foreign exchange and gold contracts, futures contracts related to foreign exchange included, and gold and swap contracts related to foreign exchange and gold, in so far as these contracts are not included in the undertaking's net spot position. Currency swaps shall be treated as assets in one currency and liabilities in another.
3. Irrevocable guarantees and similar instruments that are certain to be called and unlikely to be reclaimable.
4. The total delta value of foreign currency and gold options. Undertakings trading in options shall apply specially for the Financial Supervisory Authority's approval of the assessment method used in this connection.
5. The market value of other foreign currency options.
6. Future income/expenses not yet accrued but already fully hedged.
7. Any positions which an undertaking has deliberately taken in order to hedge against the adverse effects of exchange rate movements on its capital ratio, as well as participation in subsidiaries which has been deducted in the calculation of own funds. Such positions may be excluded from the assessment of the currency position, provided that they are of a non-trading or structural nature.

An undertaking applying items 6 and 7 when assessing its foreign-exchange position must have a special authorization from the Financial Supervisory Authority.

Article 20

The foreign-exchange position in each currency and gold shall be converted into ISK at the official exchange rate on the accounting date.

Notwithstanding the provisions of paragraph 1, an undertaking may, after obtaining the explicit approval of the Financial Supervisory Authority, use the present value of asset and liability items and off balance sheet items when calculating the foreign-exchange position. Present value, in this connection, means the total value of the computed present value of all future amounts received and paid, taking into account the market yield.

Article 21

In order to calculate an undertaking's overall net foreign-exchange position it is necessary to sum the open foreign-exchange position in currencies and gold showing long positions on the one hand and the open currency position in currencies and gold showing short positions on the other hand. The higher of these two totals shall be the undertaking's overall net foreign-exchange position to be used for the assessment of the undertaking's risk weighted base related to foreign-exchange risk, cf. Article 17.

Notwithstanding the provisions of paragraph 1, undertakings which have been granted special authorization by the Financial Supervisory Authority to this end may calculate the risk weighted base related to all or some of the currencies and gold in which the undertaking has positions, taking account, in accordance with further rules laid down by the Financial Supervisory Authority, of the relative correlation in the development of the exchange and gold rates.

CHAPTER 5

Risk-Weighted Base Related to Position Risk on Debt Instruments, Equities and Commodities Included in the Trading Book

Provisions on Position Risk

Article 22

When an undertaking's trading book has been divided into positions in debt instruments, positions in equities and positions in commodities in accordance with Article 5, the risk weighted base related to the position risk on two first mentioned items shall be the sum of the risk weighted base related to specific position risk, calculated in accordance with the provisions of Articles 26 and 30, and general position risk, calculated in accordance with the provisions of Articles 28 and 31. The risk-weighted base related to position risk on commodities shall be calculated in accordance with the provisons of Article 23.

Specific position risk on a debt instrument shall mean the interest rate risk related to a position in a debt instrument arising from the risk of a price change in the instrument concerned, due to factors related to its issuer.

General position risk on a debt instrument shall mean the interest rate risk related to a position in a debt instrument arising from the risk of a price change in the instrument concerned, due to changes in the interest rates in general.

Specific position risk on equities shall mean the interest rate risk related to a position in equities arising from the risk of a change in the price of the relevant equity due to factors related to its issuer.

General position risk on equities and risk on derivative contracts related to equities shall mean the position risk arising from the risk of a price change in the relevant equity due to a broad equity market movement unrelated to any specific attributes of individual equities or their issuer.

In the case of derivative contracts, account shall be taken of the issuer of the underlying principal instrument when assessing the position risk.

Article 23.

Risk weighted base related to position risk on commodities shall be calculated as the sum of the weighted amounts according to paragraphs 3 and 4 of this Article based on the position for each commoditiy. The spot price for each commodity shall be expressed in Icelandic króna on the accounting date. Both short and long positions related to commodities deriving from splitting up of commodities' related derivatives shall be included in the calculation. When calculating net positions of commodities only positions in similar commodities may be netted out. Positions in financial instruments related to gold shall be included in the calculation of the risk weighted base related to foreign excahange risk.

Call and put options, commodity futures, forward commitments to buy or sell individual commodities or other financial instruments of similar nature shall be divided into long and short positions in accordance with the provisions of Article 24.

Positions in financial instruments related to commodities, which are similar regarding commodities, settlement date and instrument but with opposite signs, shall have zero weight.

For each commodity an overall net position shall be calculated taking into consideration settlement date and instrument. The overall net position is calculated as the difference between the total of long positions and the total of short positions. Then the overall net position for each commodity shall be multiplied by the factor 1.875. The overall gross position for each commodity is calculated as the total of the numerical values of long and short positions. Then the overall gross position for each commodiy shall be multiplied by the factor 0.375.

Provisions on Net Position

Article 24

Net position in securities shall mean the difference between the long position and the short position in identical securities. In this connection the derivative contracts of an undertaking included in the trading book shall be treated as balance sheet securities, and the long positions and short positions in the security underlying a derivative contract or in an underlying security, shall be calculated in accordance with the provisions of Annex IV. Furthermore, account shall be taken of repo transactions when calculating net positions in debt instruments and equities in accordance with the abovementioned Annex.

In addition to the risk weighted base resulting from the position risk, calculated in accordance with the provisions of this Chapter, on derivative contracts included in the trading book the risk weighted base related to the counterparty risk on these derivatives shall be calculated in accordance with the provisions of Chapter 6, except in the case of standardized derivatives traded on an organized securities exchange and other contracts secured by daily settlements approved by the Financial Supervisory Authority. Furthermore, the risk weighted base of repo transactions shall be calculated in accordance with the provisions of Chapter 6.

Net positions in foreign-exchange instruments shall be converted into ISK at the official exchange rate prior to further calculation of the risk-weighted base.

Provisions on Position Risk on Debt Instruments

Article 25

The undertaking shall classify its net position in debt instruments according to the currency in which they are denominated and shall calculate the risk weighted base related to general and specific position risks in each individual currency separately.

The Risk Weighted Base Related to Specific Position Risk on Debt Instruments

Article 26

In order to calculate the risk weighted base related to specific position risk on debt instruments included in the trading book, the individual net positions in debt instruments shall be assigned to the categories of risk set out below, cf. Article 27.

Next the gross position in each category of risk shall be found by summing the individual net positions, irrespective of their signs, i.e. regardless of whether the position in the relevant debt instrument is long or short.

The risk-weighted base for specific position risk on debt instruments is the gross position in each category, multiplied by the appropriate risk weighting.

Article 27

The categories of risk related to the specific position risk on debt instruments are as follows:

1. *Risk weighting 0.00*
   All net positions in asset items constituting claims in debt instruments on the National Treasury, cf. Article 12, paragraph 1.
2. *Risk weighting 0.03125*
   All net positions in debt instruments recognized as qualifying items with residual maturity which on the accounting date is shorter than 6 months.
3. *Risk weighting 0.125*
   All net positions in debt instruments recognized as qualifying items with residual maturity which on the accounting date is between 6 and 24 months.
4. *Risk weighting 0.20*
   All net positions in debt instrument recognized as qualifying items with residual maturity which on the accounting date is longer than 24 months.
5. *Risk weighting 1.00*
   All other items than those listed in points 1 to 4.

If there is a significant counterparty risk on the debt instrument, the Financial Supervisory Authority may decide that a specified debt instrument belonging to categories of risk 1 to 4 should be assigned to a higher category of risk.

For the purposes of paragraph one, points 2 to 4, residual maturity shall mean the time remaining until the due date of a debt instrument.

The Risk Weighted Base Related to
General Position Risk on Debt Instruments

Article 28

The risk weighted base related to general position risk on debt instruments included in the trading book shall be calculated in accordance with the provisions of Annex III on the calculation of general position risk on debt instruments. Undertakings shall calculate the risk-weighted base according to the maturity-based method or the duration-based method. The Financial Supervisory Authority may, taking into account the scope of the transactions, decide that individual undertakings use the one method rather than the other.

undertakings shall use the following risk weightings for Matchings 1 to 7, calculated in accordance with the abovementioned annex.

	Maturity-based method	*Duration-based method*
Matching 1	1.25	0.25
Matching 2	5.00	0.25
Matching 3	3.75	0.25
Matching 4	3.75	5.00
Matching 5	5.00	5.00
Matching 6	18.75	18.75
Matching 7	12.50	12.50

The risk-weighted base related to general position risk shall be the sum of Matchings 1 to 7 after each of them has been multiplied with the above risk weightings.

Provisions on Position Risk on Equities

Article 29

An undertaking shall sum all its net long positions and net short positions, cf. Article 23, in equities and derivatives where equities constitute the underlying instrument or share indices are the underlying factor.

An undertaking's overall gross position in equities shall be the sum of its net long positions and net short positions, regardless of signs. The difference between them shall be the undertaking's overall net position.

The Risk Weighted Base Related to Specific Position Risk on Equities

Article 30

An undertaking's risk weighted base related to specific position risk on equities included in the trading book shall be its overall gross position in equities multiplied by risk weighting 0.5.

The Risk Weighted Base Related to General Position Risk on Equities

Article 31

An undertaking's risk weighted base related to general position risk on equities included in the trading book shall be its overall net position in equities multiplied by risk weighting 1.0.

Provisions on Position Risk Due to Underwritten Securities

Article 32

The position risk arising from the underwriting of debt instruments and equities shall be included in the risk weighted base of an undertaking. The following reduction procedure may be used in calculating the position risk:

1. Firstly, it is necessary to deduct from the net position the underwriting position in a security, subscribed by or sub-underwritten by a third party on the basis of a formal agreement.
2. Secondly, the undertaking shall calculate its net positions in underwriting instruments by the following reduction factors:
   - working day 0: 100%
   - working day 1: 90%
   - working days 2 to 3: 75%
   - working day 4: 50%
   - working day 5: 25%
   - after working day 5: 0%.

Working day zero shall be the day on which the agreement is concluded, i.e. the working day on which the undertaking becomes unconditionally committed to accepting a known quantity of securities at an agreed price.

The Financial Supervisory Authority may lay down further capital requirements against the risk of loss which exists between the time of the initial commitment, i.e. working day zero, and working day 1.

CHAPTER 6
Risk Weighted Base Related to Counterparty Risk of Trading Book's Securities and Commodities Transactions

Settlement/Delivery Risk on Unsettled Transactions

Article 33

The risk weighted base of an undertaking related to settlement risk on trading book's securities and commodities transactions, in the case of transactions which are unsettled after their due delivery date has expired, is as indicated below:

In the case of the selling of a security or a commodity, the risk weighted base shall be the same as the positive difference between the agreed price and the market price of the relevant security or commodity multiplied by the relevant risk weighting in accordance with the table below.

In the case of the buying of a security or a commodity the risk weighted base shall be the same as the positive difference between the market price and the agreed price, multiplied by the relevant risk weighting in accordance with the table below.

Number of working days after due settlement date	*Risk weighting*
5-15	100%
16-30	625%
31-45	937,5%
46 or more	1.250%

The provisions of this Article do not apply to repurchase agreements, reverse repurchase agreements and securities- and commodities-lending and securities- and commodities-borrowing.

Counterparty Risk on Free Deliveries

Article 34

The counterparty risk on free deliveries shall be included in the risk weighted base of an undertaking when:

1. The undertaking has paid for securities or commodities before receiving them.
2. The undertaking has delivered securities or commodities before receiving payment for them.

In the case of cross-border transactions, one day or more shall have elapsed since the undertaking made that payment or delivery.

The risk weighted base of an undertaking due to the counterparty risk on these transactions shall be calculated as the value of the securities or the commodities multiplied by the risk weighting applicable to the relevant counterparty, cf. Article 12, if the undertaking has paid for securities or commodities before receiving them.

If the undertaking has delivered securites or commodities without receiving payment for them the claims on the counterparty shall be taken into account instead of the value of the securities or the commodities.

Counterparty Risk on Repurchase and Reverse Repurchase Agreements, Securities- or Commodities-Lending and Securities- or Commodities-Borrowing

Article 35

The risk weighted base related to the counterparty risk on repurchase and reverse repurchase agreements, securities- or commodities-lending and securities- or commodities-borrowing, shall be the undertaking's position calculated in accordance with the following provisions and multiplied by the risk weighting applicable to the relevant counterparty, cf. the provisions of Article 12.

1. In the case of repurchase agreements based on securities or commodities included in the undertaking's trading book, the position shall be calculated as the difference between the market value of the securities or the commodities delivered and the amount received by the undertaking, where that difference is positive.
2. In the case of reverse repurchase agreements based on securities or commodities included in the undertaking's trading book, the position shall be calculated as the difference between the amount the undertaking has delivered and the market value of the securities or the commodities, where that difference is positive.
3. In the case of securities- or commodities-lending, the undertaking's position shall be calculated as the difference between the market value of the securities or the commodities lent by the undertaking and the market value of the collateral, where that difference is positive.
4. In the case of securities- or commodities-borrowing, the undertaking's position shall be calculated as the difference between the collateral given by the undertaking and the market value of the securities or the commodities it has received, where that difference is positive.

Accrued interest shall be included in calculating the market value of amounts borrowed or lent and collateral.

Counterparty risk on OTC derivative instruments

Article 36

The risk weighted base related to counterparty risks on OTC derivative instruments included in the trading book, other than instruments traded on an organized securities exchange or otherwise secured by daily settlements approved by the Financial Supervisory Authority, shall be found by using the marking to market method to calculate the credit equivalent of these contracts, cf. the provisions of Article 14, and by multiplying the results with the risk weighting applicable to the relevant counterparty's credit risk, cf. the provisions of Article 12.

Counterparty Risk on Other Trading Book Items

Article 37

The risk weighted base related to counterparty risk on claims included in the trading book in the form of fees, commission, interest, dividends and margin in futures and options traded on recognized securities exchanges shall be determined by multiplying the claim with the relevant counterparty's risk weighting, cf. The provisions of Article 12, provided that these claims have not previously been used for the calculation of the undertaking's risk weighted base.

CHAPTER 7
The Risk-Weighted Base Related to Excess Due to Large Exposures

Article 38

Undertakings may exceed the limits specified in the Rules on large exposures of 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 undertaking's total equity, based on the provision for authorization 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 39

The capital requirement on the excess due to individual clients or connected clients shall be determined by adding to the risk weighted base an amount computed in accordance with the provisions of Articles 40 and 41.

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 anexcess, it is permitted to take account of the part of the undertaking's capital coming under own funds part C.

Article 40

The risk weighted base 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 base related to the specific position risk on the relevant trading book item, cf. the provisions of Chapter 5 and/or the risk weighted base related to settlement risk and counterparty risk, cf. the provisions of Chapter 6.

Account shall not be taken of the general position risk on trading book items when calculating the risk weighted base related to the excess due to large exposures.

Article 41

Where the excess has persisted for more than 10 days the components of the excess shall, when calculating the undertaking's risk weighted base, 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

base, 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 base related to an excess which has persisted for more than 10 days shall then be calculated by multiplying the risk weighted base related to the specific position risk on a trading book item, cf. the provisions of Chapter 5, and/or the risk weighted base related to settlement and counterparty risk, cf. the provision of Chapter 6, by the relevant factor according to the table below.

Exposures in excess of 25% of own funds (A + B + C)	*Factor*
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 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 + C.

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 + C.

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 8
Consolidated accounts
Article 42

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 base of a consolidation it is permitted to offset position in debt instruments, equities and commodities, cf. the provisions of Chapter 5, between the undertakings belonging to the consolidation. The same applies to positions in currencies and gold, cf. the provisions of Chapter 4.

CHAPTER 9
Entry into force
Article 43

These Rules are laid down with reference to Article 84, paragraph 3, of Act No. 161/2002 on Financial Undertakings.

The Rules will enter into force immediately. At the same time Rules No. 693/2001, on the Solvency Ratio of Credit Institutions and Undertakings Engaged in Securities Services, will cease to apply.

Reykjavík, 30 June 2003

FJÁRMÁLAEFTIRLITIÐ
(The Financial Supervisory Authority, Iceland)

Páll Gunnar Pálsson   Ragnar Haflidason

ANNEX I
Classification of countries within Zone A and B, cf. Article 12 of the Rules

Zone A shall include the following countries:
(Any country which must reschedule its external sovereign debts is, however, excluded from Zone A for a period of 5 years.)

Austria	Italy	Spain
Australia	Japan	United Kingdom
United States of America	Canada	South Korea
Belgium	Luxembourg	Switzerland
Denmark	Mexico	Sweden
Finland	Norway	Czech Republic
France	New Zealand	Turkey
Greece	Portugal	Hungary
Netherlands	Poland	Germany
Ireland	Saudi-Arabia	
Iceland	Slovakia	

Zone B
All countries not included in Zone A.

ANNEX II
List of public undertakings and institutions in Iceland
cf. Article 12, paragraph 1, point 2c of the Rules

Risk weighting 0.0:
Ríkissjóður Íslands (National Treasury)
Seðlabanki Íslands (Central Bank of Iceland)
Landsvirkjun (National Power Company)

Risk weighting 0.2:
Flugmálastjórn (Directorate of Civil Aviation)
Hitaveita Suðurnesja (Sudurnes Regional Heating)
Lánasjóður sveitarfélaga (The Municipalities Loan Fund)
Orkubú Vestfjarða (Vestfjord Power Company)
Rafmagnsveitur ríkisins (State Electric Power Works)

Landspítali-Háskólasjúkrahús (National University Hospital)
Vegagerð ríkisins (Public Roads Administration)
Þróunarsjóður sjávarútvegsins (The Fisheries Development Fund)
Other public undertakings and institutions which meet the requirements of Article 2 of the Rules according to written statement from the Financial Suprevisory Authority.

Risk weighting 1.0:
All other public undertakings and institutions which do not meet the requirements of Article 2 of the Rules.

ANNEX III
Calculation of the Risk Weighted Base Related to General Risk on Debt Instruments and Derivative Contracts, cf. Article 28 of the Rules

A. Maturity-based method
The procedure for calculating the risk weighted base related to general risk on debt instruments and derivate contracts included in the trading book involves the steps below.

For undertakings which only show long positions in debt instruments it is sufficient to calculate the risk weighted base in accordance with step 1, 2 and 3(A) but the risk weighted base of other undertakings shall be calculated in accordance with step 1, 2 and 3(B) and then step 4 to 7.

Step 1
Net positions in debt instruments shall be assigned to the appropriate maturity band. Each maturity band has its percentage weighting in the further calculation.

Which maturity band the net position in a debt instrument falls into is based on the one hand on the maturity of the interest rate and on the other hand on whether interest payments during the life cycle of the debt instrument have a fixed coupon rate of more or less than 3%.

In the case of fixed-rate debt instruments the interest rate maturity is the same as the residual maturity. In the case of instruments on which the interest rate is variable before final maturity, the period until the interest rate is next set shall be used.

The maturity bands and their zones are as follows:

Maturity Zone	Maturity band	Coupon rate of 3% or more	Coupon rate of less than 3%	Weighting in %	*Assumed interst rate change (in %)*
I	1	0 ≤ 1 month	0 ≤ 1 month	0,00	-
	2	> 1 ≤ 3 months	> 1 ≤ 3 months	0,20	*1,00*
	3	> 3 ≤ 6 months	> 3 ≤ 6 months	0,40	*1,00*
	4	> 6 ≤ 12 months	> 6 ≤ 12 months	0,70	*1,00*
II	5	> 1 ≤ 2 years	> 1,0 ≤ 1,9 years	1,25	*0,90*
	6	> 2 ≤ 3 years	> 1,9 ≤ 2,8 years	1,75	*0,80*
	7	> 3 ≤ 4 years	> 2,8 ≤ 3,6 years	2,25	*0,75*
III	8	> 4 ≤ 5 years	> 3,6 ≤ 4,3 years	2,75	*0,75*
	9	> 5 ≤ 7 years	> 4,3 ≤ 5,7 years	3,25	*0,70*
	10	> 7 ≤ 10 years	> 5,7 ≤ 7,3 years	3,75	*0,65*
	11	> 10 ≤ 15 years	> 7,3 ≤ 9,3 years	4,50	*0,60*
	12	> 15 ≤ 20 years	> 9,3 ≤ 10,6 years	5,25	*0,60*
	13	> 20 years	> 10,6 ≤ 12,0 years	6,00	*0,60*
	14		> 12,0 ≤ 20 years	8,00	*0,60*
	15		> 20 years	12,50	*0,60*

Step 2
Net long positions and net short positions in debt instruments within each maturity band shall be summed separately.

The totals shall be multiplied by the percentage weighting of the relevant maturity band.

Step 3 (A)
If an undertaking only has a long position in debt instruments included in the trading book the sum of the weighted long position in all maturity bands shall be called *Matching 7.*

Step 3(B)
For undertakings, other than referred to in step 3(A), the matched position for the maturity band shall be the lower of the two totals formed by the weighted long position or the weighted short position for the maturity band. The total of the matched positions in all bands shall be called *Matching 1.*

The difference between the sum of the weighted long position and the sum of the weighted short position in each maturity band shall be the unmatched position for the maturity band.

Step 4
The total of the unmatched long positions within each maturity zone shall then be summed and matched with the total of the unmatched short positions within the same maturity zone.

The matched position for maturity zone I shall be called *Matching 2*, the matched position for zone II shall be called *Matching 3* and the matched position for zone III shall be called *Matching 4.*

Step 5
Positions which have not been matched in accordance with step 4 shall then be matched between maturity zones I, II and III.

First the unmatched positions shall be matched between zones I and II. The remaining unmatched position for zone II shall then be matched with the unmatched position for zone III.

The matched positions between maturity zones I and II shall then be added to the matched positions between maturity zones II and III. This total shall be called *Matching 5.*

It is permitted to match positions between zones II and III before the matching between zones I and II takes place.

Step 6
The unmatched positions for zones I and III which remain unmatched after step 4 shall now be matched. This matching shall be called *Matching 6.*

Step 7
Any unmatched positions remaining shall be called *Matching 7.*

The risk weighted base related to general position risk shall be the sum of Matching 1 to 7 after each of them has been multiplied by the risk weighting specified in Article 28 of these Rules.

B. Duration-based method
The procedure for calculating the risk weighted base related to general risk on debt instruments and derivative contracts included in the trading book involves the steps below.

Step 1
With reference to the market value, the yield to maturity of each fixed rate debt instrument shall be calculated. In the case of floating-rate instruments the yield shall be calculated in the same manner on the assumption that the principal is due when the interest rate can next be changed.

Step 2
The so-called modified duration for net positions in individual debt instruments shall be calculated on the basis of the following formula:

$$\text{Modified duration} = \frac{Duration}{(1+r)}$$

$$\text{Duration} = \frac{\sum_{t=1}^{m} \frac{tC_t}{(1+r)\uparrow t}}{\sum_{t=1}^{m} \frac{C_t}{(1+r)\uparrow t}}$$

where

r = yield in % to maturity

C_t = cash payment in time t,
m = total maturity (year).
t = time to maturity (year)
↑*t* = to the t power

Step 3
The net position in individual debt instruments shall be allocated tothe appropriate duration zone, cf. the following table. It shall bedone on the basis of the modified duration of each instrument.

Duration Zone	*Modified duration (in years)*	*Assumed interest rate change (in %)*
I	$> 0 \leq 1$	1.00
II	$> 0 \leq 3.6$	0.85
III	> 3.6	0.7

Step 4
The undertaking shall then calculate the duration-weighted position for each instrument by multiplying its market price by its modified duration and by the assumed interest-rate change for the appropriate duration zone, cf. the table above.

The weighted long positons and weighted short positions within each duration zone shall then be summed separately.

The matched position for a duration zone shall be the lower of the two totals formed by the long position and short position within each duration zone. Matching within zone I shall be called *Matching 1*, matching within zone II shall be called *Matching 2* and matching within zone III shall be called *Matching 3*.

The difference between the sum of the weighted long position and the sum of the weighted short position in each duration zone is the unmatched position for the duration zone.

Step 5
Unmatched positions within each duration zone shall then be matched against unmatched positions for other zones.

First the unmatched positions for zone I and II shall be matched. This is *Matching 4*.

The unmatched position remaining for duration zone II shall then be matched against the unmatched positions for duration zone III. This shall be *Matching 5*.

Undertakings may match positions between duration zones II and III before matching between zone I and II.

Step 6
Any unmatched positions remaining of the unmatched positions for duration zones I and III after step 5 has been completed shall now be matched. This is *Matching 6.*

Step 7
Any unmatched positions remaining shall be called *Matching 7.*

The risk weighted base related to general position risk shall be the sum of Matchings 1 to 7 after they have been multiplied by the risk weightings specified in Article 28 of these Rules.

ANNEX IV
Treatment of Derivative Contracts and Repo Transactions in the Calculation of Net Positions in Debt Instruments and Equities, cf. Article 24 of the Rules

1. Swaps
Swaps shall be treated for position risk purposes on the same basis as on balance sheet securities.

An interest-rate swap under which an undertaking receives floating-rate interest and pays fixed-rate interest shall be treated as equivalent to a long position in a floating-rate instrument of maturity equivalent to the period until the next interest fixing, and a short position in a fixed-rate instrument with the same maturity as the swap itself.

An interest rate swap under which an undertaking receives fixed rate interest and pays floating rate interest shall be treated as equivalent to a short position in a floating rate instrument of maturity equivalent to the period until the next interest fixing, and a long position in a fixed rate instrument with the same maturity as the swap itself.

Currency swaps shall be treated as if they were forward foreign-exchange contracts.

For the purposes of calculating specific position risk, in accordance with Chapter 5, positions in swaps shall be treated as if they were positions in treasury bonds.

The risk-weighted base related to the counterparty risk on a swap shall be calculated in accordance with the provisions of Article 36.

2. Forward foreign exchange and gold contracts
Positions in forward foreign exchange and gold contracts shall be treated on the one hand as positions in the currency and the gold which the undertaking has undertaken to sell and on the other hand as positions in the currency and the gold which the undertaking has undertaken to buy.

When calculating general position risk on individual currencies and gold, in accordance with the duration-based method, cf. the provisions of Chapter 5, the market value or calculated present value of a forward foreign exchange and gold contracts shall be assigned to the appropriate duration zone. When using the maturity-

based method the nominal value of a contract shall be assigned to the appropriate maturity band.

Positions arising from forward foreign exchange and gold contracts shall be classified with regard to general and specific position risk as if they were positions in treasury bonds with 0% nominal interest rates.

Notwithstanding the provisions of Article 4 of the Rules, the Financial Supervisory Authority may grant an undertaking authorization to treat positions in forward foreign-exchange and gold contracts as non-trading book items.

The risk weighted base related to the counterparty risk on forward foreign-exchange and gold contracts shall be calculated in accordance with the provisions of Article 36 of the Rules.

3. Futures contracts

This provision covers futures contracts and other standardized forward contracts traded on an organized securites exchange and/or secured by a securities exchange, market maker or clearing house by daily settlements and margin requirements.

Futures contracts shall be treated as a combination of long and short positions, cf. the following:

1. A position in a bought contract shall be treated as a combination of a liability maturing on the settlement date of the futures contract and an asset item with maturity date equal to that of the instrument underlying the derivative in question.
2. A position in a sold contract shall be treated as a combination of a an asset item with a maturity date equal to that of the derivative contract and a liability with a maturity date equal to that of the instrument underlying the derivative in question.

When calculating specific position risk and assigning to maturity bands, long and short positions shall be treated as if they were positions in a treasury bond with 0% nominal interest rates.

4. Forward rate agreements (FRA)

Forward rate agreements shall be treated as a combination of long and short positions, cf. the following:

1. A position in a bought contract shall be treated as a combination of a liability maturing on the settlement date of the futures contract and an asset item with maturity date equal to that of the instrument underlying the derivative in question.
2. A position in a sold contract shall be treated as a combination of a an asset item with a maturity date equal to that of the derivative contract and a liability with a maturity date equal to that of the instrument underlying the derivative in question.

When calculating specific position risk and assigning to maturity bands, long and short positions shall be treated as if they were positions in a treasury bond with 0% nominal interest rates.

The risk-weighted base related to the counterparty risk on a forward rate agreement shall be calculated in accordance with the provisions of Article 36.

5. Options
Options shall be treated as a combination of an asset and a liability item. Positions arising from these instruments shall be treated as if they were equal in value to the amount of the underlying financial instrument to which the option refers, multiplied by the delta of the option. These positions may be netted against any position in an identical underlying instrument or derivative within the same maturity band or duration zone, cf. Annex III. The delta used shall be that of the securities exchange concerned. In the case of OTC options the undertaking itself shall calculate the delta, using a methodology approved by the Financial Supervisory Authority. The Financial Supervisory Authority may lay down further provisions on the methods for calculating the delta of options, as well as a special capital requirement against other risks associated with options, such as gamma and vega risk.

The risk-weighted base related to the counterparty risk on an option shall be calculated in accordance with Article 36.

6. Repo transactions
On genuine sale and repurchase transactions in securities included in the trading book, the transferor shall continue to treat the transferred asset as a balance sheet item. These securites must be included in the calculation of the position risk of the transferor but not the transferee.

In the case of a repurchase agreement where the repurchase price is predetermined in the agreement, the transferor shall also take account of the position risk associated with the repurchase commitment. The transferor shall consider the repurchase commitment as a short position and classify it in the same way as a short position in treasury bonds with 0% nominal interest rates.

Similarly the transferee shall take into account the position risk associated with the resale commitment in such agreements. When calculating the position risk, the transferee shall therefore consider the resale claim as a long position and classify it in the same way as an asset holding in treasury bonds with 0% nominal interest rates.

The risk weighted base related to the counterparty risk on repo transactions shall be calculated in accordance with the provisions of Article 35.

7. Share-index derivative contracts
The Financial Supervisory Authority may grant an undertaking authorization, when calculating its net position in a security, cf. Article 24, to break down a share-index future into its underlying positions in each of their constituent equities.

Furthermore, the Financial Supervisory Authority may grant an undertaking authorization to excempt derivative contracts which represent broadly diversified share index from the calculation of the specific position risk on equities, cf. Article 30.