NATIONAL BANK OF THE REPUBLIC OF MACEDONIA

Pursuant to Article 64 paragraph 1 item 22 of the Law on the National Bank of the Republic of Macedonia ("Official Gazette of the Republic of Macedonia" No. 3/2002, 51/2003, 85/2003, 40/2004, 61/2005 and 129/2006), and Article 2 paragraph 1 item 29 and Article 64 paragraph 3 of the Banking Law ("Official Gazette of the Republic of Macedonia" No. 67/2007), the National Bank of the Republic of Macedonia Council adopted the following

DECISION
on the methodology for determining capital adequacy
("Official Gazette of the Republic of Macedonia" no. 159/2007)

I. GENERAL PROVISIONS

1. This Decision lays down the methodology for determining the capital adequacy ratio and its elements.

2. The capital adequacy ratio shall be calculated as a ratio between the bank's own funds, as determined in Section II of this Decision and the risk weighted assets, as determined in Section V of this Decision.

3. The bank shall permanently maintain capital adequacy ratio not lower than 8%.

The Governor of the National Bank of the Republic of Macedonia (hereinafter referred to as: NBRM) may prescribe percentage higher than 8%, if it is required by the nature, the type and the scope of activities the bank performs and the risks it is exposed to as a result of such activities.

4. The bank shall ensure adequate level of own funds, depending of the type and the scope of financial activities and the level of risks arising from the conduct of such activities.

The portion of own funds necessary for covering a certain risk shall not be simultaneously used for covering other risks.

5. In the cases when the bank is subject to consolidated supervision, required to compile consolidated financial reports for the banking group, the bank shall calculate capital adequacy both on individual and consolidated basis.

II. OWN FUNDS

6. For the purpose of this Decision, "own funds" is a category used for calculating the capital adequacy ratio and other prudential limits.

7. Bank's own funds are a sum of core capital, supplementary capital I, and supplementary capital II laid down in items 1, 2, 3 and 4 of this Section, taking into account the restrictions referred to in item 9 of this Decision.

8. The amount of core capital and supplementary capital I may be used for covering the credit risk, the currency risk, the commodity risk and market risks taking into account the restrictions under item 9 of this Decision.

The amount of supplementary capital II may be used only for covering market risks, except for the counterparty risk and the settlement risk, taking into account the restrictions under item 9 of this Decision.

9. When determining the amount of own funds, the bank shall observe the following restrictions:

- the amount of supplementary capital I and II may not exceed the amount of bank's core capital,

- the sum of the nominal value of subscribed and paid-in common shares, the sales premium of such shares and the amount of reserves and the retained profit, less the deductions under item 12 of this Decision, should exceed the sum of other positions which are part of the bank's core capital,

- the amount of subordinated instruments which are part of the supplementary capital I may not exceed 50% of the amount of core capital,

- the amount of subordinated instruments as a part of the supplementary capital II shall not exceed 150% of the amount of core capital, less the deductions under item 12 of this Decision, which is not used for covering the credit risk, the commodity risk, the counterparty risk, the settlement risk and the currency risk (hereinafter: excess core capital),

- the bank may exceed the limit referred to in indent 4 of this item, unless the sum of supplementary capital I and subordinated instruments as a part of the supplementary capital II exceeds 250% of the excess core capital.

1. Core capital

10. Bank's core capital shall be the sum of the positions under item 11 of this Decision, less the deductions under item 12 of this Decision, taking into account the restriction referred to in item 9 indent 2 of this Decision.

The positions which are part of the core capital shall meet the following requirements:

a) to be unconditionally non-redeemable,

b) to be fully and readily available for covering the bank's risks and losses during the bank’s operations,

c) in the event of bankruptcy or liquidation of the bank, to be fully and unlimitedly available to cover the bank’s losses and liabilities to its creditors.

11. The bank's core capital shall consist of the following:

a) nominal value of subscribed and paid-in common and non-cumulative preference shares, premium of selling such shares, as well as immediately paid-in funds (for savings houses not founded as joint-stock companies).

Premium from sold shares shall be the difference between the sale and the nominal value of the shares. If the shares' sale value is lower than their nominal value, the premium from shares sold is negative. If the shares' sales value is higher than their nominal value, the premium from shares sold is positive.

b) bank reserves and retained unallocated profit or loss,

- reserves appropriated from taxed profit, that serve for covering losses arising from risks the bank faces in its operations,

- retained profit not encumbered by any future obligations, stated in the balance sheet and confirmed by a Decision of the bank's General meeting of shareholders. The Decision shall contain a provision stating that the retained profit is not available for payment of dividend to shareholders in the future (restricted for distributions to shareholder). This position shall also include the accumulated loss from previous years, with negative sign,

- current profit if the following requirements have been met:

  - o the amount of the current profit, on a certain cut-off date, is confirmed by a certified auditor, where the current profit might be a part of the bank's core capital for the next reporting period, only if in the next period the bank generated higher current profit than that confirmed by the certified auditor.

  - o the amount of current profit has been reduced by any payments for partial dividend paid during the year, tax liabilities and other types of levies paid from the current profit,

  - o the bank evaluates its assets and liabilities on the basis of established accounting standards,

  - o the bank's supervisory board adopted a decision allowing for appropriation of the current profit in the reserves or the bank's retained profit, without such profit being available for payment of dividend to shareholders,

  - o the bank submitted evidence to the NBRM that it has met the requirements stated in the sub-indents above.

If the aforementioned conditions are fullfiled, the bank may include in the core capital the profit after taxes at the end of the year, until the adoption of a Decision of the bank's General meeting of shareholders on the distribution of the realized profit.

The reserves and the retained profit or loss referred to in paragraph 1 of this sub-item shall not include the revaluation reserves and other differences from the evaluation of hedging of cash flows and any profits or losses from liabilities of the bank measured at fair value, the profits and losses of which results from changes in the creditworthiness (rating) of the bank.

The amount of unrealized loss from equities available for sale and measured at fair value shall be deducted from the sum of the positions referred to in paragraph 1 of this sub-item.

12. The following items shall be deducted from the core capital:

a) amount of loss at the year-end or current loss,
b) the amount of licenses, patents, goodwill, and other intangible assets, including the revaluation excess generated from such assets,
c) the amount of purchased own shares,
d) other net negative revaluation reserves not generated on the basis of deductible items from the core capital and are not included in the determining of the bank's own funds. These reserves are primarily net negative revaluation reserves and other differences from the evaluation of hedging of net investments in foreign currency, non-current assets or groups intended for disposal held for sale, the effective part of the hedging of cash flows and investments in affiliates or joint ventures evaluated by using the principal method, and other similar revaluation reserves and other differences,
e) amount of impairment of financial assets measured at depreciation value and special reserve for off-balance sheet assets which, as a result of accounting delay, have not been determined on the date of calculation of the own funds,
f) the difference between the disclosed impairment of financial assets and the special reserve for off-balance sheet assets and the amount of impairment and the special reserve as specified under the Decision on credit risk management.

2. Supplementary capital I

13. The supplementary capital I shall be the sum of the positions in item 14 of this Decision, taking into account the restrictions referred to in item 9 indents 1, 3 and 5 of this Decision.

The positions which are part of the supplementary capital I shall:

- be immediately and without restrictions available for covering the risks and losses during the bank's operations,

- be reduced by the amount of future tax payments.

14. The supplementary capital I shall include:

a) nominal value of the subscribed and paid-in cumulative preference shares and the premium arising from the sold cumulative preference shares, less the amount of purchased own cumulative preference shares,

b) reserves based on revaluation as follows:

   - 80% of the unrealized profit from revaluation of equities available for sale and measured at fair value,

   - 80% of the unrealized profit from revaluation of debt instruments available for sale, measured at fair value,

c) hybrid capital instruments issued by the bank, defined in item 15 of this Decision,

d) subordinated instruments issued by the bank, defined in item 16 of this Decision.

The cumulative preference shares referred to in paragraph 1 sub-item a) of this item, apart from the requirements listed under item 13 paragraph 2 of this Decision, shall also meet the following requirements:

- to be unconditionally non-redeemable;
- to be subordinated against other bank's creditors, including the holders of subordinated and hybrid instruments,
- to allow the bank restrict the payment of dividend on such shares.

15. Hybrid capital instruments included in the supplementary capital I shall be financial instruments showing features of liabilities and capital, which besides the requirements under item 13 paragraph 2 of this Decision, meet the following requirements:

- to be in money form, i.e. incurred by cash inflow in the bank, where only the paid-in portion is included in the supplementary capital I,

- the term of their maturity not to be pre-specified,

- not to be covered by other type of collateral by the bank or a person/entity connected to the bank (not additionally covered by a guarantee, mortgage or other type of collateral by the bank or by a person/entity connected to the bank),

- to be recorded on a special account in the accounting records of the bank,

- to contain a subordination clause, i.e. a clause stating that in the case of bankruptcy or liquidation of the bank, these liabilities will be paid before settling the liabilities to the bank's shareholders, and after settling the liabilities to other creditors, including the liabilities based on subordinated instruments,

- not to be payable by the bank prior to a period of five years and one day after the issuance date and if no prior approval is granted by the NBRM,

- the hybrid capital instrument agreement to contain an option of deferred payment of the yield on instrument, when the bank generates no profit or when the capital adequacy ratio drops below the minimum requirement set by the NBRM increased by 4 percentage points,

- not to be used as a collateral for claims and contingent liabilities of the bank, and

- the hybrid capital instrument agreement to contain a clause allowing for conversion of the hybrid capital instrument into common or non-cumulative preference shares, provided that the capital adequacy ratio drops below the minimum requirement set by the NBRM.

The NBRM shall issue the approval referred to in paragraph 1 indent 6 of this item provided that one of the following requirements has been fulfilled:

  - the bank provided an amount of core or supplementary capital I with same or higher quality which would fully substitute the amount of paid hybrid instrument,

  - the bank submitted evidence that even without the paid hybrid capital instrument, it holds adequate level of own funds relative to the nature, the type and the volume of its activities and the risks it has been exposed to as a result of such activities.

To obtain the approval referred to in paragraph 1 indent 6 of this item, the bank shall submit the following documentation to the NBRM:

  - in the cases of paragraph 2 indent 1 of this item, projection of the level of own funds and the capital adequacy ratio for the next 3 years, by including the core or supplementary capital I which will replace the paid hybrid capital instrument,

  - in the cases of paragraph 2 indent 2 of this item, projection of the level of own funds, the capital adequacy ratio and the nature, the type and the volume of activities the bank is to perform over the next 3 years.

16. Subordinated instruments included in the supplementary capital I are bank's financial instruments which, irrespective of the form, in spite of the requirements specified under item 13 paragraph 2 of this Decision, should meet the following criteria:

- to be in money form, i.e. incurred by cash inflow in the bank, where only the paid-in portion is included in the supplementary capital I,

- not to be covered by other type of collateral by the bank or a person/entity connected to the bank (not additionally covered by a guarantee, mortgage or other type of collateral by the bank or by a person/entity connected to the bank)

- to contain a subordination clause, i.e. a clause stating that in the case of bankruptcy or liquidation of the bank, these liabilities will be paid before settling the liabilities to the bank's shareholders and the bearers of hybrid capital instruments, and after settling the liabilities to other creditors,

- not to have a fix maturity date or to have a maturity date that exceeds five years and one day after the cash inflow date in the bank on the basis of these instruments. If the subordinated instrument does not have a maturity date, the bank can repay the instrument, only if it has informed the NBRM at least 5 years before the planned repayment. If the subordinated instrument has a maturity date, the subordinated instrument agreement may not contain an early repayment provision, except in the case of bankruptcy or liquidation of the bank, and

- not to be used as collateral for claims and contingent liabilities of the bank.

As an exception to paragraph 1 indent 4 of this item, the bank may make (early) payment of the subordinated instrument provided that it obtain a prior approval by the NBRM. The NBRM shall issue the approval if one of the following requirements has been met:

- the bank ensures an adequate amount of core or supplementary capital I enjoying same or higher quality, thus fully replacing the amount of the paid subordinated instrument,

- the bank submits an evidence that even without the paid subordinated instrument, it holds adequate level of own funds relative to the nature, the type and the volume of its activities and the risks it has been exposed to as a result of such activities.

To obtain the approval referred to in paragraph 2 of this item, the bank shall submit the following documentation to the NBRM:

- in the cases of paragraph 2 indent 1 of this item, projection of the level of own funds and the capital adequacy ratio for the next 3 years, by including the core or supplementary capital I which will replace the paid subordinated instrument,

- in the cases of paragraph 2 indent 2 of this item, projection of the level of own funds, the capital adequacy ratio and of the nature, the type and the volume of activities the bank is to perform over the next 3 years.

In the calculation of the bank's own funds in the last five years to the maturity or payment date, the amount of subordinated instrument shall be discounted by 20% p.a. In the last year prior to the maturity or payment date, the subordinated instrument shall not be included in the calculation of own funds.

3. Deductions from the core capital and supplementary capital I

17. The sum of the core capital and the supplementary capital I, determined in accordance with parts 1 and 2 of this Section shall be reduced by the deductions under paragraph 2 of this item, as follows: 50% of the core capital and 50% of the supplementary capital I. If the amount of deductions referred to in paragraph 2 of this

item which is to be deducted from the supplementary capital I exceeds its amount, the other deductions shall be deducted by the core capital.

Deductions from the core capital and the supplementary capital I shall be:

a) capital investments in other bank or other financial institutions, except for financial institutions referred to in sub-item d), exceeding 10% of the capital of such institutions. The calculations of the bank's capital investments in other banks or other financial institutions include all direct and indirect capital investments in these institutions. If such derived amount exceeds 10% of the capital of such institutions, only the bank's direct capital investments in such institutions shall be considered deductions,

b) investments in subordinated and hybrid capital instruments and other instruments which, in consistence with the regulations, are included in the determination of the capital adequacy ratio of other banks or other financial institutions, other than financial institutions referred to in sub-item e), where the bank holds more than 10% of the capital of such institutions,

c) the aggregate amount of bank's capital investments, subordinated and hybrid instruments and other instruments which, as specified by the regulations, are included in the determining of the capital adequacy ratio of other banks and other financial institutions, other than investments in the entities referred to in sub-items a) and b), which exceeds 10% of the bank's core and supplementary capital I, calculated before the deductions referred to in this item. The aggregate amount shall not include bank's investments in the financial institutions referred to in sub-items d) and e),

d) bank's direct capital investments in insurance and reinsurance company and in pension fund management companies,

e) investments in financial instruments issued by insurance companies and pension fund management companies, which, as defined by the regulations, are included in the capital of these companies,

f) the amount of exceeding the limits specified by the Banking Law that refers to an individual capital holding (15%) and to aggregate, i.e. total amount of capital holdings in non-financial institutions (30%). If the bank exceeds one of the indicated limits, the amount of exceeding the limit shall be taken as deduction. If the bank exceeds both indicated limits, the larger limit exceeding shall be taken as deduction.

The investments referred to in paragraph 2 sub-items a), b) and c) of this item, which are part of the bank's trading book, shall not be deductions from the core capital and the supplementary capital I.

4. Supplementary capital II

18. The bank's supplementary capital II shall consist of the amount of subordinated instruments defined in paragraph 2 of this item, taking into account the restrictions under item 9 indents 4 and 5 of this Decision.

Subordinated instruments included in the supplementary capital II shall, regardless of the form, fulfill the following requirements besides those prescribed in item 16 paragraph 1 indents 1, 2, 3 and 5:

- to have fixed maturity exceeding two years and one day from the cash inflow date in the bank. The subordinated instrument agreement may not contain an early repayment provision, except in the case of bankruptcy or liquidation of the bank,

- not to be payable by the bank before their maturity date, and

- to contain a clause forbidding the interest and the principal to be paid, even on the maturity date, if such payment decreases the capital adequacy ratio below the minimum requirement set by the NBRM.

As an exception to paragraph 2 indent 1 of this item, the bank may make early repayment of the subordinated instrument provided that it obtain a prior approval by the NBRM. The NBRM shall issue the approval if one of the following requirements has been met:

- the bank ensures an adequate amount of core or supplementary capital I showing same or higher quality, thus fully replacing the amount of the paid subordinated instrument,

- the bank submits an evidence that even without the paid subordinated instrument, it holds adequate level of own funds relative to the nature, the type and the volume of its activities and the risks it has been exposed to as a result of such activities.

To obtain the approval referred to in paragraph 3 of this item, the bank shall submit the following documentation to the NBRM:

- in the cases of paragraph 3 indent 1 of this item, projection of the level of own funds and the capital adequacy ratio for the next 2 years, by including the core or supplementary capital I which will replace the repaid subordinated instrument,

- in the cases of paragraph 3 indent 2 of this item, projection of the level of own funds, the capital adequacy ratio and of the nature, the type and the volume of activities the bank is to perform over the next 2 years.

19. Before including the hybrid capital instrument referred to in item 15 and subordinated instruments under items 16 and 18 of this Decision in the calculation of own funds, the bank shall inform the NBRM on the terms under which the hybrid capital instruments and subordinated instruments occurred, by presenting the agreement and other documentation.

The documentation under paragraph 1 of this item that considers hybrid capital instruments under item 15 and subordinated instruments under items 16 and 18 of this Decision should contain all listed terms, including a provisions stating that the hybrid capital instruments and subordinated instruments are not treated as deposits and are nut subject to insurance by the Deposit Insurance Fund.

III. TRADING BOOK AND BANKING BOOK

20. When calculating capital requirements for credit, currency and market risks, a bank shall distribute its positions in the trading book and the banking book.

21. Positions distributed in the trading book, for the purpose of this Decision, shall comprise positions in financial instruments and commodities held for trading purposes or for hedging of other trading book positions. These positions are held for the purposes of generating profit from later short-term sale and/or profiting from the generated or expected short-term market price changes.

With a view to adequate allocation of the positions in the financial instruments and commodities to the trading book, the purpose of their acquisition or conclusion of an agreement/contract relating to a financial instrument or commodity must be known prior to the acquisition or signing of the agreement/contract.

In order to be included in the trading book, the positions in the financial instruments and commodities must be released from any restrictive provisions limiting their free trade or hedging their value.

Positions distributed in the trading book, for the purpose of this Decision, shall comprise all positions of item 22 of this Decision arising from the bank's trading on its own behalf and for its own account (proprietary positions) and on behalf and for account of its clients, and those occurring when the bank is authorized to act as a market maker.

22. Positions which, according to this Section, shall be included in the trading book are:

a) Financial instruments:
   - equity securities,
   - debt instruments,
   - financial derivatives (futures contracts and forward agreements, options, swaps, etc.).
b) exposure arising from the settlement/delivery risk and the counterparty risk to financial instruments and commodities which are a part of the trading book,

c) repurchase agreements and agreements on lending securities or commodities which are part of the trading book to counterparty,

d) agreements on borrowing securities or commodities, eligible to be included in the trading book, from counterparty,

e) commissions, fees, interests, dividends and margins based on financial derivatives traded on exchange, directly related to trading book items,

f) exposure arising from security issue underwriting agreement.

23. For the purpose of this Decision, a repurchase agreement shall denote any agreement on prompt purchase/sale of securities or commodities where the seller/buyer is obliged to repurchase/resell them or similar securities or commodities on a future date, at a pre-specific price, with the fulfillment of the following requirements:

- the bank or the counterparty shall transfer the title of the securities or commodities,

- according to the agreement, the bank shall not transfer or pledge, simultaneously, the securities or commodities to or with third parties, with a commitment to repurchase or exchange them for same or similar securities or commodities.

For the purpose of this Decision, an agreement on lending securities or commodities to counterparty and an agreement on borrowing securities or commodities from counterparty shall denote an agreement in which a bank or its counterparty transfers securities or commodities against appropriate collateral where the borrower is obliged to return the same or similar securities or commodities on a future date or when requested to do so by the lender.

The bank may include the exposure arising from reverse repurchase agreements in its trading book, in which it buys securities or commodities, and the agreements on borrowing securities or commodities from the counterparty in the trading book, if:

- the exposure is evaluated daily, according to the market value (daily marking-to-market),

- the collateral value adjusted by each change in the value of the underlying securities or commodities,

- the contract providing for automatic and immediate offsetting of a bank's claims against the claims of its counterparty in the event of default of the latter,

- the counterparty is a domestic bank, a foreign bank enjoying credit rating of at least A- (according to the rating of Standard & Poor's[1]) or at least A3 (according to the rating of Moody's), an exchange or a clearing house,

- the provisions of the agreement clearly express the intent of both parties to conclude such type of agreement.

[1] The Standard & Poor's and Moody's ratings, used throughout the methodology, do not exclude the possibility for applying ratings of other recognized international rating institutions.

In the event of default of the counterparty to the agreements referred to in paragraphs 1 and 2 of this item, the bank shall notify the NBRM forthwith.

24. The bank shall evaluate all trading book positions on a daily basis, at market value (marking to market). In the absence of market prices for certain positions, the bank may apply alternative methods of valuation (for example, market value of similar instruments), upon prior approval of the NBRM.

25. Items not included in the trading book, shall be considered a part of the banking book.

26. The bank shall allocate the items included in the trading book and the banking book by using objective criteria in line with the international standards. The bank shall apply these criteria on a permanent basis.

The bank shall establish and apply appropriate written policies for allocation of a particular item in the trading book or the banking book. The presumptions for distributing a certain item to the trading book or to the banking book and their application should be properly documented and subject to regular internal audit.

The bank shall adopt the policies referred to in paragraph 2 of this Decision and submit them to the NBRM prior to the implementation of this Decision.

IV. CAPITAL REQUIREMENT FOR COVERING RISKS

27. The bank shall hold adequate capital requirements for covering:

- credit risk arising from its banking book,

- currency risk and the commodity risk arising from its banking book and its trading book, and

- market risks arising from its trading book.

The capital requirements for covering the risks referred to in paragraph 1 of this item shall be the sum of the capital requirement for credit risk, as defined under item 36 of this Decision, the capital requirement for currency risk as defined under section VII of this Decision, the capital requirement for commodity risk, as specified under section IX of this Decision and the capital requirement for market risks, as defined under section VIII of this Decision.

Besides the risks referred to in paragraph 1 of this item, the calculation of the capital requirement for covering risks shall also include other risks, if the bank or the NBRM considers it to be necessary for the nature, type and the volume of the bank's activities (e.g. liquidity risk, interest rate risk arising from the banking book, concentration risk, etc.).

28. As an exception to item 27 of this Decision, the bank shall not determine and hold capital requirements for currency risk, unless the amount of net position in gold and

of the aggregate currency position, as specified by Section VII of this Decision, exceeds 2% of its own funds.

29. As an exception to item 27 of this Decision, the bank shall not calculate and hold capital requirements for market risks provided that:

- the bank's trading book positions usually does not exceed 5% of its total business and simultaneously does not exceed Denar 915 million, and

- the bank's total trading book positions never exceeds 6% of its total business and simultaneously does not exceed Denar 1,220 million.

The total bank's business shall be the sum of on-balance sheet and off-balance sheet asset items. The bank shall determine the value of on-balance and off-balance sheet assets items as specified by the Decision on the methodology for recording and evaluating of accounting items and for preparation of financial statements.

The bank shall evaluate the derivatives at their contractual notional value or market value of their underlying derivative. The long and the short positions shall be summed, regardless of their sign.

A bank not being bound to calculate capital requirements for market risks shall be still required to evaluate the trading book positions on a daily basis.

30. The bank, which more than three times in 30 days exceeds the limit referred to in item 29, paragraph 1 indent 1, but does not exceed the limit referred to in item 29, paragraph 1 indent 2, shall submit to the NBRM a report showing daily and average monthly values of the trading book activities in absolute amount and share in the total business, enclosing an explanation for exceeding the threshold. The bank shall submit the report within three business days following the day of the third excess of the limit. Having examined the data and the explanation submitted by the bank, the NBRM shall, within ten business days, decide whether the bank should start calculating the capital requirements for market risks.

31. The bank, which exceeds the limit referred to in item 29, paragraph 1 indent 2, shall immediately (no later than one business day) notify the NBRM on the excesses over the limits and the reasons behind. The NBRM shall, within ten business days, set the date on which the bank is to start calculating the capital requirements for market risks, unless on the basis of the explanation, it is determined that the reason behind the excess over the limit under item 29 paragraph 1 indent 2 is of exceptional nature.

32. The bank, which in accordance with items 29, 30 and 31, is exempted from calculating capital requirements for market risks, shall calculate its capital requirements for credit risk, currency risk and commodity risk arising from all positions in both banking book and trading book.

33. For the purpose of adequate calculation of the limits prescribed in this Section, the bank shall monitor on a daily basis the amount of positions in the trading book and positions included in the calculation of its aggregate foreign currency position, and provide adequate records reflecting the movement of this amount.

V. RISK WEIGHTED ASSETS

34. Risk-weighted assets shall be the sum of credit risk-weighted assets defined in line with Section VI of this Decision and other risks-weighted assets referred to in the paragraph 2 of this item.

Other risks-weighted assets shall be the sum of capital requirements for currency risk referred to in Section VII of this Decision, the capital requirements for commodity risk referred to in Section IX of this Decision and the capital requirements for market risks referred to in Section VIII of this Decision, multiplied by 12.5.

35. In case the NBRM sets a higher capital adequacy ratio for the banks than the minimum requirement of 8%, the calculation of the risk-weighted assets shall be appropriately adjusted to the higher capital adequacy ratio.

VI. CREDIT RISK WEIGHTED ASSETS

36. Credit risk weighted assets are equal to the sum of on-balance-sheet asset items multiplied by the respective risk weighting, according to part 1 of this Section and the off-balance-sheet asset items multiplied by the respective risk weighting, as defined in part 2 of this Section.

The capital requirement for credit risk shall be derived from the credit risk weighted assets multiplied by 8%.

37. For the purpose of this Decision, the risk weight of certain banks' claims shall be determined on the basis of the type of asset item, the features of the debtor and the type of collateral.

Under some specific circumstances (war, force majeure and other states of emergency in the country), the NBRM may prescribe higher risk weights for certain bank's claims.

38. The bank not required to calculate its capital requirements for market risks, shall include the credit risk arising from the trading book items in the amount of its credit risk weighted assets, by applying appropriate risk weightings and credit equivalents.

1. On-Balance Sheet Asset Items

39. On-balance sheet asset items are presented in a net amount, as a difference between their accounting value and the respective impairment, accumulated depreciation and effects from the change in the fair value.

40. The following risk weightings shall be used for determining the credit risk weighted assets:

0% for:

a) cash, gold and deposits with the NBRM,

b) claims on the NBRM and claims covered by securities issued by the NBRM,

c) claims on the Republic of Macedonia and claims covered by irrevocable, unconditional guarantees payable on first written call and securities issued by the Republic of Macedonia,

d) claims on European Central Bank and on governments and central banks of the EU member-states, Switzerland, Canada, Japan, Australia, Norway and the USA and claims covered by irrevocable, unconditional guarantees payable on first written call and securities issued by the European Central Bank and on governments of these countries or their central banks,

e) claims on multilateral development banks and claims covered by irrevocable, unconditional guarantees and securities issued by these banks,

For the purpose of this Decision, the group of multilateral development banks shall consist of the International Bank for Reconstruction and Development (IBRD), the International Financial Corporation (IFC), the Inter-American Development Bank, the Asian Development Bank, the African Development Bank, the European Council Development Bank, the Nordic Investment Bank, the Caribbean Development Bank, the European Bank for Reconstruction and Development (EBRD), the European Investment Bank (EIB), the European Investment Fund, the Multilateral Investment Guarantee Agency (MIGA), the International Finance Facility for Immunization, Islamic Development Bank,

f) claims or parts thereof covered by cash deposit or cash in depot, up to the amount of cash deposit, i.e. cash in the depot, with the following requirements being simultaneously met:

- the cash deposit maturity is equal or longer than the maturity indicated in the credit risk exposure agreement, i.e. the cash in the depot may be withdrawn only if the bank's credit exposure is completely settled,

- there is a written document confirming the purpose of the deposit, i.e. the cash in the depot, as a collateral of the credit exposure,

- in case of foreclosure, the bank shall be the single beneficiary of the deposit, i.e. the cash in the depot,

- the collateral shall be foreclosed if the client fails to fulfill the obligations arising from the credit risk exposure agreement.

f) all on-balance sheet asset items which, according to Section II of this Decision, are deductions from the own funds or its components.

20% for:

a) claims covered by other type of collateral provided by the Republic of Macedonia, European Central Bank, governments and central banks of EU member-states, Switzerland, Canada, Japan, Australia, Norway and the USA, other than claims with 0% risk weight,

This position shall also include claims on institutions established by the institutions referred to in paragraph 1 of this sub-item, the business and liabilities are fully covered by an explicit guarantee issued by such institutions.

b) claims covered by gold, up to the amount of the collateral, with the requirements stipulated under sub-item f) pertaining to claims with 0% risk weight, being simultaneously fulfilled,

c) claims on first-class banks and claims covered by irrevocable, unconditional guarantees and securities issued by these banks,

For the purpose of this Decision, a first-class bank shall be any bank rated with at least A- (according to the credit rating system of Standard & Poor's) or A3 (according to the rating of Moody's).

d) claims on domestic and foreign banks not considered first-class banks, with residual maturity of up to one year and claims with residual maturity of up to one year, covered by irrevocable, unconditional guarantees and securities issued by these banks,

For the purpose of this Decision, domestic banks shall be banks and savings houses licensed by the NBRM.

For the purpose of this Decision, claims on banks shall not include bank's claims serving as collateral in other banks, claims included as a component of the own funds of those banks, as well as claims on banks in court procedure.

e) claims covered by other type of collateral provided by multilateral development banks, other than claims with 0% risk weigh.

50% for:

a) claims on government funds and government agencies in the Republic of Macedonia and claims collateralized with irrevocable, unconditional guarantees and securities issued by these entities,

b) housing credits completely collateralized with mortgages on residences the client resides or will reside in, or which the client leases,

c) claims on regional or local governments of the EU member-states, Switzerland, Canada, Japan, Australia, Norway and the USA,

100% for:

a) land, real estate and equipment,

b) investments in capital, subordinated instruments and hybrid instruments and other investments in capital of other banks and financial institutions, which, as specified by Section II of this Decision, are not deductions of the own funds,

c) long-term claims on banks not included in the claims with 20% risk weight,

d) claims based on credits, interests and other claims, other than claims with lower risk weights,

e) other assets.

This position shall also include all due claims and paid guarantees, L/Cs, backing guarantees and other on-balance sheet claims arising from the bank's off-balance sheet exposure, irrespective of the risk weight category the overall claim belongs to.

2. Off-balance sheet asset items

41. The off-balance sheet asset items, with regard to this Decision, shall be divided in two groups of off-balance sheet items: basic and specific off-balance sheet items, with the differences originating not only from their character, but also from the method of determining credit equivalents.

2.1. Credit equivalents of basic off-balance sheet items

42. Credit equivalents of basic off-balance sheet items shall be the product of the net amount of off-balance sheet items and the respective conversion factor, as defined under item 43 of this Decision.

The net amount of the basic off-balance sheet items is a difference between their accounting value and the respective amount of the allocated special reserve.

43. The following conversion factors shall be applied for the purposes of determining credit equivalents of the basic off-balance sheet items:

0%:

a) unused, unconditionally revocable credit commitments, revocable by the bank at any time without prior notice,

b) covered guarantees, letters of credit or other covered non-credit risk bearing off-balance sheet asset items i.e. that do not represent contingent credit liability for the bank.

Covered off-balance sheet items shall denote off-balance sheet items for which the client provided Denar or foreign currency coverage at the moment of approval, the purpose of which is strictly determined and that cannot be withdrawn until the moment of closing the off-balance sheet item. Coverage shall not denote mortgages or other types of collateral, except cash.

20%:

a) unused irrevocable credit commitments based on permitted overdrafts on current accounts, credit cards and other type of potential credit risk exposure with maturity of up to one year,

50%:

a) unused irrevocable credit commitments based on permitted overdrafts on current accounts, credit cards and other type of potential credit risk exposure with maturity exceeding one year,

b) performance guarantees.

100%:

a) uncovered letters of credit and guarantees,

b) other off-balance sheet assets related to undertaken contingent liabilities.

2.2 Credit equivalents of specific off-balance sheet items

44. Credit equivalents of specific off-balance sheet items - financial derivatives shall be calculated by applying one of the following two methods:

- original exposure method (item 45 of the Decision),
- mark-to-market method (item 46 of the Decision).

Only the bank using the original exposure method may switch to mark-to-market method. The bank shall apply the mark-to-market method for determining the credit equivalents of financial derivatives, underlying of which are shares, precious metals, or commodities.

Financial derivatives traded on an exchange shall not be included in the calculation of the credit equivalents under paragraph 1 of this item, i.e. they shall be exempted from the amount of the credit risk weighted assets.

45. When using the original exposure method, the conversion factors of the specific off-balance sheet items shall be divided in two groups, depending on the subject of the financial derivative contract: interest rate or exchange rate. The credit equivalent shall be the product of the notional value of the financial derivative principal and the following conversion factors:

Table 1

Maturity	Interest rate contracts	Exchange rate and gold contracts
Up to one year	0.5%	2%
One or two years	1.0%	5%
For each additional year	+1.0%	+3%

Maturity shall denote the period indicated in the concluded financial derivative contract.

46. According to the mark-to-market value method, the bank shall calculate the credit equivalents as a sum of:

- **current exposure** which is a derivative replacement cost. The replacement cost shall be the derivative market value, i.e. the amount payable by the bank in case of a need of derivative replacement. If this amount is negative, then the cost shall be equal to zero,

- **potential credit risk exposure** which is a product of the notional value of the derivative's principal and the conversion factor presented in table 2, determined according to the residual maturity of the derivative.

Table 2

Residual maturity	Interest rate contracts	Exchange rate and gold contracts	Equity contracts	Contracts concerning precious metals, other than gold	Commodity contracts
Up to 1 year	0%	1.0%	6.0%	7.0%	10.0%
From 1 to 5 years	0.5%	5.0%	8.0%	7.0%	12.0%
Over 5 years	1.5%	7.5%	10.0%	8.0%	15.0%

47. After the calculation of the credit equivalents pursuant to item 42 and item 44 of this Decision, the derived amounts shall be weighted with the risk weights under item 40 of this Decision by the category housing the potential debtor of the bank and the type of collateral.

VII. CAPITAL REQUIREMENTS FOR CURRENCY RISK

48. Currency risk with regard to this Decision shall be the risk of loss due to change in the cross-currency exchange rates, change in the value of the Denar against other foreign currencies and changes in the value of gold.

49. The capital requirements for currency risk shall be calculated by multiplying the sum of the absolute amount of the net position in gold and the bank's aggregate foreign currency position by 8%.

50. The bank's net position in gold shall denote the difference between all bank's asset and liability items in gold, including also all off-balance sheet items presented in gold (forward and futures contracts in gold, options in gold, etc.)

51. The bank's aggregate foreign currency position, determined according to items 52 and 53 of this Decision, shall include the bank's foreign currency asset and liability items.

Foreign currency asset and liability items shall include foreign currency indexed asset i.e. liability items.

52. The net foreign currency item in one currency shall be a sum of the following:

- net spot position equal to the difference between the foreign currency assets and the foreign currency liabilities in that currency, also including the undue interest,

- net forward position equal to the difference between all amounts that will be received and paid based on currency forward contracts, including also the currency futures contracts and the principal of the currency swap contracts that is not included in the spot position,

- off-balance sheet items in foreign currency (irrevocable guarantees, uncovered letters of credit and similar instruments) classified in D and E risk categories. In case of guarantees and letters of credit in a particular currency covered by deposit in such currency, the uncovered amount of these guarantees and letters of credit shall be included in the calculation of the net currency position. The off-balance sheet items shall not be presented on a net basis, i.e. shall not be reduced by the respective amount of special reserve,

- value of currency options presented as specified under item 108 of this Decision.

The bank's currency positions originating from its operations on behalf of third parties and for the account of third parties, and the positions which, as specified by section II of this Decision represent deductions from own funds, shall not be included in the net currency position.

The net currency position in one currency shall be presented in Denars, by applying the middle exchange rate of the NBRM valid on the date of calculating the net currency position for such currency.

53. The sum of all net currency short positions in separate currencies in Denars shall represent the total short currency position of the bank, while the sum of all long net currency positions in separate currencies expressed in Denars shall represent the total long currency position of the bank.

Short currency position shall appear when the sum of asset items is lower than the sum of liability items.

Long currency position shall appear when the sum of asset items is higher than the sum of liability items.

The larger amount of the total short currency position and the total long currency position shall represent the aggregate currency position of the bank.

VIII. CAPITAL REQUIREMENTS FOR MARKET RISK

54. With regard to this Decision, market risks shall be defined as risks of losses in the bank's trading book positions, arising from changes in the market prices. Market risks shall include:

- risk of investments in equity securities that are part of the trading book,

- risk of investments in debt instruments that are part of the trading book,

- settlement/delivery risk and counterparty risk.

The capital requirements for market risks shall be a sum of:

- capital requirements for risk of investments in debt instruments, determined according to part 3 of this Section,

- capital requirements for risk of investments in equity, identified according to part 4 of this Section,

- capital requirements for settlement/delivery risk and counterparty risk, determined according to part 5 of this Section.

The capital referred to in paragraph 2 of this item shall respectively include the capital requirement for covering the exceeding of the exposure limits, as defined by part 6 of this Section.

The capital set according to Section X of this Decision, shall also be accordingly included in the amount of capital under paragraph 2, in line with the underlying option.

55. The capital requirements for risk of investments in debt instruments and risk of investments in equity shall be determined on the basis of the following two components: specific and general risk.

Specific risk is the risk of change in the price of financial instrument as a result of factors associated to the issuer of such instrument, i.e. the underlying derivative issuer in the case of financial derivatives.

General risk is a risk of the change in prices of financial instruments as a result of changes in the market interest rates or changes in the capital market prices.

56. The bank shall set the net position of one financial instrument, as a difference between its long (purchase) and short position (selling, lending). When determining the net position, the derivatives shall be treated as positions related to the underlying derivative.

The netting with regard to paragraph 1 of this item shall be allowed only in the case of instrument issued by same issuer, denominated in same currency, having same interest rate, same maturity and same treatment in case of bankruptcy.

57. The bank's exposure to a person/entity or persons/entities connected thereto arising from trading book shall be the sum of the following positions:

- the difference between the long and the short position in all instruments issued by a person/entity and persons/entities connected thereto, only if such difference is positive,

- the bank's net-position in equities or debt instruments issued by a person/entity or persons/entities connected thereto, whose issue is underwritten by the bank, as specified by part 2 of this Section,

- positions related to transactions and agreements with a person/entity and persons/entities connected thereto which expose the bank to settlement/delivery and counterparty risk where the exposure is defined by part 5 of this Section.

1. Treatment of financial derivatives and other financial instruments

58. Financial derivatives shall be instruments the value of which directly or indirectly depends on the price of securities, commodities, stock exchange indices, currencies or interest rates which are underlying financial instrument. These instruments shall be settled on a certain future date and no investment of funds is registered, or the invested amount is very small at the moment of their conclusion.

When determining the capital requirements for market risks, the positions in the financial derivatives under paragraph 1 of this item and other financial instruments shall be a combination of long or short position, presented in line with the provisions stipulated in this part. Annex 1 which is an integral part of this Decision includes a summary review of the treatment of financial derivatives when determining the capital requirements for risk of investments in debt securities and equity.

59. Financial derivatives that underlie the obligation for purchase or sale of a certain debt instrument or interest rate (forward contracts, futures and other contracts) shall be presented as a combination of long or short position, where:

- one position falls due on the maturity date of the futures contract, i.e. on the settlement date of the forward or similar contract;
- other position falls due on the maturity date of the underlying derivative.

The calculation of the capital requirements for risk (specific and general risk) of investments in debt instruments shall include positions under paragraph 1 of this item, presented through the market or current value of the underlying derivative.

In forward contracts and futures referred to in paragraph 1 of this item, long position shall be considered a position where the bank obtains pre-negotiated interest rate, while short position shall be the one where the bank pays at to pre-specified interest rate.

60. The purchase of interest rate futures or forward interest rate agreements shall be presented as a combination of short position in debt instrument that falls due on the maturity date of the futures, i.e. on the settlement date of the forward and long position in debt instrument that falls due on the maturity date of the underlying derivative.

The sale of interest rate futures or forward interest rate agreements shall be presented as a combination of long position in debt instrument that falls due on the maturity date of the futures, i.e. on the settlement date of the forward and short position in debt instrument that falls due on the maturity date of the underlying derivative.

In the calculation of the capital requirements for specific risk of investments in debt instruments, the positions referred to in paragraphs 1 and 2 of this item shall be included in the category of risk-free positions (0% weight).

The FX forwards shall be presented as a long position in debt instrument in purchasing currency and short position in debt instrument in selling currency, taking into account the maturity of the purchasing i.e. selling currency. The long and short positions in FX forwards shall be included in the determining of capital requirements for general risk of investments in debt instruments, i.e. the FX forwards, besides being included in the determining of capital requirements for currency risk, shall also be included in the determining of capital requirements for risk of investments in debt instruments.

61. The purchase of forward contract or bond future shall be presented as a combination of short position in debt instrument that falls due on the maturity date of the futures, i.e. on the settlement date of the forward and long position in debt instrument that falls due on the maturity date of the debt instrument.

The sale of forward contract or bond future shall be presented as a combination of long position in debt instrument that falls due on the maturity date of the futures, i.e. on the settlement date of the forward and short position in debt instrument that falls due on the maturity date of the debt instrument.

In the calculation of the capital requirements for specific risk of investments in debt instruments, the short position referred to in paragraph 1 of this item and the long position referred to in paragraph 2 of this item shall be included in the category of risk-free positions (0% weight).

62. The purchase of equity forward contract or equity futures shall be presented as a combination of short position in debt instrument that falls due on the maturity date of the futures, i.e. on the settlement date of the forward and long position in equity (or equity portfolio). The short position shall be included in the determining of general risk of investments in debt instruments, and the long position shall be included in the determining of risk (specific and general risk) of investments in equities.

The sale of equity forward contract or equity futures shall be presented as a combination of long position in debt instrument that falls due on the maturity date of the futures, i.e. on the settlement date of the forward and short position in equity (or equity portfolio). The long position shall be included in the determining of general risk of investments in debt instruments, and the short position shall be included in the determining of risk (specific and general risk) of investments in equities.

The forward contracts and futures on stock exchange indices shall be presented as specified by paragraphs 1 and 2 of this item, where the stock exchange index positions may be presented as one position in the stock exchange index or as positions in each equity underlying the stock exchange index - stock exchange index components. Depending on the method of presenting, the stock exchange index positions shall be presented through the market value of the stock exchange index or through the market or current value of each stock exchange index component.

63. The interest rate swaps where the bank receives floating interest rate and pays fixed interest rate shall be presented as a combination of long position in debt instruments with floating interest rate that falls due on the date of the next change in the interest rate and short position in debt instrument which falls due on the maturity date of the swap.

The interest rate swaps where the bank receives fixed interest rate and pays floating interest rate shall be presented as a combination of short position in debt instruments with floating interest rate that falls due on the date of the next change in the interest rate and long position in debt instrument which falls due on the maturity date of the swap.

In the calculation of the capital requirements for specific risk of investments in debt instruments, the positions referred to in paragraphs 1 and 2 of this item shall be included in the category of risk-free positions (0% weight).

The cross-currency swap shall be presented in consistence with paragraphs 1, 2 and 3 of this item, as a combination of long position in debt instrument in one currency with fixed/floating interest rate and short position in debt instrument in other currency with fixed/floating interest rate, taking into account the maturity of each exchanging currency. The positions of this type of swap shall also be included in the determining of capital requirements for currency risk as positions in currencies exchanged according to their maturity.

64. The equity swap shall be presented as a combination of long position in the equity received and short position in the equity provided.

The equity swaps where the bank receives fixed or floating interest rate shall be presented as a combination of long position in debt instruments with fixed or floating interest rate that falls due on the maturity date of the swap, i.e. on the date of the next change in the interest rate and short position in equity. The long position shall be included in the determining of general risk of investments in debt instruments, and the short position shall be included in the determining of risk (specific and general risk) of investments in equities.

The equity swaps where the bank pays fixed or floating interest rate shall be presented as a combination of short position in debt instruments with fixed or floating interest rate that falls due on the maturity date of the swap, i.e. on the date of the next change in the interest rate and long position in equity. The short position shall be included in the determining of general risk of investments in debt instruments, and the long position shall be included in the determining of risk (specific and general risk) of investments in equities.

65. The investments in financial instrument portfolio (collective investment units) shall be included in the calculation of capital requirements for credit risk and currency risk (in the case of investments in foreign currency), and shall not be included in the calculation of the capital requirements for market risks.

66. The positions in convertible securities shall be presented as positions in debt instrument or equities. Convertible security shall be considered equity when:

- there are less than three months to the first conversion date, i.e. there is less than one year to the next conversion date (if the first date has already passed),

- the current market value of the debt instrument is not more than 10% higher than the value of the appropriate quantity of equity that could be acquired in the case of conversion.

67. The positions in securities (equities, debt instruments) from the trading book temporarily sold to the counterparty on the basis of repo agreement, or lent to the counterparty on the basis of appropriate agreement, shall be presented as a combination of long position in the temporarily sold security i.e. lent and short position in risk-free debt instrument with appropriate maturity and interest equal to the yield on such agreements.

The position in the security subject to sale, i.e. lending and the position in risk-free debt instrument shall be included in the determining of the capital requirements for risk of investments in debt instrument, and/or equity, presented through the market value of the subject to the contract. When determining the capital requirements for specific risk, the positions in the risk-free debt instrument shall be included in the category of risk-free positions (0% weight).

The positions in trading book securities temporarily purchased from counterparty on the basis of repo agreement, or borrowed from other counterparty on the basis of appropriate agreement shall be presented as long position in risk-free debt instrument with appropriate maturity and interest equal to the yield on such agreements.

The position under paragraph 3 of this item shall be included in determining capital requirements for general risk from investments in debt instrument.

68. The positions in options and instruments having options features (interest rate options, debt instrument options, equity options, stock indices options, financial future options, swaptions, foreign currency options, warrants) shall be presented

according to Section X of this Decision and shall be included in the capital requirements for market risks, commodity risk and currency risk.

2. Underwriting securities issue

69. Securities issue underwriting, with regard to this Decision shall denote an agreement which binds the bank to organize and perform securities issue, for the account of the securities issuer, as well as to subscribe and pay-in all securities, or only those unsubscribed, for the purpose of their further sale to potential investors, and placement of already issued securities on a new market.

The bank shall treat the agreements in which it occurs as a co-underwriter, or member of a group of banks that underwrite securities issue, in the same manner.

70. The positions originating from the bank's obligation for underwriting securities issue, shall be accordingly included in the calculation of the capital requirements for risk of investments in equity and investments in debt instruments, according to parts 3 and 4 of this Section.

The positions under paragraph 1 of this item shall be presented as a net position of the bank in securities the issue of which is underwritten. Net position shall be the difference between the amount of the securities issue underwritten by the bank and the amount of securities transferred to third parties that purchased such securities, or assumed an obligation to sub-underwrite the issue.

The bank may reduce the net position under paragraph 2 of this item included in determining the capital requirements for general and specific risk of investments in debt instruments and equity, by using the reduction factors given in Table 3 below. Prior approval of the NBRM shall be required for using the reduction factors.

Table 3

	Reduction factor
Working day 0	100%
Working day 1	90%
Working day 2-3	75%
Working day 4	50%
Working day 5	25%
Over 5 working days	0%

Working day 0 shall denote the working day on which the bank acquires unconditional obligation to undertake the determined amount of securities at pre-specified price.

3. Capital requirements for risk of investments in debt instruments

71. The bank shall determine the capital requirements for risk of investments in debt instruments maintained in the trading book.

72. For the purposes of this Decision, the following shall be considered debt instruments maintained in the trading book:

- bonds,
- instruments traded on money market,
- derivatives and other financial instruments related to interest rates and/or debt instruments under indent 1 and 2 of this paragraph.

The bank shall include positions on the basis of underwriting debt instrument issue in the determining of capital requirements for risk of investments in debt instruments, and any other position the value of which depends on the interest rate development (e.g. FX forward)

The bank shall determine the positions of each debt instrument referred to in paragraph 1 of this item as specified in tem 56 and part 1 of this Section and the capital requirements for risk of investments in debt instruments for each currency.

3.1. Specific risk

73. The bank shall classify the positions by their residual maturity and the features of the issuer.

For the purposes of this Decision, residual maturity of debt instruments shall imply the residual period to their actual maturity (as for instruments with fixed interest rates), i.e. to the period of resetting the interest rates (as for the instruments with floating interest rates).

74. The bank shall weigh the positions according to the weighs presented in Table 4 on the basis of the classification according to the residual maturity.

Table 4

Risk-free positions	Qualified positions			Other positions
	To 6 months	From 6 to 24 months	Over 24 months	
0.00%	0.25%	1.00%	1.60%	8.00%

Risk-free positions shall be positions issued or completely collateralized by persons/entities which, according to item 40 of this Decision, have been assigned 0% credit risk weight.

Qualified positions shall be positions issued by persons/entities, i.e. completely collateralized by instruments which, according to item 40 of this Decision, have been assigned 20% credit risk weight and 50% credit risk weight for the persons/entities referred to in sub-items a) and c).

Any position not included in positions under paragraphs 2 and 3 of this item shall be considered other positions.

75. The capital requirements for specific risk shall be the sum of absolute values of the derived weighted positions.

3.2. General risk

76. The bank shall calculate the general risk on the basis of the residual maturity of the positions in debt instruments and their interest rate. The application of weighs presented in Table 5 derives weighted long and short positions in each debt instrument.

Table 5

Zone	Groups of residual maturity		Weigh (in %)
	Interest rate of 3% and more	Interest rate to 3%	
Zone 1	0-1 month 1-3 months 3-6 months 6-12 months	0-1 month 1-3 months 3-6 months 6-12 months	0,00 0,20 0,40 0,70
Zone 2	1-2 years 2-3 years 3-4 years	1,0 - 1,9 years 1,9-2,8 years 2,8-3,6 years	1,25 1,75 2,25
Zone 3	4-5 years 5-7 years 7-10 years 10-15 years 15-20 years over 20 years	3,6-4,3 years 4,3-5,7 years 5,7-7,3 years 7,3-9,3 years 9,3-10,6 years 10,6-12 years 12-20 years over 20 years	2,75 3,25 3,75 4,50 5,25 6,00 8,00 12,50

77. Prior to the presentation of the positions in financial derivatives, as defined in part 1 of this Section, the bank may net the long and short position in same financial derivative, provided that:

a) the positions have same nominal value and are denominated in same currency,

b) have same reference interest rate (on positions with floating interest rates) or same coupon interest (on positions with fixed interest rate), or the rate does not differ significantly (not more than 15 basis points = 0.15 percentage points),

c) the due dates of the positions with fixed interest rates, i.e. the next periods of resetting the interest rates (on positions with floating interest rates) meet the following limitations:

- fall on same date, as to positions the due dates of which are shorter than one month,

- do not differ by more than seven days, as to positions the due periods of which lasts from one month to one year,

- do not differ by more than thirty days, as to positions the due dates of which are longer than one year.

78. The sum of all weighted long positions in a group of residual maturity shall give the weighted long position for such group of residual maturity. The sum of all

weighted short positions in a group of residual maturity shall give the weighted short position for such group of residual maturity. The lower amount of these two sums in each group of residual maturity shall be considered matched weighted position in the respective group of residual maturity.

The residual amount (difference which could be with a positive or negative sign) shall be considered unmatched weighted long or unmatched weighted short position for that group of residual maturity, taken into account when determining the horizontal matching in any zone (item 79 of this Decision).

79. The sum of unmatched weighted long positions of the groups of residual maturity that belong to one zone shall be considered unmatched weighted long position of such zone. The sum of unmatched weighted short positions of the groups of residual maturity that belong to one zone shall be considered unmatched weighted short position of such zone. The lower amount of these two sums shall be considered matched weighted position of the zone.

The residual amount (difference which could be with a positive or negative sign) shall be considered unmatched long or unmatched short weighted position of the respective zone, taken into account when determining the horizontal matching between zones referred to in item 80 of this Decision.

80. The lower amount of the unmatched weighted long or short position in zone 1 and the unmatched weighted short or long position in zone 2 shall be considered matched weighted position between zones 1 and 2.

If the amount of unmatched weighted long or short position of zone 2 exceeds the amount of unmatched weighted short or long position of zone 1, the residual amount of zone 2 shall be compared with the unmatched weighted long or short position of zone 3. The lower amount of these two amounts shall be considered matched weighted position between zones 2 and 3.

If the amount of unmatched weighted long or short position of zone 1 exceeds the amount of unmatched weighted short or long position of zone 2, the residual amount of zone 1 shall be compared with the unmatched weighted long or short position of zone 3. The lower amount of these two amounts shall be considered matched weighted position between zones 1 and 3.

The horizontal match between the zones referred to in paragraphs 1, 2 and 3 of this item shall be made only if the mismatched weighted zone positions subject to comparison have different sign (the mismatch weighted long position of one zone is compared with the mismatched weighted short position of another zone). If the mismatched weighted zone positions subject to comparison have the same sign (e.g. the two zones subject to comparison have mismatched long position), their sum shall be a part of the residual position referred to in paragraph 5 of this item.

The residual amount of the unmatched position between zones 1, 2 and 3 shall be considered residual position.

81. The amount of capital requirements for general risk of investment in debt instruments shall be the sum of:

- 10% of the amount of matched weighted position of each group of residual maturity,
- 40% of the amount of matched position of zone 1,
- 30% of the amount of matched position of zone 2,
- 30% of the amount of matched position of zone 3,
- 40% of the amount of matched position between zones 1 and 2,
- 40% of the amount of matched position between zones 2 and 3,
- 150% of the amount of matched position between zones 1 and 3,
- 100% of the amount of residual position.

4. Capital requirements for risk of investments in equity

82. For the purpose of this Decision, equity shall include common shares with or without voting right, confirmation for shares of a deposit institution (such as CSD), convertible securities (securities which provide an opportunity for converting into shares), stock exchange indices, and positions in financial derivatives which refer to equity presented as specified by part 1 of this Section.

Positions in equity shall also denote positions based on underwriting an equity issue.

83. The bank shall determine long or short position of any equity security for any national market where the banks trade in such security (market-by-market basis) and shall determine the capital requirements for risk of investments in equity as a sum of the capital requirements for such risk for each national market.

84. The capital requirements for risk of investments in equity on any national market shall be calculated as a sum of:

- the amount of specific risk determined according to item 85 of this Decision, multiplied by 4%,

- the amount of general risk determined according to item 86 of this Decision, multiplied by 8%.

85. Specific risk shall be defined as a gross position of equity, i.e. the sum of the absolute value of all long and all short positions in any equity.

86. General risk shall represent the net position of the equity, i.e. the difference between the sum of long and the sum of short positions in any equity.

5. Capital requirements for settlement/delivery risk and counterparty risk

87. The settlement/delivery risk and the counterparty risk are risks arising from factors related to the counterparty in the trade in the respective financial instrument, and not to the issuer of such instrument.

The settlement/delivery risk is related to transactions in debt instruments, equities, currencies and commodities in the trading book which are not settled on the settlement/delivery date. The counterparty risk is present in all unsettled positions in the trading book. Delivery date is the settlement date agreed upon between the bank and the counterparty.

5.1. Settlement/delivery risk

88. The bank shall calculate the capital requirements for settlement/delivery risk for any transaction in debt instruments, equities and commodity, not settled within five working days or more after the specified delivery date.

The bank shall not calculate capital requirements for settlement/delivery risk based on repo agreements and agreements on borrowing, i.e. lending securities and commodities from/to counterparty.

89. The capital requirements for settlement/delivery risk shall be calculated when the bank's exposure is multiplied by the respective weight referred to in column 2 of table 6. The bank's exposure is the difference between the negotiated settlement price for the specific instrument and its current market.

Table 6

Number of working days after the delivery date	% of the price difference
5-15	8%
16-30	50%
31-45	75%
46 and more	100%

The capital under paragraph 1 of this item shall be calculated only if the difference between the prices of the respective instrument means a loss for the bank (in the case of purchase, when the current market price exceeds the contractual price, or in the case of sale, when the current market price is lower than the agreed settlement price).

5.2. Counterparty risk

90. The capital requirements for counterparty risk shall be a sum of the capital as defined under items 91, 92, 93 and 94 of this Decision.

The inclusion of the trading book positions in the calculation of the capital requirements for settlement/delivery risk, as defined by part 5.1 of this Section, shall not mean their exclusion from the calculation of the capital requirements for counterparty risk, in the light of items 91, 92, 93 and 94 of this Decision.

91. The bank shall calculate the capital requirements for counterparty risk in the cases of mismatch between the payment date based on securities, currency or commodity and their delivery date (free deliveries), when:

- the bank made the payment on the basis of purchased securities, currency or commodities before delivery or delivered the sold securities, currency or commodities before the payment,

- in international transactions, one or several days passed after the payment date or after the delivery of the securities, currency or the commodities.

The capital requirements for counterparty risk based on positions of paragraph 1 of this item shall equal 8% of the product of the value of security, currency, commodity or cash claimed by the bank (bank exposure), and the credit risk weigh applied to the respective counterparty, as defined in item 40 of this Decision.

92. In repo agreements for sale of securities and commodities and agreements on lending securities and commodities, the bank shall determine its exposure as a difference between the market value of the sold, i.e. lent securities and commodities and the cash or the market value of the collateral the bank received on the basis of such agreement. The bank shall include this difference in the calculation of the capital requirements for counterparty risk arising from such agreements, only if the difference is positive.

In repo agreements for purchasing securities and commodities (reverse repo) and agreements on borrowing securities and commodities from counterparty, the bank shall determine its exposure as a difference between the cash paid, i.e. the market value of the collateral provided to the counterparty and the market value of the purchased, i.e. borrowed securities and commodities from the counterparty. The bank shall include this difference (exposure) in the calculation of the capital requirements for counterparty risk arising from such agreements, only if this difference is positive.

The capital requirements for counterparty risk based on positions of paragraphs 1 and 2 of this item shall equal 8% of the product of the difference (exposure) as defined by paragraphs 1 and 2 of this item, and the credit risk weigh applied to the respective counterparty, as defined in item 40 of this Decision.

93. The capital requirements for counterparty risk for positions in financial derivatives traded over the counter, shall equal 8% of the product of the replacement cost determined according to the mark-to-market method referred to in item 46 of this Decision (bank exposure), and the credit risk weigh applied to such counterparty, as defined in item 40 of this Decision.

94. The bank shall calculate capital requirements for counterparty risk on the basis of exposure to fees, interests, dividends or margins for financial derivative calculated and paid daily, referring to trading book positions.

The capital requirements for counterparty risk shall equal 8% of the product of the exposure referred to in paragraph 1 of this item and the credit risk weigh applied to such counterparty, as defined in item 40 of this Decision.

6. Capital requirement for exceeding the exposure limits

95. For each exceeding of exposure limits specified by the Banking Law (3%, 10%, 25%, 65%, 800%), resulting from higher exposure arising from the trading book, the bank shall set capital requirements for exceeding the exposure limits.

The bank exposure to a person/entity or persons/entities connected thereto, arising from positions in the banking book, defined in consistence with the Decision on credit risk management, shall not exceed the exposure limits stated by the Banking Law.

96. The exceeding referred to in item 95 paragraph 1 of this Decision shall be derived by including those positions of the total exposure arising from the trading book with the highest specific risk, in consistence with parts 3 and 4 of this section, and/or the highest capital requirement for settlement/delivery risk and the counterparty risk, as specified by part 5 of this section.

97. If the exceeding of exposure limits lasts less than 10 days, the capital requirement for such exceeding shall be obtained by multiplying the amount as defined by item 96 of this Decision by 200%.

If the exceeding of exposure limits lasts 10 days and more, the bank shall distribute the amount of the exceeding in column 1 of table 7, according to the proportional share in the own funds. The capital requirement for the exceeding shall be derived by multiplying the amount of exceeding by the respective weigh of table7.

Table 7

Exceeding of limit (as a percentage of own funds)	Weigh
To 40%	200%
40 - 60%	300%
60 - 80%	400%
80 - 100%	500%
100 - 250%	600%
Over 250%	900%

IX. CAPITAL REQUIREMENTS FOR COMMODITY RISK

98. The bank shall determine the capital requirements for commodity risk for each position of the banking book and the trading book.

99. Commodity, for the purposes of this Decision, shall denote physical product traded or tradable on the secondary market, such as agricultural products, minerals (including oil), precious metals (excluding gold) and derivatives and any other financial instrument pertaining to these products.

Each bank's position in commodities shall be presented in standard measurement units (such as barrels, tons, kilograms). The bank shall present the market value of any commodity in Denars. When the commodity market value is presented in other currency, the bank shall present such value in Denars, by applying market exchange rate.

100. When determining the capital requirements for commodity risk, the bank shall present the long or short position in each commodity. The position in each commodity, the positions in financial derivatives and other financial instruments concerning commodities shall be presented as specified by items 101 and 102 of this Decision.

If a certain position in commodity is also an exposure to other risks defined by this Decision, the bank shall accordingly include it in the calculations of the capital requirements for such risks.

101. The positions in financial derivatives and other financial instruments that relate to commodities shall be presented as combination of long and short position in the underlying derivative according to the respective maturity, as follows:

- as to futures and forward contracts with a commodity as a subject, as a long or short position of the subject to contract (commodity),

- as to swap of commodities, as a combination of long and short position of commodities which are underlying swap.

The positions in repo agreements and agreements on borrowing or lending commodities from/to counterparty shall be included in the calculations of capital requirements for commodity risk as positions in the commodities subject to such agreements.

102. The bank may net the short and long positions in derivatives of commodities in the case of same type and same quantity of commodity, the value of which is presented in same currency and which have same due date.

103. The capital requirements for commodity risk shall be calculated for each commodity, separately, as a sum of:

- 15% of the net position of the commodity determined according to item 104 of this Decision, multiplied by the current market price of such commodity, and

- 3% of the gross position of the commodity determined according to item 105 of this Decision, multiplied by the current market price of such commodity.

104. The net position of the bank in a commodity shall be the difference between long and short positions in such commodity.

105. The gross position of the bank in a commodity shall be the sum of the absolute values of long and short positions in such commodity.

106. The total bank's capital requirements for commodity risk shall be the sum of the bank's capital requirements for risk of change in price of the traded commodity.

X. TREATMENT OF OPTIONS

107. For the purposes of this Decision, option positions shall imply any option of interest rates, debt instruments, equity, exchange rate and other financial instruments traded by the bank on the official Stock Exchange or over the counter, and any other instrument having features similar to options.

108. Bank that purchases options shall calculate capital requirements for market risks of purchased securities options, including the options purchased for hedging certain positions in the trading book.

The amount of capital derived as specified by items 109 and 110 of this Decision shall be accordingly included in the capital requirements for market risk of investments in debt instruments and risk of investments in equity (part 3 and 4 of Section VIII), the capital requirement for currency risk (section VII of this Decision) and the capital requirements for commodity risk (Section IX of this Decision).

109. The capital requirements for risk of purchased "call" and "put" options, shall be the lower of the following:

a) the market value of the underlying option multiplied by:
   - the sum of the specific and general risk - as for options of debt instruments or equity,
   - 8% - for currency options,
   - 15% - for commodity options, or

b) the market value of the option.

110. The capital requirements for the risk of purchased options for hedging a certain position in the trading book (a combination of purchased "put" option and long position in the financial instrument, foreign currency or commodity with hedged position, or a combination of purchased "call" option and short position in the financial instrument, foreign currency or commodity with hedged position), shall be the difference between:

a) the market value of the underlying option multiplied by:
   - the sum of the capital requirements for specific and general risk on the basis of the underlying option - as for options of debt instruments and equity,
   - 8% - for currency options,
   - 15% - for commodity options, and

b) intrinsic option value, i.e. the amount that represent an income for the option purchaser ("in the money").

111. The bank shall not sell options without prior approval of the NBRM on the method used for calculating the capital requirements for market risks, commodity risk and currency risk related to such options (e.g. delta-plus method or other internal model).

XI. CAPITAL ADEQUACY ON CONSOLIDATED BASIS

112. Any bank subject to consolidated supervision shall apply this Decision on individual and consolidated basis.

Any bank subject to consolidated supervision shall determine its capital adequacy ratio by calculating the amount of own funds and the risk-weighted assets, on the basis of the consolidated reports of the banking group.

113. Any bank subject to consolidated supervision, which according to this Decision, is bound to calculate capital requirements for currency risk and market risks on individual basis, shall also calculate the capital requirements for such risks on consolidated basis.

Any bank subject to consolidated supervision, which according to this Decision, is not bound to calculate capital requirements for currency risk and market risks on individual basis, shall calculate the capital requirements for such risks on consolidated basis, in the case of failure of the banking group to meet the exceptions under items 28 and 29 of this Decision.

114. The calculation of capital adequacy on consolidated basis shall be based on the determination of positions included in the banking book and in the trading book across the banking group, i.e. on the determination of credit risk weighted assets and other risk weighted assets of the banking group.

1. Determining own funds on consolidated basis

115. The amount of own funds of the banking group shall not be lower than the amount set by the Banking Law.

116. The own funds of the banking group shall be determined in consistence with section II of this Decision, on the basis of consolidated financial statements of the banking group.

Besides the positions referred to in paragraph 1 of this item, the following positions shall be also included in the calculation of the own funds on consolidated basis as consolidated reserves:

- amount of minority participation;
- each difference determined as a result of the consolidation, including the reserves of exchange rate differentials generated during the consolidation,
- participation of the group members in third parties for which the NBRM issued an approval not to be included in the consolidation.

The positions referred to in paragraph 2 of this item shall be an integral part of the core capital of the banking group. If these positions have negative value, they shall be included in the deductions under item 17 of this Decision, i.e. they shall be deduction of the core capital and the supplementary capital I.

2. Determining credit risk weighted assets on consolidated basis

117. The banking book positions of the banking group shall be determined on the basis of consolidated financial statements of the group, prepared by applying the

method of full consolidation or other method, depending on the relations between the parent entity of the banking group and other group members.

Banking book positions shall include positions of item 25 of this Decision, and any other similar positions of other group members.

118. Credit risk weighted assets shall be determined by applying risk weights referred to in Section VI of this Decision to the banking book positions of the banking group.

The capital requirements for credit risk across a banking group shall be at least 8% of the amount of credit risk weighted asset of the banking group referred to in paragraph 1 of this item.

3. Determining other risk weighted assets on consolidated basis

119. Other risk weighted asset of the banking group shall be determined by multiplying the sum of capital requirements for currency risk to the banking group, as determined by item 120 of this Decision, the capital requirements for the market risks to the banking group as determined by items 121 and 122 of this Decision and the capital requirements for commodity risk as determined by item 123 of this Decision, by 12.5.

When determining the capital requirements for currency risk to the banking group, the capital requirements for market risks to the banking group and the capital requirements for commodity risk to the banking group, an aggregated method shall be used as defined by items 120, 121 and 123 of this Decision.

120. Each banking group member shall determine the capital requirements for currency risk on individual basis, as specified by Section VII of this Decision.

The sum of determined capital referred to in paragraph 1 of this item for all group members shall give the capital requirements for currency risk to the banking group. When determining the capital, no netting of the short and the long positions is possible in same currency among group members.

121. Each banking group member shall determine the capital requirements for market risks on individual basis, as specified by Section VIII of this Decision.

The sum of determined capital referred to in paragraph 1 of this item for all group members shall provide the capital requirements for market risks to the banking group. When determining the capital, no netting of the short and the long positions is possible in same financial instruments and commodities among group members.

The trading book positions shall include positions determined by items 21 and 22 of this Decision.

122. When a group member is not bound to determine capital requirements for market risks, its trading book positions shall be included in the determining the credit risk weighted assets on consolidated basis.

123. Each banking group member shall determine the capital requirements for commodity risk on individual basis, as specified by Section IX of this Decision.

The sum of the capital referred to in paragraph 1 of this item for all group members shall provide the capital requirements for commodity risk to the banking group. When determining the capital, no netting of the short and the long positions in same financial instruments and commodities is allowed among group members.

124. As an exception to item 119 paragraph 2 of this Decision, upon prior approval of the NBRM, the bank subject to consolidated supervision may apply the method of full consolidation for determining other risk weighted assets if the following requirements are met:

- the parent entity determines the trading book positions and/or aggregate foreign exchange position and permanently monitors the market risks, the currency risk and the commodity risk related to such positions across the group,

- each group member shall, on individual basis, maintain the set capital adequacy ratio,

- the parent entity has adequate expertness and resources to implement the method of full consolidation on a daily basis,

- the own funds may be freely transferred among the group members.

If the NBRM issue an approval for applying the method of full consolidation in the determining of capital requirement for market risks, currency risk and commodity risk, netting of the short and the long positions in same financial instruments and commodities among the group members shall be allowed. If the bank subject to consolidated supervision decides to net the short and the long positions in same financial instruments and commodities, it shall apply the same approach to all banking group members.

XII. REPORT

125. The banks shall compile a report on the implementation of this Decision by the accounting value as of March 31, June 30, September 30 and December 31 and submit it to the NBRM.

The submission date of the report as of December 31 shall be five working days after the expiration of the submission date of non-audited annual financial statement.

The submission date of the report as of March 31, June 30 and September 30 shall be fifteen working days after the expiration of the reporting period.

As an exception to paragraph 1 of this item, the bank subject to consolidated supervision shall submit a capital adequacy report on consolidated basis according to the accounting value as of June 30 and December 31, within 30 days after the expiration of the deadlines referred to in paragraphs 2 and 3 of this item specified for submitting the capital adequacy report on individual basis.

126. At a special request of the NBRM, the bank shall compile a report as of another date and within deadlines different from those indicated in item 125 of this Decision.

127. The bank shall prepare the first report referred to in item 125 of this Decision as of December 31, 2007 and submit it to the National Bank of the Republic of Macedonia not later than the date determined under item 125 of this Decision.

XIII. TRANSITIONAL AND CLOSING PROVISIONS

128. The National Bank of the Republic of Macedonia shall prescribe the instructions for implementation of this Decision.

129. The provisions of this Decision that apply to banks shall also apply to savings houses.

The foreign bank branches shall observe the provisions of this Decision, taking into account the provisions of the Banking Law and bylaws adopted on the basis of this Law that regulates the operations of foreign bank branches in the Republic of Macedonia.

130. This Decision shall enter into force on the date of its publishing in the Official Gazette of the Republic of Macedonia.

As an exception to paragraph 1 of this item, sections II.4, III, IV, V, VIII, IX, X and XI.3 (except for item 120), and the provisions of this Decision that imply application of the international financial reporting standards (item 11 sub-item b) paragraphs 3 and 4, item 12 sub-item d), e) and f), item 14 sub-item b), shall start being applied on January 1, 2009.

Until the start of application of the provisions specified by paragraph 2 of this item, the following shall be taken into account in the determining of the amount of own funds and risk weighted assets:

- the core capital shall decrease by the difference between the amount of the required special loan loss provisions in line with the risk classification of clients and the appropriated special reserves of the bank,

- risk weighted assets shall be the sum of the credit risk weighted assets and the absolute amount of the net-position in gold and the aggregate currency position of the bank. If the sum of net position in gold and on aggregate currency position does not exceed 2% of the own funds, the banks shall not include this amount in the calculation of the risk weighted assets,

- the bank shall include the trading book positions in the determination of the credit risk weighted assets.

131. Once this Decision enters into force, the Decision on methodology for determining capital adequacy ("Official Gazette of the Republic of Macedonia" no. 5/2007) becomes void.

D. no. 02-15/XII-10/2007
December 27, 2007
Skopje

Petar Goshev, MSc.
Governor

President of the
National Bank of the Republic of
Macedonia Council

Annex 1

Financial derivative	**Risk of investments in debt instruments**		**Risk of equity investments**	
	Specific risk	General risk	Specific risk	General risk
Futures and forwards of				
- government bonds	No	Yes, as two positions		
- corporate bonds	Yes	Yes, as two positions		
- interest rate indices (e.g. LIBOR)	No	Yes, as two positions		
- equity		Yes, as position in zero-coupon debt instrument	Yes	Yes, as underlying position
- stock exchange indices		Yes, as position in zero-coupon debt instrument	Yes	Yes, as underlying position
Interest rate forwards (FRA)	No	Yes, as two positions		
FX forwards	No	Yes, as one position in each currency		
Swaps	No	Yes, as two positions	Yes	Yes, as two underlying positions